



Submitted via electronic filing: <https://www.sec.gov/cgi-bin/ruling-comments>

Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

May 5, 2020

**Re MSCI Inc.'s ("MSCI") Response to Request for Comments on Fund Names, Release Nos. IC-33809, File No. S7-04-20**

Dear Secretary:

This letter responds to the request of the Securities and Exchange Commission (the "Commission") for comments on the Rule 35d-1 of the Investment Company Act of 1940 (the "Names Rule"). MSCI commends the Commission for reviewing the Names Rule and appreciates the opportunity to provide suggestions that we believe would result in more transparent and accurate disclosure to investors and may have the effect of a fund holding exposures that are more consistent with its name. While the request for comment covers a range of issues, we comment only on those matters where we believe MSCI's expertise and experience in indexes, portfolio and risk analytics, and ESG ratings and data are most relevant. In particular, we respond to (1) the Commission's question whether the requirement under the Names Rule that a fund adopt a policy to invest at least 80% of its assets in the "type" of investment, particular industry or industries, or particular country or geographic region, suggested by its name (the "80% test") continues to be appropriate and (2) whether the 80% test or other requirements should apply to names with environment, social, governance ("ESG") or similar terms such as sustainable.

**1. The Commission should update the 80% test in view of modern portfolio analytics**

As detailed below, MSCI believes the 80% test does not provide an accurate or transparent measure of a fund's financial exposures in relation to the type of investment described in its name. We believe that instead the Names Rule should require a fund to adopt a policy to achieve, under normal circumstances, a defined material financial exposure to any investment type, style, strategy, country or geographic location referenced in its name and to measure and report on its policy compliance.

The 80% test may produce results that are misleading because a fund's assets may not be an accurate measure of its financial exposure. For example, a fund may invest 80% of its assets in the type of investment suggested by its name (the "named type") but have a financial exposure to the named type that is significantly less than 80% of its financial exposure. The same fund could have a more material financial exposure to one or more other investment types or strategies with a different risk profile that are not in the fund's name. MSCI believes there are far more accurate ways to measure financial exposure to the named type than an asset-based test.

Asset managers and other institutional investors currently employ modern portfolio analysis to measure a fund's dollar weighted exposure to different factors or financial characteristics. This analysis provides asset managers with a readily available means for investigating sources of exposures and alpha, understanding returns, and measuring risk due to various factors. Asset managers can employ factor analytics, for example, to calculate dollar weighted exposure to an investment type across multiple asset classes. Asset managers perform this type of portfolio and factor analytics using widely available, industry leading tools, such as MSCI's BarraOne®.

In particular, we believe the Names Rule should require a fund to adopt and publicly disclose a policy to achieve, under normal circumstances, a defined material financial exposure to its named type. (See Names Rule, Section (a)(2)(i)). A fund could set its policy goal to achieve a financial exposure that is measured, for example, as a percentage of the fund's total financial exposure or as a ratio or relative weight in comparison to the financial exposure to another relevant individual investment type or group of investment types. We believe the Names Rule should require a fund's asset manager to set such a specific exposure goal to the named type and periodically measure and disclose the fund's exposure to the named type so that investors may evaluate the exposure for themselves. We believe that as a practical matter asset managers would comply with this requirement by employing modern portfolio analytics.

We also believe that the scope of terms and classifications subject to the Names Rule and the above proposed requirements for a fund's named investment type should be more encompassing. The same type of portfolio analytics that asset managers can use to measure and report on a fund's named investment type equally can be used by them to measure and report on exposure to investment styles and strategies, as well as countries or geographic regions, that are referenced in fund names. (See Names Rule, Section (a)(3)(i) & (ii)). This includes styles and strategies such as "ESG," "growth," "value," "quality," "momentum" and "low volatility." Portfolio analytics tools can measure exposures with greater granularity, including, for example, the E, S and G components of ESG on an individual basis. In other words, the ability to accurately measure a fund's financial exposure to investment styles, strategies, countries and regions, has been solved using tried and true fundamental metrics and factor analysis using modern portfolio analytics. The Names Rule therefore should require that a fund quantify financial exposure to these characteristics that are highlighted in the fund's name in the same manner as for named investment types.

