OnPoint / A legal update from Dechert's Financial Services group

SEC Issues Proposed Rule Amendments Regarding Fund Naming Conventions

Authored by Julien Bourgeois, Brenden Carroll, James Catano, Steve Cohen, Philip Hinkle, Megan Johnson, Mark Perlow, Corey Rose, Anthony Zacharski, Nicholas DiLorenzo, Matthew Barsamian, Claire Hinshaw and Tyler Payne

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Dechert LLP

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Overview

The U.S. Securities and Exchange Commission, by a vote of three-to-one, proposed for public comment on May 25, 2022, amendments to the rule governing naming conventions of funds[1] subject to the U.S. Investment Company Act of 1940. The "names rule" generally requires a fund to invest, under normal circumstances, at least 80% of its assets in the investments suggested by its name. The proposed amendments would (among other items):

- expand the scope of funds subject to Rule 35d-1 under the Investment Company Act (Names Rule);
- address certain funds that use environmental, social and/or governance (ESG) investment practices and ESG and related terms in their names;
- limit the circumstances under which a fund may temporarily depart from its 80% investment policy and include time frames for returning to compliance with its 80% investment policy; and
- include certain form changes and new disclosure requirements.[2]

As further discussed below, these proposed amendments have the potential to meaningfully impact fund names, strategies, management and operations.

Background

Section 35(d) of the Investment Company Act prohibits a registered investment company (and Section 59 of the Investment Company Act prohibits a BDC) from adopting as part of its name or title any word or words that the SEC finds to be materially deceptive or misleading. In 2001, the SEC adopted the Names Rule, which deems certain types of fund names to be materially deceptive or misleading for purposes of Section 35(d) and subjects certain fund names to specific conditions.

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1 Unless otherwise specified, the term "fund" as used in this *Dechert OnPoint* refers to a registered investment company or a business development company (BDC).

2 *See* Investment Company Names, Release No. IC-34593 (May 25, 2022) (Names Rule Release). At the same open meeting, the SEC also voted to propose for public comment amendments to rules under the U.S. Investment Advisers Act of 1940 and the Investment Company Act relating to the disclosure of ESG investment practices. For further information on the ESG proposal, please refer to *Dechert OnPoint*, SEC Issues Rule Proposal Related to Certain Investment Advisers' and Funds' Disclosures About ESG Investment Practices.

At times, this *Dechert OnPoint* tracks the Names Rule Release without the use of quotation marks. Terms not defined in this *Dechert OnPoint* have the meaning assigned to them in the Names Rule Release. Exhibit A to this *Dechert OnPoint* contains a comparison of the text of the proposed amendments to the Names Rule to that of the current rule. This OnPoint provides further analysis of the topic first published on June 1, 2022 in a Dechert NewsFlash.

The Names Rule currently requires that a fund with a name suggesting investment in a particular type of investment, industry, country or geographic region or a name suggesting certain tax treatment adopt a policy to invest – "under normal circumstances" – at least 80% of its assets[3] in such type of investment, industry, country or geographic region or that corresponds with the suggested tax treatment (80% Investment Policy). Depending on the circumstances and the type of fund name, an 80% Investment Policy may be fundamental or non-fundamental.[4] Changes in a fundamental 80% Investment Policy require shareholder approval by the vote of a majority of the fund's outstanding voting securities[5] whereas changes in a non-fundamental 80% Investment Policy require 60-days prior notice to shareholders (Notice).

In March 2020, the SEC issued a request for comments in which it sought public input on a range of questions aimed at "assessing whether the existing [Names Rule] is effective in prohibiting funds from using names that are materially deceptive or misleading, and whether there are alternatives the SEC should consider."[6] The Names Rule Release cites extensively to comment letters submitted in response to that request.

The SEC stated in the Names Rule Release that the proposed amendments are intended to modernize and enhance the investor protections provided by the Names Rule in light of the important information that fund names can convey to investors and industry developments over the last two decades, including the growth of index funds and funds that incorporate ESG factors into their investment processes. The Names Rule Release complements the SEC's contemporaneous proposal that would establish a taxonomy for ESG funds and amend certain disclosure requirements for funds and advisers that use ESG factors in their investment activities.[7]

Overview of Proposed Amendments

The proposed amendments to the Names Rule and related changes to forms and disclosure requirements would:

- Expand significantly the 80% Investment Policy requirement to include fund names with terms suggesting an investment focus in investments that have, or whose issuers have, "particular characteristics," including "growth," "value" and terms indicating that the fund's "investment decisions incorporate one or more ESG factors";
- Designate as materially deceptive and misleading the use of ESG or related terms in names of "integration funds" (as defined below);
- Specify situations where a fund may deviate from its 80% Investment Policy and, with some exceptions, impose a 30-day time period for a fund to come back into compliance with its 80% Investment Policy;

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3 Under the Names Rule, "assets" means "net assets, plus the amount of any borrowing for investment purposes."

