

MEMO# 8696

March 6, 1997

SEC PROPOSED RULE NAME TEST RULE

* Investment Company Act Release No. 22530 (February 27, 1997). March 6, 1997 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 7-97 RE: SEC PROPOSES NAME TEST RULE _____ The Securities and Exchange Commission has proposed for comment a new rule 35d-1 under the Investment Company Act that would require any registered investment company with a name that suggests that it focuses on a particular type of investment to have a fundamental policy requiring it to invest at least 80% of its net assets in the type of investment suggested by its name.* Under current staff positions, such a fund generally must invest only 65% of its assets in the type of investment suggested by its name. The proposed rule is summarized below and a copy of the Commission's release is attached. Proposed rule 35d-1 would apply to a fund with a name that suggests that it focuses its investments in a particular type of security (e.g., the ABC Stock Fund) or in securities of issuers in a particular industry (e.g., the ABC Health Care Fund). In addition, the 80% rule would apply to a fund with a name that suggests that it focuses its investments in a particular country (e.g., the ABC Japan Fund) or geographic region (e.g., the ABC Latin America Fund). (The release sets forth proposed criteria for ascertaining whether a security would satisfy the 80% test for funds that focus their investments in particular countries or geographic regions.) It also would apply to a fund whose name indicates that its distributions are exempt from federal income tax (e.g., the XYZ Tax-Exempt Fund) or from both federal and state income tax (e.g., the XYZ New York Tax-Exempt Fund). Such a fund could meet either an asset or income test. Funds with names that do not suggest a particular investment emphasis would not be bound by the 80% rule. The Commission proposes to allow funds up to one year from the effective date of the rule, if adopted, to comply with the rule's requirements. The proposed 80% requirement would apply at the time a fund invests its assets and would require a fund that no longer meets the 80% requirement to make future investments in a manner that would bring the fund into compliance with the 80% requirement. The rule would provide an exception for funds that take a temporary defensive position to avoid losses in response to adverse market, economic, political, or other conditions. The proposed 80% requirement would be based on a fund's net assets plus any borrowings that are senior securities under the Investment Company Act. Cash and cash equivalents would be included in a fund's net assets for purposes of the 80% test. 2The staff of the Division of Investment Management would continue to evaluate, and give interpretive advice regarding, fund names that are not covered by the proposed rule (e.g., fund names that include the words global or international). In determining whether a name is misleading, the Division would consider whether the name would lead a reasonable investor to conclude that the fund invests in a manner that is inconsistent with its intended investments or the risks of those investments. The proposed rule would prohibit a fund from using a name that suggests that it is guaranteed or approved by the U.S. government. The proposed rule also would codify a

staff position that prohibits a fund from using a name that includes the words "guaranteed" or "insured" or similar terms in conjunction with "United States" or "U.S. government." The staff no longer intends to require funds that have names that suggest that their investments have certain maturities (e.g., short-term) to have average weighted portfolio maturities of specified lengths because it believes that a reasonable investor would not necessarily expect funds with these names to be limited in this manner. Because of the shortcomings associated with the use of average weighted maturity and the increasing use by investment professionals of duration to evaluate bond portfolios, the Division is developing recommendations relating to duration and the maturity of a funds investments. Comments on proposed rule 35d-1 are due to the Commission 90 days after publication in the Federal Register. Please provide the undersigned with your comments on the proposal by April 4, 1997. My direct number is 202/326-5824, the fax number is 202/326- 5827 and my e-mail address is amy@ici.org. Amy B.R. Lancellotta Associate Counsel Attachment (in .pdf format)

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