

**MEMO# 35456**

September 28, 2023

# SEC Adopts Final Amendments to the Fund Names Rule

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TO: ICI Members

Chief Compliance Officer Committee

Closed-End Investment Company Committee

Disclosure Working Group

SEC Rules Committee SUBJECTS: Closed-End Funds

Compliance

Derivatives

Disclosure

ESG

Unit Investment Trusts (UITs) RE: SEC Adopts Final Amendments to the Fund Names Rule

On September 20, the Securities and Exchange Commission ("SEC" or "Commission") adopted amendments to Rule 35d-1 under the Investment Company Act of 1940 ("Names Rule"), as well as associated forms and disclosure requirements.[\[1\]](#) The final amendments passed by a vote of four to one, with Commissioner Uyeda dissenting. At a high level, the amendments make the following changes:

- **Scope:** Expand the scope of the Names Rule to apply to any fund name with terms suggesting that the fund focuses on investments that have, or whose issuers have, particular characteristics.
- **Temporary Departures from Compliance:** Retain the current "time of investment" test for compliance and "under normal circumstances" standard. However, the amended rule will now require funds to, at least quarterly, review their portfolio investments to determine whether the fund's investments continue to be consistent with the fund's 80% investment policy. If a fund is out of compliance with its 80% investment policy, it will generally have 90 days to return to compliance.
- **Derivatives:** Require funds to use a derivative instrument's notional amount, with certain required or permitted adjustments, for the purpose of determining compliance with funds' 80% investment policies.
- **Unlisted closed-end funds and business development companies ("BDCs"):** Require unlisted closed-end funds and BDCs to make their 80% investment policies fundamental. The amended rule includes an exception which will permit such a fund

to change its 80% investment policy without a shareholder vote if the fund conducts a tender or repurchase offer in advance of the change, subject to certain conditions.

- Enhanced prospectus disclosure: Require funds to define terms used in their names and the criteria used to select investments in their prospectuses. A fund will have the flexibility to reasonably define the terms used in its name, but such definitions must be consistent with the terms' plain English meaning or established industry use.
- Modernized notice requirement: Update the notice requirement to address funds' use of electronic delivery and clarify certain content requirements.
- Form N-PORT: Require funds to report information regarding Names Rule compliance on a quarterly basis, including whether each portfolio holding is included in a fund's 80% basket.

## **Background on the Names Rule**

The currently effective Names Rule generally requires that, if a fund name suggests that a fund has an investment focus (particularly a focus on type of investment, geography, or industry) or that a fund is tax-exempt, the fund must adopt a policy to invest 80% of the value of its assets consistent with the fund name. The fund can either designate the 80% investment policy as a "fundamental policy" that cannot be changed without shareholder approval or provide investors 60 days' notice of any change in the investment policy. The currently effective Names Rule requires that a fund's 80% investment policy apply "under normal circumstances," and compliance with the 80% investment policy requirement is generally measured at the time of investment ("time of investment test").

## **Expanded Scope of the Names Rule**

As proposed, the final amendments broaden the scope of the Names Rule's 80% investment policy requirement to apply to fund names that include terms suggesting that the fund focuses on investments that have, or whose issuers have, particular characteristics.<sup>[2]</sup> The amended rule does not define "particular characteristics," but it includes "an illustrative parenthetical that is designed to give non-exclusive examples of terms" that are in scope of the amended rule, including "growth," "value," and ESG-related terms.<sup>[3]</sup> The Adopting Release also states that terms that reference a thematic investment focus will be within the scope of the amended rule.

Consistent with the proposal, the Adopting Release states that "names that suggest a portfolio-wide result to be achieved, such as 'real return,' 'balanced,' or 'managed risk,' names that reference a particular investment technique, such as 'long/short' or 'hedged,' and names that reference asset allocation determinations that evolve over time, such as retirement target date or 'sector rotation' funds" would not be within the expanded scope of the rule.<sup>[4]</sup> In a change from the proposal, the Adopting Release states that the terms "intermediate term (or similar)," "global" and "international" will not require an 80% investment policy.<sup>[5]</sup> Notably, the Adopting Release states the following regarding terms that may be understood to have more than one meaning:

If terms in a fund's name can reasonably be understood to reference either the characteristics of a fund's individual investments or the intended result of a fund's portfolio investments in the aggregate, the fund will be required to adopt an 80% investment policy, consistent with the proposal.<sup>[6]</sup>

The Adopting Release also discusses fund names that include multiple terms suggesting an investment focus and states that, in such cases, the fund's 80% investment policy must address all of the elements in the name. The Adopting Release states that a fund "can take a reasonable approach in specifying how the fund's investments will incorporate each

element."[\[7\]](#)

## **Temporary Departures from a Fund's 80% Investment Policy**

The SEC proposed to permit funds to depart temporarily from compliance with their 80% investment policies only under certain enumerated circumstances, and the proposal would have required a fund to bring its investments back into compliance with its 80% investment policy within 30 consecutive days. This would have replaced the current "under normal circumstances" standard and "time of investment" test, and would have, in effect, required a fund to monitor each of its holdings for compliance with its 80% investment policy on a daily basis.