4 Generally, a fund may choose whether an 80% Investment Policy is fundamental or non-fundamental; however an 80% Investment Policy for a tax-exempt fund must be a fundamental policy. *See* Investment Company Act Rule 35d-1(a)(2)(ii), (a)(3)(iii), (a)(4).

5 Section 2(a)(42) of the Investment Company Act provides that "[t]he majority of the outstanding voting securities of a fund means the vote of: (i) 67% or more of the voting securities, if the holders of more than 50% of the outstanding voting securities of such fund are present or represented by proxy; or (ii) more than 50% of the outstanding voting securities of such fund, whichever is the less."

6 Request for Comments on Fund Names, Release No. IC-33809 (March 2, 2020).

7 Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, Release No. IC-34594 (May 25, 2022) (ESG Release).

- Require additional disclosure within a fund's prospectus to define terms used in the fund's name, including related investment criteria for selecting investments described by the name, and require that such definitions be consistent with the term's plain English meaning or established industry use;[8]
- Require additional reporting on Form N-PORT relating to Names Rule compliance and to the 80% Investment Policy basket;
- Amend the Notice requirement to expand its scope and modernize the delivery requirements (by making clear that it may be satisfied through electronic delivery);
- For purposes of compliance with an 80% Investment Policy, require funds to value all derivatives instruments based on notional amounts (with certain adjustments) rather than market value (with certain adjustments) and reduce the value of its assets by excluding any cash and cash equivalents up to the notional amount of the derivatives instruments;
- Require registered closed-end investment companies or BDCs that do not have shares listed on a national securities exchange (collectively, Unlisted Funds) to make any 80% Investment Policy a fundamental policy;
- Exempt, in certain situations, unit investment trusts (UITs) from the 80% Investment Policy requirement, consistent with the current exemptions under the Names Rule; and
- Establish certain recordkeeping requirements relating to fund names applicable to funds both with and without an 80% Investment Policy.

Expansion of Terms Subject to the Names Rule

The SEC proposes to expand the Names Rule to require that a fund adopt an 80% Investment Policy if its name suggests a focus "in investments that have, or whose issuers have, particular characteristics."[9] The Names Rule Release identifies "growth," "value" and terms indicating that the fund's investment decisions incorporate one or more ESG factor(s)[10] as examples of names indicating an investment focus.[11]

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8 The SEC has not proposed to change the requirement in the Names Rule that funds with names suggesting that their distributions are exempt from federal income tax or from both federal and state income tax adopt a fundamental 80% Investment Policy.

9 In the Names Rule Release, the SEC clarified that the proposed amendments only would expand the Names Rule in this area and that funds that are currently required to adopt an 80% Investment Policy (*i.e.*, funds whose names suggest a focus in a particular type of investments or industry, or in particular countries or geographic regions, or suggest certain tax treatment) under the Names Rule will still be required to do so.

10 For purposes of the proposed amendments, the term "ESG" would encompass terms such as "socially responsible investing," "sustainable," "green," "ethical," "impact," or "good governance" to the extent they describe ESG factors that may be considered when making an investment decision.

11 Although the Names Rule Release proposed a one-year transition period from the date a final rule is published in the Federal Register, the Names Rule Release does not appear to contain a grandfathering or lookback provision for any of the proposed changes, and, as a result, fund sponsors should consider the impact on their existing fund lineup if the proposed amendments are adopted.

These terms and certain other terms are currently not subject to the requirement to have a corresponding 80% Investment Policy because, under the current Names Rule framework, they suggest an investment strategy and not a type of investment.[12] Names indicating an ESG-related investment focus are generally considered by fund sponsors to also suggest investment *strategies* not subject to the 80% Investment Policy requirement, although the SEC staff frequently requests during the disclosure review process that such a fund adopt a related 80% Investment Policy.

