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May 5, 2020

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

Re: Release No. IC–33809; File No. S7–04– 20; RIN 3235–AM72, Request for Comments: Fund Names

Ladies and Gentlemen:

Thank you for the opportunity to share our views on the Request for Comments: Fund Names (hereafter, the RFC).

Morningstar brings a unique perspective to the questions in the RFC. As the world's largest provider of mutual fund data and ratings, Morningstar has a long history of advocating for transparency in global financial markets. Morningstar's mission is to empower investor success. Morningstar evaluates how funds perform along a variety of environmental, social, and governance factors. We evaluate funds based on their ESG disclosures in regulatory filings, through data on fund manager stewardship activities like proxy voting, and based on their underlying holdings using Sustainalytics' company level ESG Ratings that are aggregated up to the fund. Because we offer an extensive line of products for individual investors, professional financial advisors, and institutional clients, we have a broad view on the RFC and the possible effects of a future proposed rule for investors.

In this letter, we are responding to the Commission's following question:

> Should the Names Rule apply to terms such as "ESG" or "sustainable" that reflect certain qualitative characteristics of an investment? Are investors relying on these terms as indications of the types of assets in which a fund invests or does not invest (e.g., investing only in companies that are carbon neutral, or not investing in oil and gas companies or companies that provide substantial services to oil and gas companies)? Or are investors relying on these terms as indications of a strategy (e.g., investing with the objective of bringing value-enhancing governance, asset allocation or other changes to the operations of the underlying companies)? Or are investors relying on these terms as indications that the funds' objectives include non-economic objectives? Or are investor perceptions mixed among these alternatives or otherwise indeterminate? If investor perceptions are mixed or indeterminate, should the Names Rule impose specific requirements on when a particular investment may be characterized as ESG or sustainable and, if so, what should those requirements be? Should there be other limits on a fund's ability to characterize its investments as ESG or sustainable? For example, ESG

> (environment, social, and governance) relates to three broad factors: must a fund select investments that satisfy all three factors to use the "ESG" term? For funds that currently treat "ESG" as a type of investment subject to the Names Rule, how do such funds determine whether a particular investment satisfies one or more "ESG" factors? Are these determinations reasonably consistent across funds that use similar names? Instead of tying terms such as "ESG" in a fund's name to any particular investments or investment strategies, should we instead require funds using these terms to explain to investors what they mean by the use of these terms?[1]

The 80% Rule Is Generally Not Appropriate for ESG Funds

We understand that, currently, the naming of funds following an ESG factor strategy would be subject to the general prohibition on misleading names in Section 35(d) of the Investment Company Act, as well as other antifraud provisions of the Federal securities laws.[2] We believe that such regulation is sufficient and appropriate in the case of funds with "ESG," "Sustainability," or other nonfinancial terms in their names.

With regard to these "ESG funds,"[3] we do not see a widespread problem of misleading names. We also think the 80% rule is generally inappropriate for ESG funds, as ESG funds tend to follow strategies rather than investing in particular asset types. Nonetheless, we think a principles-based approach toward regulation should focus on intentionality and whether ESG funds evaluate all aspects of ESG, both qualitatively and quantitatively. The funds Morningstar identifies as "Sustainable Investment" funds often incorporate terminology in their names to reflect that ESG or sustainable investing is a core tenet of their investment strategy. The Sustainable Investment funds framework includes three subgroups of funds: ESG focus funds, impact funds, and environmental sector funds. ESG focus funds incorporate ESG principles into their investment process or engagement activities, such as by taking on issues such as climate change or voting in favor of shareholder proposals asking for certain disclosures. Impact funds seek to make a measurable impact with investments on specific areas like gender diversity and community development. Environmental sector funds are nondiversified funds investing in environmentally oriented industries, such as renewable energy.

Morningstar draws a distinction between "Sustainable Investment" funds and "ESG Consideration" funds. ESG Consideration funds are otherwise conventional, actively

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[1] Request for Comments on Fund Names (Securities and Exchange Commission) P. 13224. https://www.govinfo.gov/content/pkg/FR-2020-03-06/pdf/2020-04573.pdf (RFC).

[2] RFC, P. 13222.

[3] Morningstar does not use the term "ESG funds" in its classification system. We are using this term in the same way as the SEC does in its question.

managed funds that have added environmental, social, and governance criteria to their prospectuses but do not make the claim that they invest only in full-fledged sustainable investments (meaning that they do not meet the criteria for any of the subcategories described above).[4]

For both of these categories (Sustainable Investment and ESG Consideration) and sustainable subcategories (ESG Focus, Impact, and Sustainable Sector), no one asset or subasset class is a fit for that fund type; they invest across a variety of asset and subasset classes and implement their goals in a variety of ways, including through both investment and voting. For both categories of funds, we believe the current restrictions on misleading names is sufficient.

As of March 2020, there are 311 Sustainable Investment funds, many of which, but not all, reference "ESG" in their name.[5] Further, in the past two years, we have seen the number of ESG Consideration funds grow over tenfold, from under 50 at the end of 2017 to over 500 as of December 2019.[6] We expect this trend to continue and for ESG Consideration to become mainstream, thereby making the 80% rule irrelevant in most cases.

We thank the Commission for the opportunity to comment on the RFC. Should you wish to discuss any of the comments in this letter, please do not hesitate to contact either of us as indicated below:

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Sincerely,

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[4] Hale, J. 2020. "The Number of Funds Considering ESG Explodes in 2019." Morningstar.com. March 30, 2020. https://www.morningstar.com/articles/973432/the-number-of-funds-considering-esg-explodes-in-2019 ("Number of Funds Considering ESG Explodes").

[5] This number is updated from the 303 Sustainable Investment funds as of December 2019. Hale, J. 2020. "Sustainable Funds U.S. Landscape Report." Morningstar.com. February 14, 2020. P.7. https://www.morningstar.com/lp/sustainable-funds-landscape-report. Note that this number may not encompass all funds identified as Sustainable Investment as it reflects a point-in-time snapshot of the universe of sustainable funds. Additionally, funds of funds and funds that exclusively utilize active engagement without other sustainable attributes are excluded from the list.

[6] "Number of Funds Considering ESG Explodes."