BlackRock.

December 16, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Submitted via email.

RE: Investment Company Names (File No. S7-16-22)

Dear Ms. Countryman:

BlackRock, Inc. (together with its subsidiaries, "BlackRock") respectfully submits the following response to the Securities and Exchange Commission's ("SEC" or the "Commission") proposal to amend Rule 35d-1 under the Investment Company Act of 1940, as amended ("1940 Act") (such rule as proposed, the "Names Rule")[1]. We are supportive of the SEC's efforts to modernize and address challenges posed by the existing names rule. Since Rule 35d-1 was adopted in 2001, the fund industry has changed considerably, warranting revisions to the existing guidance. We welcome updates to the existing names rule to address the evolutions in the asset management industry and current, specific challenges presented by the names rule.[2] We believe further clarification is needed with respect to the applicability of the Names Rule to certain themes, including, but not limited to environmental, social, and governance ("ESG") strategies. We believe that the current proposal presents significant interpretive questions, compliance challenges, and could also result in significant changes to certain fund names that we believe will result in increased investor confusion.

We are providing a short list of recommendations below. Our key recommendations are as follows:

- Clarification on the overlap between the Names Rule and the recent proposal regarding ESG investments by 1940 Act registered funds (the "ESG Rule")[3]. In particular, we recommend that ESG Focused Funds (as defined in the ESG Rule) that employ "uplift" strategies (as described below) be permitted to comply with the Names Rule by either adopting a security-by-security approach to satisfy the 80% test <u>or</u> by providing improved ESG metrics relative to a parent benchmark or investment universe, in each case subject to certain conditions.
- Confirmation that fund advisers have discretion to define "reasonable" criteria used to tie a security to a particular theme or investment focus (including an ESG-related focus) for purposes of a fund's compliance with its 80% test.
- Clarification of guidance which is included in the proposed rule release to suggest a heightened degree of oversight responsibilities by advisers over index methodologies sponsored by *independent* index providers. We suggest an approach we believe strikes a balance between "truth in naming" and independence of index providers.
- Re-underwriting of the cost-benefit analysis, which we believe materially understates the burden associated with implementation.

[1] "Investment Company Names", Securities Act No. 11067; Securities Exchange Act No. 94981; and Investment Company Act No. 34593; 87 Fed. Reg. 36594 (June 17, 2022) ("Names Rule Proposing Release").
[2] BlackRock, Comments on Comments on Fund Names (May 5, 2020), available at https://www.sec.gov/comments/s7-04-20/s70420-7153851-216451.pdf
[3] "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environment, Social, and Governance Investment Practices", Securities Act No. 11068; Securities Exchange Act No. 94985; Investment Company Act No.34594; and Advisers Act No. 6034, 87 Fed. Reg. 117 (June 17, 2022), 36654.

ESG Uplift Strategies

Certain funds in the ESG space, both active and index, have a principal strategy to overweight issuers with higher ESG metrics and underweight other issuers with lower ESG metrics, relative to a parent benchmark or investment universe, with the objective of achieving a more favorable ESG profile at an aggregate fund level as compared to the benchmark or investment universe. These strategies are often referred to as ESG "Uplift" as they weight the fund toward issuers with higher ESG metrics. Under the ESG Rule, as proposed, these funds would likely be labeled as ESG Focused Funds because ESG factors are a "significant or main" consideration in selecting investments.

We respectfully note the intersection between the Names Rule and the recently proposed ESG Rule. If a fund meets the criteria to be considered an "ESG Focused Fund" under the ESG Rule, we believe the fund should be able to use "ESG" or "Sustainable" in its name without also being subject to an 80% test under an amended Names Rule. We believe that the definition of ESG Focused Funds proposed in the ESG Rule (and also the alternative definition proposed in BlackRock's comment letter on the ESG Rule) is robust, and that the two rules should directly connect. Otherwise, there is a potential disconnect between a fund's name and how it is required to describe itself in its prospectus pursuant to the ESG Rule, which could lead to investor confusion. For example, under the proposed ESG Rule, ESG uplift strategies are likely within the definition of ESG Focused Funds, but under the proposed Names Rule, it is unclear how these funds would comply with an 80% test.

If the Commission, however, opts to maintain a separate test under the Names Rule for funds with ESG strategies, we recommend certain clarifications be made as to the applicability of the Names Rule, in particular with respect to uplift products, which are described below. The Names Rule as applied to an 80% test raises significant interpretive questions, which we believe will lead to confusion for investors, inconsistent comments from disclosure staff, and compliance implementation challenges.