In the Names Rule Release, the SEC expressed the view that even a term that suggests an investment strategy may also "connote an investment focus" and thus should be covered by the Names Rule to align the fund's name with investor expectations. The proposed amendments would also apply to other terms in fund names that the SEC and its staff have previously recognized as falling outside the scope of the current Names Rule, including "global," "international," "income," and "intermediate term (or similar) bond."[13] The Names Rule Release also identifies categories of terms that would not be covered under the proposed amendments, all of which are also generally not viewed as covered under current interpretations of the Names Rule. Specifically, the SEC indicated that the proposed amendments would not apply to names that suggest:

- characteristics of a fund's overall portfolio (such as "balanced" or a name indicating that the fund targets a particular duration);
- particular investment techniques (such as long/short);
- possible results to be achieved (such as real return);
- retirement target dates; and
- other terms that indicate a fund's objectives without specifying the fund's investments or intended investments.[14]

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12 In the 2001 adopting release of the Names Rule, the SEC stated that the Names Rule "does not apply to fund names that incorporate terms such as 'growth' and 'value' that connote types of investment strategies as opposed to types of investments." Investment Company Names, Release No. IC-24828 (January 17, 2001) (2001 Adopting Release). *See also* Frequently Asked Questions about Rule 35d-1 (Investment Company Names) (Investment Company Names FAQ). Note that Frequently Asked Questions issued by the SEC staff have no legal force or effect and do not alter or amend applicable law.

13 In the 2001 Adopting Release, the SEC explained that while "foreign" suggests investments outside of the U.S., the terms "international" and "global" only suggest "diversification among investments in a number of different countries throughout the world" and are not subject to the Names Rule. 2001 Adopting Release at note 42. *See also* Investment Company Names FAQ at Questions 9-11.

14 Names Rule Release at 24-25.

The table below presents examples of terms covered under the existing Names Rules and terms that would be covered under the proposed amended Names Rule:

Existing Names Rule	Proposed Amended Names Rule
Existing Standard: Names that suggest the fund focuses its investments in a particular type of investment or investments or industry or group of industries, a particular country or geographic region, or those that suggest certain tax treatment.	**Proposed Standard:** Names that suggest the fund focuses its investments in a particular type of investment or investments; a particular industry or group of industries; particular countries or geographic regions; those that suggest certain tax treatment; or investments that have, or whose issuers have, particular characteristics.
Examples of terms currently covered under the Names Rule:[15] • *Specific countries (e.g., Japan)* • *Specific regions (e.g., Latin America)* • *Foreign* • *Types of investments (e.g., Stock or Bond)* • *Specific industries (e.g., Utilities or Healthcare)* • *Small-, mid-, large-capitalization* • *High-yield* • *Tax-exempt* • *Municipal*	***Examples of additional terms covered under proposed amended Names Rule:***[16] • *Growth* • *Value* • *Global* • *International* • *Income* • *Intermediate term (or similar) bond* • *Terms indicating that the fund's investment decisions incorporate one or more ESG factors (e.g., ESG, socially responsible investing, sustainable, green, ethical, impact, good governance)* ***Examples of terms not covered under proposed amended Names Rule:***[17] • *Duration-type terms* • *Balanced* • *Long/short* • *Real return* • *Retirement target date*

The Names Rule Release also addresses fund names that suggest an investment focus with multiple elements. Under the proposed amendments, if a fund name suggests multiple elements, the fund's 80% Investment Policy would be required to address all elements of the name. The SEC cited as examples names such as the "ABC Wind and Solar Power Fund" and the "XYZ Preferred Securities and Income Fund." Such funds would be required to have an 80% Investment Policy addressing each element either in the aggregate or individually (for example, the ABC Wind and Solar Power Fund could have a policy to invest 80% of its assets in investments in both the wind and solar industries or a mix of wind and solar industry investments).[18] The SEC requested comment on whether there should be any limit on the requirement to address each element of a fund name. The SEC also requested comment on whether funds should be required to invest a specific minimum percentage in each element instead of allowing funds to aggregate their investments.

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15 *See* 2001 Adopting Release; Investment Company Names FAQ.

16 Names Rule Release at 19, 23-24.

17 *Id.* at 24-25.

