

Amendments to the Fund “Names Rule”



The Securities and Exchange Commission proposed amendments to Rule 35d-1 under the Investment Company Act of 1940, the fund “Names Rule.” The proposed amendments would further serve the SEC’s mission of investor protection by:

- Improving and expanding the current requirement for certain funds to adopt a policy to invest at least 80 percent of their assets in accordance with the investment focus the fund’s name suggests;
- Providing new enhanced disclosure and reporting requirements; and
- Updating the rule’s current notice requirements and establishing recordkeeping requirements.

Background

The name of a registered investment company or business development company (“BDC”) communicates information about the fund to investors and is an important marketing tool for the fund. The Names Rule helps ensure that a fund’s name accurately reflects the fund’s investments and risks. As the fund industry has developed and practices regarding Names Rule compliance have continued to evolve over the past two decades since the rule was adopted, improvements to the Names Rule would help ensure that it continues to meet its purpose.

Proposed Amendments

Modernization of the 80 percent Investment Policy Requirement

The Names Rule currently requires funds with certain names to adopt a policy to invest 80 percent of their assets in the investments suggested by that name. The proposal would expand this requirement to apply to any fund name with terms suggesting that the fund focuses in investments that have, or investments whose issuers have, particular characteristics. This would include, for example, fund names with terms such as “growth” or “value” and those indicating that the fund’s investment decisions incorporate one or more environmental, social, or governance (“ESG”) factors. Further, to address the rule’s application to derivatives investments, the proposal would require a fund to use a derivatives instrument’s notional amount, rather than its market value, for the purpose of determining the fund’s compliance with its 80 percent investment policy.

Temporary Departures from a Fund’s 80 percent Investment Policy

The proposal would specify the particular circumstances under which a fund may depart from its 80 percent investment policy, such as sudden changes in market value of underlying investments, including specific time frames for returning to 80 percent.

Unlisted Closed-End Funds and BDCs

The proposal would prohibit a registered closed-end fund or BDC whose shares are not listed on a national securities exchange from changing its 80 percent investment policy without a shareholder vote. This prohibition would ensure these investors could vote on a change in investment policy given their limited options to exit their investments if the change were made.

Enhanced Prospectus Disclosure, Reporting, and Recordkeeping

The proposal would include a number of amendments to provide enhanced information to investors and the Commission about how fund names track their investments. The proposal would require fund prospectus disclosure that defines the terms used in a fund’s name. The proposal also includes amendments to Form N-PORT to require greater transparency on how the fund’s investments match the fund’s investment focus. The proposal would, furthermore, require funds to keep certain records regarding how they comply with the rule or why they think they are not subject to it.

Materially Deceptive and Misleading Use of ESG Terminology

Under the proposal, a fund that considers ESG factors alongside but not more centrally than other, non-ESG factors in its investment decisions would not be permitted to use ESG or similar terminology in its name. Doing so would be defined to be materially deceptive or misleading. For such “integration funds,” the ESG factors are generally no more significant than other factors in the investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio.

Modernization of Notice Requirement

The proposal would retain the current rule’s requirement that, unless the 80 percent investment policy is a fundamental policy of the fund, notice must be provided to fund shareholders of any change in the fund’s 80 percent investment policy. The proposal would update the rule’s notice requirement to expressly address funds that use electronic delivery methods to provide information to their shareholders.

Additional Information:

The proposing release will be published on SEC.gov and in the Federal Register. The comment period will remain open for 60 days after the date of publication in the Federal Register.