As proposed, the amendments to the Names Rule provide that at least 80% of the value of a fund's assets must be invested in accordance with the "**investment focus"** that the fund's name suggests. **Investment focus** in the proposal refers to a fund that focuses its investments in issuers who have particular characteristics, such as names that suggest that the fund's **investment decisions incorporate one or more ESG factors**. ESG Uplift funds (and, where applicable, uplift indexes that funds track) incorporate ESG factors into investment decisions by applying an ESG Uplift methodology generally to the entire fund or index (see discussion below on Multi-Asset/Fixed Income funds for exceptions). It is unclear based on the drafting of the Names Rule and the associated proposing rule release how this definition applies to Uplift products.

The two largest US-domiciled ESG ETFs iShares ESG Aware MSCI USA ETF (ESGU) and iShares ESG Aware MSCI EAFE ETF (ESGD)[4] employ an "Uplift" methodology. These funds track indices that optimize a portfolio for the highest possible weighted average ESG metrics within a specific tracking error target. This methodology allows investors to incorporate meaningful exposure to ESG, while still maintaining broad market exposure and minimizing any unintended biases (such as sector or country biases). We observe that investors that want to replace their market-capitalization weighted exposures with an ESG index exposure generally chose this approach because of their ability to offer efficient exposure to ESG with reduced tracking error to their policy benchmark. Uplift ESG ETFs represent roughly 23% of total

[4] Source: Broadridge, BlackRock as of December 8, 2022.

global ESG ETF assets, with roughly $93 billion in assets out of $400 billion.[5] In the U.S., Uplift ESG ETFs represent roughly 42% of total ESG ETF assets with roughly $43 billion in assets out of $102 billion.[6]

Such ESG Uplift funds provide an investor exposure to a portfolio of securities with more favorable ESG metrics in aggregate versus a parent benchmark or investment universe, while delivering a similar risk and return profile. We believe that using “ESG Aware” in these fund names is critical to clearly representing their exposure to investors, and to differentiating them from parent index products with no such uplift. Similarly, we believe that not including a reference to the ESG uplift in the fund name is potentially misleading to investors. For example, it is not clear without such naming convention how to differentiate an EAFE index strategy (iShares MSCI EAFE ETF) from one with ESG uplift (iShares ESG Aware MSCI EAFE ETF).

We ask that a final rule or associated guidance clarify that Uplift funds can continue to operate under the Names Rule, provided that they (1) are ESG Focused Funds under the ESG Rule, (2) are required to name their funds in a manner that conveys this “uplift” approach (e.g., funds could use the word “uplift”, “tilts”, “optimized”, “aware”, or other similar terminology) and that disclosure in the principal investment strategies section of the prospectus describes this approach and (3) (a) adopt a security-by-security approach for complying with the Names Rule such that at least 80% of the value of a fund’s assets are invested in accordance with the fund’s investment focus, *or alternatively*, (b) comply with the Names Rule by providing improved ESG metrics at the *portfolio level* relative to the fund’s non-ESG benchmark. We believe optionality to comply with 3(a) or 3(b) is critical to ensuring clear and accurate fund naming. In order to ensure rigor around the portfolio level approach in 3(b), funds would be expected to adopt governance procedures to ensure that a process is in place to determine the level of uplift is sufficient to differentiate ESG Focused Funds from non-ESG funds with similar strategies.

Should the Commission require funds to comply with the Names Rule on a security-by-security basis (recommendation 3(a)), we make the following recommendations for the Commission’s consideration. Under these approaches, an uplift methodology that effectuates the fund’s ESG objective would be applied to at least 80% of the value of a fund’s assets. A methodology could be absolute or relative. We recommend that the full menu of options noted below be available for funds to select based on appropriateness in light of their ESG objective.

- **Absolute Sustainable/ESG Methodology Applied to Each Security.** Under an absolute approach, 80% of the value of a fund’s assets with an ESG objective would be required to meet an established methodology disclosed in a fund’s prospectus.
  - *Minimum Criteria Methodology:* A fund with an ESG investment focus could establish a minimum rating of BB under a third-party’s ESG ratings criteria, or establish a minimum utilizing a proprietary ratings system. Alternatively, a fund with an ESG focus could base a minimum on the average or median rating of a non-ESG parent index, or on a top percentile (e.g., top half) of ESG rated issuers in a non-ESG parent index. Minimums could vary within a fund by sector based on, for example, the average or median rating of such sector. Different funds could maintain differing thresholds depending on the strategy of the fund. The fund would disclose all minimum criteria, and such criteria would be subject to internal governance to ensure reasonableness of standards. Holdings classified as ESG under the methodology would count toward the 80%.
  - *Asset Type Criteria Methodology:* A fund could classify certain types of assets as ESG or Sustainable, such as bonds which proceeds fund the electrification of mass transit or rural

[5] Source: Broadridge, BlackRock as of December 8, 2022.
[6] Source: Broadridge, BlackRock as of December 8, 2022.

housing, or companies that have meaningful revenue aligned to the United Nations Sustainable Development Goals. This could be based on an internal methodology, or a third-party methodology if available. Holdings classified as ESG or Sustainable under the methodology would count toward the 80%.