18 The SEC also clarified in the Names Rule Release that if a fund has a name containing a term that triggers the 80% Investment Policy requirement along with a term that does not trigger the requirement (like "technology" and "real return" in the same name) then the fund would still be required to adopt an 80% Investment Policy addressing the term that triggers the requirement.

The Names Rule Release indicates that fund sponsors would retain a degree of flexibility in specifying the contours of their required 80% Investment Policies, defining the terms used in such policies, and generally determining the types of investments that are appropriate to include in the 80% Investment Policy basket.[19] To this point, the Names Rule Release affirms that funds may define terms used in their names in a "reasonable" way, which the SEC characterized in the release as requiring "a meaningful nexus" between a fund's name and investments that satisfy its 80% Investment Policy. However, as discussed in more detail below, any investment focus-related terms used in a fund's name would be required to be defined "consistent with those terms' plain English meaning or established industry use." The Names Rule Release highlights the importance of adopting compliance policies and procedures to address a fund's process for allocating investments to its 80% Investment Policy basket.

Under the current Names Rule, funds are required to use a "percentage-of-assets-based" calculation to determine compliance with their 80% Investment Policies. Although the SEC did not propose any changes to this requirement, the SEC did request comment on whether a different calculation method would be appropriate. In the Names Rule Release, the SEC discussed alternative options, including a returns-based method requiring that a fund's historical returns exhibit minimum exposures to certain risk factors. The SEC noted its view that a returns-based method would provide investors with greater insight into a fund's risks and eliminate the need for specifying derivatives valuation methods.

Designation of Materially Misleading and Deceptive Names and Integration Funds

The proposed amendments would explicitly provide that compliance with a fund's 80% Investment Policy is not a safe harbor to the prohibitions on adopting a fund name that is materially deceptive or misleading under Section 35(d) of the Investment Company Act. The Names Rule Release identifies the following as potentially materially deceptive or misleading practices: "substantial"[20] investments made outside the 80% Investment Policy that are "antithetical" to the fund's investment focus[21] or an index fund's 80% Investment Policy to invest in assets connoted by a specific index in circumstances where the reference index's composition is contradictory to the index's name.[22]

The proposed amendments also specifically address the use of ESG and ESG-related terms in the name of an "integration fund." An integration fund, as defined by the SEC in the Names Rule Release, is a fund that considers one or more ESG factors alongside other, non-ESG factors in its investment decisions, but where 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

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19 The SEC indicated in the Names Rule Release that a fund of funds or other "acquiring" fund that has adopted an 80% Investment Policy would not need to look through to the underlying investments of an acquired fund for purposes of determining the extent to which the investment satisfies the acquiring fund's 80% Investment Policy. Instead, the Names Rule Release states that an acquiring fund generally may treat its entire investment in an appropriate acquired fund that itself has an 80% Investment Policy towards the acquiring fund's 80% Investment Policy.

20 "Substantial" investment could include, for example, investing in a way "such that the source of a substantial portion of the fund's risk or returns is different from that which an investor reasonably would expect based on the fund's name." In the Names Rule Release, the SEC provided the following example: a short-term bond fund that invests the remaining 20% of its portfolio in "highly volatile equity securities that introduce significant volatility into a fund that investors would expect to have lower levels of volatility associated with short-term bonds."

21 The SEC noted that, for example, a "fossil fuel-free" fund making a substantial investment in an issuer with fossil fuel reserves could be materially deceptive or misleading for purposes of Section 35(d).

22 In addition, the SEC expressed its view that an index fund generally would be expected to invest more than 80% of its value in investments connoted by the applicable index.

portfolio.[23] The proposed amendments provide that the use of ESG or an ESG-related term in an integration fund's name that suggests the fund incorporates ESG factors in its investment process would be considered *per se* materially deceptive and misleading.

The SEC's expressed concerns, shared by some commenters in response to the 2020 Request for Comment, that the use of ESG-related terms in the name of an integration fund could overstate the use of ESG criteria and lead investors to believe that ESG factors are more central to the fund's strategy, a practice commonly referred to as "greenwashing." The Names Rule Release indicates that the use of ESG or similar terminology in the name of an integration fund "would deceive and mislead investors where the identified ESG factors do not play a central role in the fund's strategy" (*i.e.*, funds for which "ESG factors are generally no more significant than other factors in the investment selection process to include ESG terminology in its name"). The Names Rule Release also indicates that an integration fund might consider ESG factors alongside conventional financial metrics but may nevertheless invest in companies that do not meet the adviser's ESG criteria. In the Names Rule Release, however, the SEC requested comment on whether funds should be permitted to use ESG-related terms alongside the term "integration" or a similar term to indicate the adviser's consideration of ESG factors as one of multiple factors.