The Commission made substantial changes to the proposed approach in the final amended rule. The amended rule retains the current "under normal circumstances" standard and "time of investment" test. Instead of the proposed daily compliance monitoring, the amended rule includes a new requirement that a fund review its holdings on a quarterly basis to determine whether each holding continues to be consistent with the fund's 80% investment policy. Accordingly, "portfolio investments that are included in the 80% basket at the time of investment will continue to be considered to be consistent with the fund's 80% investment policy unless the fund identifies otherwise as part of its required quarterly reassessments, or outside of its required quarterly reassessments identifies that these investments' characteristics are inconsistent with the fund's 80% investment policy."[\[8\]](#) If a fund departs from compliance with its 80% investment policy, the amended rule generally provides 90 days to return to compliance, instead of the proposed 30 days.

The amended rule breaks down the situations in which a fund may depart from its 80% investment policy into three general scenarios:

- If a fund discovers that it has "drifted" out of compliance with its 80% investment policy (either following its quarterly review or otherwise), the fund must make future investments in a manner that will bring the fund into compliance with its 80% investment policy as soon as reasonably practicable and, in all circumstances, within 90 consecutive days of the fund's identification that it is out of compliance.[\[9\]](#)
- If a fund departs from its 80% investment policy in "other-than-normal" circumstances, the fund must return to compliance with its 80% investment policy within 90 consecutive days from the time of initial departure.[\[10\]](#)
- If a fund departs from its 80% investment policy in connection with a fund launch, the fund must generally return to compliance within 180 days of the date the fund commences operations. The amended rule also permits a fund to depart from its 80% investment policy in connection with a fund reorganization and does not limit the length of departures in such circumstances.[\[11\]](#)

## **Considerations Regarding Derivatives in Assessing Names Rule Compliance**

As proposed, funds will be required to use notional amounts to value derivatives instruments for purposes of calculating compliance with their 80% investment policies.[\[12\]](#) In a change from the proposal, the amended rule requires funds to exclude from the calculation derivatives instruments used to hedge currency risks that are entered into and maintained by the fund for hedging purposes and for which the notional amounts of the derivatives do not exceed the value of the hedged investment (or the par value thereof, for fixed-income instruments) by more than 10%. In addition, the amended rule:

- Requires funds to adjust the notional value by converting interest rate derivatives to

their 10-year bond equivalents and delta adjusting the notional amounts of options contracts;

- Requires a fund to value each physical short position for purposes of compliance with its 80% investment policy using the value of the asset sold short;[\[13\]](#)
- Permits a fund to deduct cash and cash equivalents and U.S. Treasury securities with remaining maturities of one year or less from the denominator in the calculation ("assets"), up to the notional amounts of the fund's derivatives instruments;[\[14\]](#) and
- Permits a fund to exclude any closed-out derivatives positions when calculating assets for purposes of determining compliance with its 80% investment policy, if those positions result in no credit or market exposure to the fund.

The final amendments permit a fund to include in its 80% basket any derivatives instrument that the fund includes in its 80% basket because the derivatives provide investment exposure suggested by the fund's name, as well as derivatives instruments that provide investment exposure to one or more of the market risk factors associated with the investment focus suggested by the fund's name.

## **Unlisted Closed-End Funds and BDCs**

As proposed, the amended rule prohibits registered closed-end funds and BDCs that do not have shares that are listed on a national securities exchange from changing their 80% investment policies unless authorized by a vote of the majority of the outstanding voting shares of the fund.[\[15\]](#) In a change from the proposal, the amended rule includes a limited exception that permits unlisted closed-end funds and BDCs to make changes to their 80% investment policies without a shareholder vote if: (i) the fund conducts a tender or repurchase offer in advance of the change; (ii) the fund provides shareholders with at least 60 days' prior notice of any change in the policy in advance of the offer; (iii) the offer is not oversubscribed; and (iv) the fund purchases shares at their net asset value.

