

SEC Adopts Amendments to Fund Names Rule, Broadening the Scope of Funds that Must Comply

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September 27, 2023

On September 20, 2023, the SEC adopted amendments to the investment company names rule, Rule 35d-1 under the Investment Company Act of 1940. According to SEC estimates, the amendments will bring approximately 2,200 funds that did not previously have to comply with the rule within the scope of the rule, including its requirements for enhanced disclosure, quarterly compliance testing, Form N-PORT reporting and recordkeeping.

Under Section 35(d) of the Investment Company Act, it is unlawful for a registered fund to bear a name that includes words the SEC finds materially deceptive or misleading. In 2001, to implement this statutory provision, the SEC adopted Rule 35d-1. The current rule prohibits the use in a fund's name of terminology suggesting that the fund or its securities are issued, guaranteed, sponsored, recommended or approved by the U.S. government. The current rule also provides that a fund's name may not use terminology suggesting that the fund invests its assets in a particular industry or group of industries, or in a particular country or geographic region, unless the fund adopts a policy to invest, under normal circumstances, at least 80% of its assets in the investments suggested by its name. This 80% investment policy must be either "fundamental," meaning that it cannot be changed without shareholder approval, or one that can be changed only after at least 60 days' prior notice has been given to shareholders. Finally, the current rule provides that a fund's name may not suggest that the fund's distributions are exempt from federal or state income tax unless the fund adopts a fundamental policy either to invest at least 80% of its assets in securities producing tax-exempt income or to invest in assets 80% of the income from which is tax-exempt.

The new amendments to Rule 35d-1 build on the current names rule framework with the following modifications and additions:

- The amended rule provides that a fund whose name suggests that it invests its assets in investments that have, or whose issuers have, particular characteristics will have to adopt a policy to invest at least 80% of its net assets in the investments suggested by its name. The amended rule does not distinguish between a type of investment and an investment strategy. This change brings within the scope of the names rule, among others, funds whose names suggest a focus on "growth" or "value" and funds whose names suggest that a consideration of environmental, social and governance (ESG) factors plays a role in the fund's investment decisions. When a fund's name includes terms suggesting an investment focus with multiple elements, the fund's 80% investment policy must address all of the elements in the name.
- In a change from the proposal, the amended rule maintains the current rule's requirements that a fund must invest in accordance with its 80% investment policy "under normal circumstances" and that a fund must meet the 80% requirement at the time of investment. However, the amended rule adds a new requirement that a fund must review its portfolio assets included in the 80% basket at least quarterly. Any fund departing from its 80% investment policy must come back into compliance generally within 90 days (an increase from the proposed 30 days). The 90-day period is measured from the time a fund identifies a departure from the 80% policy or the time the fund intentionally departs from the policy in other than normal circumstances. A fund that remains out of compliance with its 80% investment policy after the expiration of the 90-day period must change its name. The SEC noted in the adopting release that a fund could seek exemptive relief from the SEC if the fund believes it "appropriate and consistent with the protection of investors for the fund to depart for a limited additional period past 90 days." The rule provides certain exceptions from the general 90-day limit. Specifically, a fund would be able to deviate from its 80% investment policy during its first 180 days of operation while it initially invests its assets or to reposition its portfolio for a reorganization or in anticipation of a previously announced change to its 80% investment policy.

- Derivative instruments that provide exposure to the investments suggested by a fund's name as well as to one or more risk factors associated with the investments suggested by the fund's name may be used to determine compliance with the 80% investment policy. For this purpose, the amended rule requires funds to use the notional values of derivative instruments rather than their market values. The rule also allows funds to exclude the values of certain currency hedges (but not other hedges) from calculations to determine compliance with the 80% investment policy.
- The amendments require a fund's prospectus to include the definitions of terms used in the fund's name and to disclose the criteria the fund uses to select the investments that the terms describe. The amended rule also requires that any terms used in a fund's name that suggest either an investment focus or that a fund's distributions are tax-exempt must be consistent with the plain English meaning or "established industry use."
- The amended rule requires a shareholder vote to amend any 80% investment policy of any closed-end fund or business development company whose shares are not listed for trading on a national securities exchange, unless (1) the fund conducts a tender or repurchase offer to allow shareholders to redeem shares before the policy change, (2) the fund provides shareholders with at least 60 days' prior notice of the change, (3) the tender or purchase offer is not oversubscribed, and (4) the fund purchases shares in the offer at their net asset value.
- Finally, consistent with the current rule, under the amended rule, unless a fund's 80% investment policy is a fundamental policy, the fund must provide at least 60 days' notice of any change in the policy to fund shareholders. The amended rule updates the notice requirement to specifically address funds that use electronic delivery methods.

A new provision in the amended rule provides that a fund's name may be materially deceptive or misleading under Section 35(d) of the Investment Company Act even if the fund adopts and implements an 80% investment policy and otherwise complies with Rule 35d-1. The SEC noted in the adopting release that "[t]o the extent a fund uses its 20% basket to invest in assets that are materially inconsistent with the investment focus or risk profile reflected by the fund's name, the fund's name would be materially deceptive or misleading under section 35(d)."

Furthermore, the SEC noted in the adopting release situations in which an index-tracking fund complies with an investment policy to invest at least 80% of its assets in an index referenced in the fund's name while the underlying index includes components inconsistent with the index's name. Under such circumstances, the SEC stated that the fund's name could be materially misleading or deceptive even though the fund follows its 80% investment policy. The SEC recommended that index funds "adopt and implement written policies and procedures reasonably designed to ensure that indexes selected by a fund do not have materially misleading or deceptive names themselves."

The SEC also adopted amendments to Form N-PORT that require a fund subject to the amended names rule to report the value of the fund's 80% basket and whether an investment is included in the fund's 80% basket. The amendments also require a fund subject to the amended names rule to include the definitions of terms used in the fund's name in Form N-PORT. The amendments furthermore impose certain additional recordkeeping obligations relative to the amended names rule.

The SEC's adopting release is available [here](#), and a fact sheet is available [here](#).

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