Commissioner Hester Peirce, who dissented from the proposed Name Rule changes, issued a statement observing that "the outright prohibition on integration funds' use of ESG in their names could result in substantive changes in the way some funds are managed."[24] Commissioner Peirce suggested that, when considered alongside the accompanying ESG disclosure proposal, the proposed amendments to the Names Rule would impose "heightened disclosure obligations" on integration funds while leaving such funds "unable to use their name to signal to investors that they are integrating ESG." She also suggested that as a consequence of the proposed amendments, "[s]ome advisers may choose to convert their integration funds into ESG-focused funds," while others "might try to run from ESG to avoid the heightened disclosure requirements." Commissioner Peirce concluded that this bifurcation could result in fewer integration-type funds being available to investors. To the extent Commissioner Peirce's concerns reflect practical challenges, fund sponsors may wish to comment on positive or negative externalities the proposed amendments might present.

Temporary Departures from an 80% Investment Policy

The proposed amendments would replace the existing Names Rule's principles-based approach of requiring that funds comply with their 80% Investment Policy "under normal circumstances" with a defined set of situations under which a fund can deviate temporarily from its 80% Investment Policy. Under the proposed amendments, such departures could occur as a result of:

- certain market fluctuations or other circumstances not caused by fund purchase/sale activity;
- unusually large inflows or redemptions;
- adverse market, economic, political or other conditions requiring a fund "to take a position in cash and cash equivalents or government securities to avoid a loss"; or
- repositioning/liquidating fund assets in connection with reorganizations, fund launches or when a notice of a change in a non-fundamental 80% Investment Policy has been provided to shareholders in accordance with the requirements of the rule.

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23 This definition is consistent with the SEC's definition of "ESG Integration" funds and strategies in the ESG Release.

24 Statement on Investment Company Names, Commissioner Hester M. Peirce (May 25, 2022).

Except in the case of fund launches, reorganizations and 80% Investment Policy changes, a fund that departs from its 80% Investment Policy would be required to return to compliance with the policy "as soon as reasonably practicable" but, in any event, within 30 consecutive days following the departure. This would not apply to: fund launches (which should achieve compliance within 180 consecutive days from the date the fund commences operations); reorganizations (with no specified time period for re-attaining compliance); and instances where 60 days' notice of a change in a non-fundamental 80% Investment Policy has been provided to shareholders. Relatedly, the SEC clarified that the "as soon as reasonably practicable" standard would not require re-attaining compliance "as soon as possible" in all instances. Instead, the Names Rule as proposed to be amended would allow "for consideration by the adviser of how to return to compliance in a manner that best serves the interest of the fund and its shareholders."[25] The Names Rule Release implies that the 30-day and 180-day time limits are not safe harbors – funds would have to come into compliance "as soon as reasonably practicable." The Names Rule Release states, for example, that newly-launched open-end funds generally would be expected to become fully invested within a much shorter period than 180 days, because such funds typically invest in relatively liquid assets and receive cash on an ongoing basis.

In voicing her dissent, Commissioner Peirce stated during the open meeting held on May 25, 2022, that "[t]he consequence of this intentionally inflexible approach may include inducing portfolio managers to make undesirable investments in order to remain in compliance with the rule or forcing funds to shut down in times of even relatively short-lived market stress."[26]

Additionally, the SEC proposed to replace the Names Rule's existing time-of-acquisition test used to determine a fund's compliance with its 80% Investment Policy with an ongoing requirement. Under the current Names Rule, compliance with the 80% Investment Policy is measured at the time a fund invests its assets,[27] and funds currently are not required to rebalance their portfolios in order to maintain ongoing compliance with an 80% Investment Policy in the event of market fluctuations, large inflows and redemptions. The 30-day period under the proposed amendments is intended to accommodate temporary departures caused by external events, while preventing a fund from investing for extended periods in a manner that is inconsistent with its 80% Investment Policy. The Names Rule Release explains that the 30-day period is intended to provide a fund with ample time to rebalance its portfolio in an orderly manner following a departure from its 80% Investment Policy.[28] The Names Rule Release requests comments as to: whether 30 days is the appropriate amount of time; and whether the rule instead should provide that a fund's board approve, or be informed in writing about, departures in excess of 30 days.