## **No Safe Harbor**

As proposed, the SEC adopted a new provision in the amended rule stating that a fund's name can be materially deceptive or misleading even if the fund complies with its 80% investment policy. The Adopting Release provides some guidance about the circumstances in which the SEC would consider a fund's name to be materially deceptive or misleading, including:

- A fund that "invests in a way such that the source of a substantial portion of the fund's risks or returns is materially different from that which an investor reasonably would expect based on the fund's name";[\[16\]](#)
- "A fund that is perpetually out of compliance with the 80% investment requirement on account of temporary departures . . . even if each temporary departure is permissible under the rule;"[\[17\]](#) or
- An acquiring fund that "was aware that an underlying fund has changed its investments such that it is not following the acquiring fund's investment focus," if the acquiring fund "continues to include the value of the investment in the acquired fund in its 80% basket."[\[18\]](#)

The Adopting Release states that this new provision is intended to codify existing guidance and "not to create new requirements or standards with respect to the selection of investments in a fund's 20% basket."[\[19\]](#)

With respect to index funds, the Adopting Release states that a fund's name that includes the name of an index "can be materially deceptive or misleading if a meaningful nexus

does not exist between the components of the underlying index and the investment focus suggested by the index's name."[\[20\]](#) The Adopting Release sets forth the Commission's view that an index fund would be expected to adopt an 80% investment policy to invest at least 80% of the fund's assets in the index's components.[\[21\]](#) Additionally, the Adopting Release sets forth the Commission's view that index funds should implement written 38a-1 policies and procedures "reasonably designed to ensure that indexes selected by a fund do not have materially misleading or deceptive names themselves."[\[22\]](#)

## **Prospectus Disclosure and Use of Plain English or Established Industry Use**

As proposed, the final amendments require a fund that is subject to the Names Rule to disclose the definitions of terms used in its name and the criteria the fund uses to select investments in its prospectus. The Commission defines "terms" to mean any word or phrase used in a fund's name related to the fund's investment focus or strategies, other than any trade name of the fund or its advisers.[\[23\]](#) Under the amended rule, open-end funds registered on Form N-1A will be required to disclose the definitions of terms used in both the summary and statutory sections of the prospectus.[\[24\]](#) In addition, funds will be required to tag prospectus disclosure using a structured data language (Inline XBRL or "iXBRL").

The SEC states that funds have flexibility to use reasonable definitions of the terms in their names and that, "what constitutes 'reasonable' in context could vary depending on the fund name, but requires that definition have a meaningful nexus between the term used in the fund's name and fund's investment focus."[\[25\]](#) A fund's use of reasonable definitions of the terms used in the fund's name may not otherwise change the meaning of these terms to be inconsistent with their plain English meaning or established industry use.[\[26\]](#)

## **Modernized Notice Requirement**

As discussed above, the currently effective Names Rule provides that funds either must have a fundamental 80% investment policy or provide 60 days' advance notice to fund shareholders if any changes are made to the 80% investment policy. The amended rule retains this requirement[\[27\]](#) but makes the following changes to the required content and format of the notices:

- The notice must continue to be delivered separately from other documents, but the amendments now specifically provide that, if the notice is delivered in paper form, it may be provided in the same envelope as other documents. The Commission states that this is not intended to substantively change the current requirements;
- A fund must prominently indicate in the required legend any change made to the name of the fund, in addition to changes made to the 80% investment policy itself;
- Notices must describe, as applicable, the 80% investment policy, the nature of the change to the 80% investment policy, the fund's old and new names, and the effective date of any 80% investment policy and/or name changes; and
- Notices that are delivered electronically must include the required legend in the subject line of the email.

## **Form N-PORT Reporting**

The Commission adopted new reporting requirements on Form N-PORT for funds that are subject to the Names Rule. Under the amended rule, funds, other than money market funds, will be required to report:

- the value of the fund's 80% basket, as a percentage of the fund's assets;
- whether each of the fund's portfolio holdings is determined to be in the fund's 80% basket; and
- the fund's definitions of the terms used in its name.[\[28\]](#)

In a change from the proposal, funds will be required to report this information on Form N-PORT for only the third month of every quarter. This is intended to align the reporting frequency with the frequency of the quarterly review requirement.

The SEC also proposed to require funds to publicly report on Form N-PORT the number of days during the reporting period that a fund was out of compliance with its 80% investment policy. Consistent with ICI comments, the SEC did not adopt this proposed requirement.

## **Recordkeeping**

The amended rule includes a variety of new recordkeeping requirements for funds that are subject to the Names Rule. Under the amended rule, funds will be required to maintain:

- Written records, at the time of investment, documenting (i) whether the investment is included in the fund's 80% basket and, if so, the basis for inclusion; and (ii) the value of the 80% basket, as a percentage of the value of the fund's assets;
- Written records documenting the fund's review (at least quarterly) of its portfolio holdings' inclusion in the 80% basket, including whether each investment is included in the fund's 80% basket and, if so, the basis for inclusion;
- Written records documenting the date that any departures due to drift were identified and the reason for any such departures from the fund's 80% investment policy;
- Written records documenting the date of any departures in other-than-normal circumstances and the reason for such departures, including why the fund determined that circumstances are other-than-normal; and
- Any notice sent to shareholders pursuant to the rule.

