

## FUND NAMES SUGGESTING PROTECTION FROM LOSS

In the staff's view, when a mutual fund or other investment company ("fund") uses a name that suggests safety or protection from loss, the name may contribute to investor misunderstanding of the risks associated with an investment in the fund and, in some circumstances, could be misleading. The staff encourages any fund that exposes investors to market, credit, or other risks, and whose name suggests safety or protection from loss, to reevaluate the name and to consider changing the name, as appropriate, to eliminate the potential for investor misunderstanding.

The staff has recently heightened its scrutiny of fund names suggesting safety or protection from loss and has determined to object to names that may create an impression of protection or safety or absence of risk of loss, where the name does not include qualifying language that defines the scope and limits of such protection. We believe that the terms "protected," "guaranteed," and similar terms, when used in a fund name without some additional qualification, may contribute to investor misunderstanding about the potential for loss associated with an investment in the fund.<sup>1</sup> As a result, in the disclosure review process, the staff recently requested that some existing and new funds change their names. The staff took this action in response to an increase in the use of the term "protected" in fund names in situations where that term was used without a qualification that would adequately describe the nature and limits of any protection offered by the fund.

For example, some funds that seek to manage the fund's volatility by investing a portion of the fund's assets in cash, short-term fixed income instruments, short positions on exchange-traded futures, or other investments included the term "protected" in their name. The staff was concerned that these names could convey to investors a level of protection from loss that was not present because the degree to which a managed volatility strategy may succeed or fail is uncertain. In response to the staff's recently articulated concerns, some funds have chosen to replace the term "protected" with terms such as "managed risk."

The staff has also become concerned about the inclusion of the term "protected" in a fund's name in some cases where the fund has entered into a contract with a third party



to make up a shortfall in the net asset value of the fund. In those cases, the protection may be limited in various ways, including by contractual limits on the amount of protection or the window of time during which the third party is obligated to make up any shortfall in the fund's net asset value, or by contractual provisions for termination of the third party's obligation in certain scenarios. In addition, an investor in the fund is subject to credit risk associated with the third party provider, which could become unable to fulfill its obligation under the contract. For these reasons, the staff believes that a fund that has entered into a contract with a third party to make up a shortfall in the net asset value of the fund should not use a term like "protected" in its name unless the name adequately communicates the limitations of the "protection" provided by the third party. To date, the staff has not identified any fund names that use the term "protected" in these circumstances and that adequately communicate the limitations of the third party "protection."

The staff acknowledges that a fund's name, like any other piece of information about a fund, cannot tell the whole story about the fund.<sup>2</sup> We also acknowledge that the staff has recently requested name changes in situations in which a fund had provided prospectus disclosures that explained limitations on the scope of "protection" provided by the fund that were not revealed by the name itself. We have made these requests because we believe that, in practice, investors sometimes focus on a fund's name to determine the fund's investments and risks, either because the name sometimes appears without the clarifying prospectus disclosures (e.g., in advertisements) or because of the prominence of a fund's name or for other reasons.<sup>3</sup> As a result, the staff believes that when a fund uses a name that suggests safety or protection from loss investors may conclude, at least in certain circumstances, that the fund offers greater protection from loss than is the case. Accordingly, we encourage investment advisers and funds' boards of directors to carefully evaluate any fund name that suggests safety or protection from loss and to consider whether a name change is appropriate to address any potential for investor misunderstanding.

### Endnotes

- 1 The staff of the Division of Corporation Finance has expressed similar concerns about the titles of structured notes. See Sample Letter Sent to Financial Institutions Regarding Their Structured Note Offerings Disclosure in Their Prospectus Supplements and Exchange Act Reports (Apr. 2012), [www.sec.gov/divisions/corpfin/guidance/structurednote0412.htm](http://www.sec.gov/divisions/corpfin/guidance/structurednote0412.htm) (noting that Division of Corporation Finance staff had previously indicated that note titles using the term "principal protected" should also include balanced information about limitations to the principal protection feature and advising issuers in future structured note offerings to evaluate the titles of the notes and revise them to clearly describe the product in a balanced manner and avoid titles that stress positive features without also identifying limiting or negative features).

- 2 Investment Company Act Release No. 24828, Section I (Jan. 17, 2001) [66 FR 8509, at 8509-10 (Feb. 1, 2001)].
- 3 See S. Rep. No. 293, 104th Cong., 2d Sess. 9 (1996) (noting that when making an investment decision, investors may focus on fund names to determine the fund's investment objective and level of risk).

This *IM Guidance Update* summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This *IM Guidance Update* is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this *IM Guidance Update*.

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- ▲ protect investors
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- ▲ facilitate appropriate innovation in investment products and services

through regulating the asset management industry.

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**If you have any questions about this IM Guidance Update, please contact:**

Disclosure Review Office

Phone: 202.551.6921

Email: [IMOCC@sec.gov](mailto:IMOCC@sec.gov)