One particular asset class that the Commission has highlighted in its request for comment is derivatives. Many asset managers currently use portfolio and factor analytics to calculate the impact of a fund's derivatives on its overall exposures, volatility, return profile and other portfolio characteristics. Therefore, in response to the Commission's question whether derivatives should be measured by notional or market value, or another measure such as measures of risk, the Names Rule should be amended to provide that funds and their asset managers will calculate the impact of a fund's derivatives when evaluating the fund's financial exposure to a named investment type, style, strategy, country or region. Again, the Names Rule should no longer require that an asset test be used. In the fixed income fund area in particular, financial exposure from heavy use of derivatives in a fund can vastly exceed the fund's hard asset exposure to the derivatives. In such a case, classification based on an asset test likely will not fully capture exposure. For example, at inception the present value of a swap, before the relevant markets move, is zero regardless of the financial exposure the swap presents.

Option adjusted exposures, key rates, and durations used in portfolio analytics are more powerful measurements of exposure than asset-oriented measures of notional exposure or present value.

While believe that the Names Rule should be amended to require a fund to adopt a policy to achieve, under normal circumstances, a defined material financial exposure to any investment type, style, strategy, country or geographic location referenced in its name and to measure and report on its policy compliance, we do not believe the Commission should specify how funds or their asset managers will comply with these requirements or the form of portfolio analytics that must be used. MSCI believes it is important for the Commission not to promulgate rules that are overly prescriptive, such as arbitrary percentage thresholds, because the area is still evolving. Favoring one standard over another also could impede innovation and competition. "Picking and choosing" particular methods or tools also would risk making regulatory compatibility and harmonization with other jurisdictions highly challenging.

## **2. A fund that references ESG (or similar terms) in its name should be required to demonstrate support in its public disclosures**

In accordance with the Rule's general requirement that fund names may not be misleading, MSCI believes that the Names Rule should require a fund to disclose its support for the use of "ESG" or similar terms in its name.

A fund using ESG or similar terms in its name should be required to demonstrate its particular focus on ESG in public disclosures to investors. Such a disclosure should include (1) the fund's criteria for the ESG terms it uses in its name; (2) the methodology the fund employs to support its defined criteria, (3) the metrics the fund uses to validate that it satisfies its criteria and methodology, and (4) historical evidence or metrics to backtest that tend to substantiate the effectiveness of the methodology, or a warning to investors that historical evidence to support the effectiveness of the fund's methodology is unavailable.

We observe that the 80% asset test may not lend itself well to ESG criteria for the reasons described above. Portfolio and factor analytics provide a readily available means for funds to measure financial exposure to ESG styles and strategies, also as addressed above. This is consistent with the manner in which portfolio and factor analytics can be used generally to measure a fund's exposure to investment types, styles, strategies, countries and regions.

We think it is important for the Commission not to be overly prescriptive regarding how funds define and measure exposure to ESG for the reasons outlined above. Prescriptive requirements also could have the effect of constricting the choices available to investors by making it harder for funds to name themselves in response to investor demand, e.g. investors may seek to invest in funds that address ESG concerns in a different manner than that prescribed. Implementing prescriptive regulatory requirements could make the United States markets and fund managers less competitive, such as in connection with global RFPs conducted by asset owners.

**Conclusion**

We believe that implementing the suggestions above in the Names Rule would result in more transparent and accurate disclosure to investors and may have the effect of a fund holding exposures more consistent with its name. We would be happy to meet with the Commission to provide further information.

Signed

Jeffrey Stern  
Managing Director, Legal and Compliance  
MSCI Inc.