- **Relative Sustainable/ESG Methodology Applied to Each Security.** Under a relative approach, an ESG methodology (or an index a fund tracks) would systematically overweight individual issuers with higher ESG metrics and underweight individual issuers with lower ESG metrics, relative to a non-ESG parent benchmark or investment universe. Fund holdings to which the ESG index methodology was applied would count toward the 80% bucket. Such a fund's 80% policy would disclose, for example, that at least 80% of the fund's net assets are subject to the adviser's "ESG uplift" methodology, which seeks to achieve an overall portfolio ESG assessment that is higher than that of a particular benchmark or universe. In addition, in order to ensure rigor around this approach, funds would be required to adopt governance procedures setting forth oversight of methodologies to ensure the portfolio level uplift is sufficient to differentiate ESG funds from non-ESG equivalents.

Definition of Reasonable

We encourage the Commission to clarify in any final guidance minimum requirements for classifying investments under a theme, such as ESG. The proposed rule release says:

> What constitutes "reasonable" in this context could vary depending on the fund name, but requires a meaningful nexus between the given investment and the focus suggested by the name…For example, we believe it would be reasonable for a fund to define securities in a given industry as securities issued by companies that derive more than 50% of their revenue or income from, or own significant assets in, the industry. In such cases, there ***may be instances*** where the percentage ***could be smaller***, such as where a large company is a dominant firm in a given industry (e.g., the firm is an acknowledged leader in the industry).

We appreciate the Commission's effort to provide general guidance without requiring prescriptive rules. However, the language noted in italics above could be interpreted to imply that deviations from a 50% revenue test should be infrequent. BlackRock believes that funds and their advisers should set reasonable criteria for ensuring a meaningful nexus, but that advisers need the flexibility to evaluate funds (and where applicable, their index selection) based on a totality of criteria. For example, an adviser may believe it is appropriate for a fund to set a revenue minimum at 20% (or to track an index with such a minimum), but also supplement such minimum revenue requirement with an additional requirement that an issuer be a market leader (e.g., top 25% of issuers), or maintain a certain revenue minimum dollar amount. We do agree, however, that there are certain minimums that are likely not acceptable.

While we agree that prescriptive rules are not necessary, we believe the Commission should more explicitly acknowledge that reasonableness thresholds come in all different combinations. This would also avoid fund advisers being subject to differing viewpoints of what constitutes "reasonableness" in the view of members of the Commission's staff who may be reviewing a particular fund's registration statement disclosure. We recommend that when advisers are not relying on third-party data classifications, that they maintain procedures that outline governance around the establishment of reasonable criteria and that such criteria be disclosed in prospectuses. For example, a "thematic" fund may have a name and principal strategy that references a particular theme, such as fintech, for which the adviser does not view third-party sources as sufficient and therefore develops its own criteria for determining whether a security should be classified as being "fintech." Such adviser's reasonable criteria may not necessarily include a 50% revenue test, but the criteria should be documented in the fund's governance procedures and disclosed in the prospectus. When advisers are relying on third-party index providers, we recommend that they be required to have internal governance to ensure that indexes selected by a fund incorporate a meaningful nexus between the given investment and the focus suggested by the fund's name.

We also note that funds (and indexes they track) should be able to classify issuers based on future projections (e.g., revenue projections) rather than exclusively existing revenue. For example, portfolio managers may identify certain issuers as likely to generate significant amounts of revenues from certain themes in the future. Such a fund may be seeking exposure to long-term thematic opportunities rather than applying current criteria to an investment. Where funds rely on such future-based methodologies they should be required to indicate so in the name through the inclusion of a word like "future" or "emergent" which suggests that the theme is future-based, not based on "present" metrics.