Consistent with ICI recommendations, the SEC did not adopt the proposed requirement that would have required funds that are not required to adopt an 80% investment policy to maintain a written record of the fund's analysis that such a policy is not required.

## **Unit Investment Trusts**

Under the amended rule, consistent with ICI recommendations, UITs will be subject to the 80% investment policy and recordkeeping requirements only at the time of initial deposit. UITs will not be required to engage in the compliance monitoring associated with temporary departures under the amended rule, nor will they be required to keep records after the initial deposit. UITs will be subject to the plain English requirements and prospectus disclosure requirements, including the requirement to tag newly required prospectus disclosure using iXBRL.[\[29\]](#)

## **ESG Integration Funds**

The SEC proposed to prohibit ESG integration funds, as defined in the SEC's pending ESG Disclosure Proposal,[\[30\]](#) from including terms suggesting that the fund's investment decisions incorporate one or more ESG factors. The SEC did not adopt this aspect of the proposal and stated in the Adopting Release:

Because the proposed provision in the names rule mirrored the separate proposed definition of an integration fund in the ESG Disclosure Proposal, we are continuing to consider comments and are not adopting the proposed approach to integration fund names



at this time.<sup>[31]</sup>

## **Compliance Period and Withdrawn Staff Guidance**

The final amendments will become effective 60 days after publication in the Federal Register. The Commission is providing a compliance period of 24 months for larger fund complexes (fund groups with at least \$1 billion in net assets) and 30 months for smaller fund complexes (fund groups with less than \$1 billion in net assets). This is an increase from the proposed one-year compliance period.

The Adopting Release states that SEC staff is reviewing current staff guidance on the Names Rule, including Frequently Asked Questions and no-action letters, to determine which guidance should be withdrawn in connection with the adoption of the amended rule.

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### **Notes**

<sup>[1]</sup> Investment Company Names, SEC Release No. IC-3500 (Sept. 20, 2023) ("Adopting Release"), available at <https://www.sec.gov/files/rules/final/2023/33-11238.pdf>. For the associated proposing release, see Investment Company Names, SEC Release No. IC-34593 (May 25, 2022) ("proposal" or "proposing release"), available at <https://www.sec.gov/files/rules/proposed/2022/ic-34593.pdf>. ICI's memo summarizing the proposal is available at: <https://www.ici.org/memo34168>.

<sup>[2]</sup> Adopting Release at 23.

<sup>[3]</sup> Id. at 29-30.

<sup>[4]</sup> Id. at 43.

<sup>[5]</sup> A footnote in the Adopting Release further states that terms that indicate a negative or exclusionary screening process, such as "fossil fuel-free," may not require an 80% investment policy. Id. at n.128.

<sup>[6]</sup> Id. at 45.

<sup>[7]</sup> Id. at 49-50.

<sup>[8]</sup> Id. at 58.

<sup>[9]</sup> See amended Rule 35d-1(b)(1)(i).

<sup>[10]</sup> See amended Rule 35d-1(b)(1)(ii).

<sup>[11]</sup> See amended Rule 35d-1(b)(1)(iii) and (g).

[12] The amended rule defines "derivatives instrument" as "any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument." See amended Rule 35d-1(g).

[13] The Adopting Release states that, "under certain circumstances, [short positions] may qualify as investments that a fund may include in its 80% basket. For example, if a fund's name indicates that its investment focus includes short exposure to a particular type of investment, this inclusion would be appropriate." Adopting Release at 102.

[14] The proposal would have required, rather than permitted, this deduction, and the proposal would have limited the deduction to cash and cash equivalents.

[15] See amended Rule 35d-1(f).

[16] Adopting Release at 109.

[17] Id. at n.314.

[18] Id.

[19] Id. at 110.

[20] Id. at 111-12.

[21] Id. at 112.

[22] Id.

[23] See, e.g., amended Instruction to Item 4(a) of Form N-1A on page 276 of the Adopting Release.

[24] The proposal would have required this disclosure in only the summary section of the prospectus.

[25] Adopting Release at 116.

[26] The Adopting Release states that the plain English and established industry use requirement "is not meant to be static and is designed to acknowledge that the language used in a fund's name may evolve as industries change and grow" and that "members of an industry need not coalesce on a standard, singular definition of a term for the term to be consistent with 'established' industry use." Adopting Release at 123-24.

[27] See, however, the discussion of unlisted closed-end funds and BDCs above.

[28] The requirement to report the fund's definitions of terms used in its name on Form N-PORT was not proposed.

[29] See the discussion of UITs on pages 147-150 of the Adopting Release.

[30] See Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, SEC Release No. IC-34594 (May 25, 2022).

[31] Adopting Release at 22-23.



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