Multi-Asset/Fixed Income ESG Focused Funds

Depending on a fund's strategies and asset class, and particularly in the fixed income space, certain instruments may not have a reliable ESG-related classification or rating. For example, while for corporate bond issuers a fund can use MSCI ESG ratings, securitized assets (such as asset-backed securities, collateralized loan obligations and mortgage-backed securities) are generally excluded from ESG analysis by third-party ratings providers. We believe that where an issuer's securities are unrated for ESG purposes (including by the index provider), that in computing the 80% test set forth in 3(a) above, the fund should be permitted to subtract the value of such securities from both the numerator and the denominator. In addition, we believe that at least 50% of the fund should be required to be invested in rated securities.

There exists investor demand for ESG Focused funds that provide the investor exposure to certain marquee indexes and parent universes, such as the Bloomberg US Aggregate Index. Such investors expect the fund to include all sectors and security types of the parent universe. Removing an entire class of securities, like securitized assets, due to lack of an ESG rating, would create unexpected and undesired gaps in the investor's exposure.

Index Funds

As the Commission recognizes, under Rule 35d-1, index funds are faced with unique challenges because their underlying indices are not investment companies and therefore not subject to the Rule.

The proposing release includes guidance stating that even though an index fund may be appropriately invested in its disclosed index, the "underlying index may have components that are contradictory to the index's name" and that in such circumstances, the fund's name may be materially deceptive or misleading. While we agree that advisers have a responsibility to ensure that a nexus exists between index fund investments and fund names, we are concerned that as drafted, the guidance creates ambiguity around the precise responsibilities of an adviser with respect to index providers, particularly in light of the expected separation between such entities. While advisers have visibility into the index methodology of a third-party index provider, advisers do not control the methodology. The determination of whether a particular investment is included within the index lies with the index provider. We seek clarification that the Commission is not suggesting that index funds comply with the Names Rule in the same way as an active fund (i.e., by requiring the adviser to evaluate at least 80% of index constituents against the fund name), but rather through an approach that is appropriate for an index strategy, as we suggest below.

BlackRock recommends that the Commission allow an index fund to comply with the Names Rule when using all or a portion of the name of its underlying index in the fund name, so long as (1) 80% of the fund's investments are in component securities of the index (or investments with economic characteristics that are substantially identical such as TBAs or depositary receipts), (2) the material aspects of the index methodology that support the use of the fund name are disclosed in the fund's prospectus, and (3) when advisers are relying on third-party index providers, that they be required to have internal governance to ensure that indexes selected by a fund incorporate a meaningful nexus between the given investment and the focus of the name. With respect to the latter, this could be effectuated through internal governance that reviews methodologies used by index providers to ensure appropriateness and/or by setting minimum standards for such methodologies (e.g., a minimum percentage of an issuer's revenues must come from green activities). We believe prong (3) strikes a balance between truth in naming and the independence of index providers.

Implementation Burden

We respectfully submit that the Paperwork Reduction Act analysis in the Names Rule proposing release significantly underestimates many steps that would need to occur in order for a fund to comply with the amended Names Rule. For example, the Commission estimates 7 hours of initial work for a fund to be able to comply with the new disclosure requirements.[7] In practice, however, before a fund can update its prospectus disclosure, an adviser must undertake significant analysis and address interpretive questions, build out compliance testing, engage with index providers through a formal consultation process, engage with other third-party data providers, analyze funds to determine whether name changes or strategy changes are appropriate, and engage with the fund's board. The fund would then go on to prepare and file a 485(a) filing, engage with counsel and internal stakeholders in responding to Commission comments, and then prepare and file a 485(b). In addition to timing considerations, certain of these costs (i.e., engaging with outside counsel or requiring additional services from index providers or vendors) may be borne by a fund and passed on to its investors.

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In conclusion, we are supportive of the SEC's efforts to modernize and address challenges posed by the existing names rule, however we believe further clarification is needed with respect to the applicability of the Names Rule to certain themes, including, but not limited to ESG strategies. We thank you for taking the time to review our input and are happy to be of further assistance if helpful. Should you have any questions about our views, please reach out to Rachel Aguirre, Head of U.S. iShares Product (rachel.aguirre@blackrock.com), Jessica Huang, Head of Sustainable Product Innovation (jessica.huang@blackrock.com), Jennifer McGovern, Americas Product Development and Governance (jennifer.mcgovern@blackrock.com), Nick Mizaur, Global Public Policy Group (nick.mizaur@blackrock.com), and Aaron Wasserman, Deputy Chief Compliance Officer (U.S.) (aaron.wasserman@blackrock.com).

Sincerely,

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[7] Names Rule Proposing Release at 36635.

Aaron D. Wasserman
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CC:

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