Additional Disclosure Requirements

The SEC is proposing additional disclosure requirements for a fund's prospectus relating to terms used in a fund's name.[29] The current Names Rule requires a fund to define in its prospectus the specific criteria used in selecting investments if its name suggests investment in particular countries or geographic regions.[30] Outside of

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25 The Names Rule Release noted, for example that "a fund need not return to compliance within 2 days, even if doing so is technically possible, if such an approach would harm the fund or its shareholders by, for instance, causing the fund to purchase illiquid assets at a premium."

26 Statement on Investment Company Names, *supra* note 24.

27 *See* Rule 35d-1(b); 2001 Adopting Release at 8513.

28 The Names Rule release states that a shorter time could force advisers to rebalance a fund's portfolio despite adverse market conditions, potentially to the disadvantage of investors.

29 The additional disclosure requirements would apply to Form N-1A, Form N-2, Form N-8B-2 and Form S-6.

30 *See* Rule 35d-1(a)(3)(ii).

the Names Rule's specific requirements, funds also customarily define the terms used in a fund name when discussing investment objectives and strategies in the prospectus and/or statement of additional information, and such terms are required to be defined in a reasonable way.[31] The SEC proposed to add a more general requirement under the Names Rule, which is intended to codify what the SEC believes to be existing best practices used in defining certain name terms.[32]

These proposed amendments would require a fund with an 80% Investment Policy to define in its prospectus: the terms used in the fund's name related to its investment focus; and the fund's investment criteria for selecting the investments described by that term. The terms subject to this requirement would include any term used in a fund name "related to the fund's investment focus or strategies."[33] The SEC also proposed to require that funds tag the new disclosure using Inline eXtensible Business Reporting Language (iXBRL).[34]

Funds would retain the flexibility, as they currently have under the existing Names Rule, to assign "reasonable definitions" in defining applicable terms, provided that the meaning of any such term is consistent with the term's plain English meaning or an established industry use. The SEC noted that such definitions should have a "meaningful nexus" between the term and the fund's investment focus.

Plain English/Industry Use Requirement

Under the proposed amendments, for funds required to adopt an 80% Investment Policy, any term used in the fund's name would have to be consistent with its plain English meaning or established industry use. The SEC explained in the Names Rule Release that such a requirement is meant to protect investors by prohibiting fund sponsors from defining fund names in a manner inconsistent with a reasonable investor's expectations.

In the Names Rule Release, the SEC further stated that a fund name would be considered materially deceptive or misleading if the fund defines a term inconsistently with its plain English meaning or established industry use, even though the fund's definition matches the fund's 80% Investment Policy.[35] This statement is in line with the SEC's proposal to codify its stance that a fund's compliance with the fund's 80% Investment Policy is not a safe harbor under the Names Rule. Under the proposed amended Names Rule, a fund's name still could be materially deceptive or misleading, notwithstanding compliance with its 80% Investment Policy if the policy defines terms in a manner inconsistent with their plain English meaning or established industry use.

The SEC requested comment as to whether the plain English or industry use standard is clear or if additional guidance would be helpful. The SEC also requested comment as to whether this provision would incentivize funds to adopt overly-broad names that ultimately would be less informative to investors.

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31 This is not a requirement of the Names Rule itself, but rather is discussed by the SEC in its adopting release of the current version of the Names Rule.

32 The SEC noted in the Names Rule Release that the new general disclosure requirement would replace the current requirement for funds with names that suggest an investment focus in particular countries or geographic regions to define the specific criteria used by a fund to select such investments.

33 Such terms exclude any trade name of the fund or its adviser, as well as words not describing an investment focus or strategy (*e.g.*, "fund" or "portfolio").

34 iXBRL is a structured data language that makes "disclosures more readily available and easily accessible for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine-readable data language."

35 In the Names Rule Release, the SEC used as an example of a materially deceptive or misleading name a "solar energy fund" with a policy invest 80% of its investments in "any type of alternative energy company."

Form N-PORT Amendments

Form N-PORT is a quarterly report used by registered investment companies to report portfolio investments information as of the last day of each month. The SEC proposed to add three additional Form N-PORT reporting requirements relating to a fund's 80% Investment Policy. Under the amended Form, registered investment companies that are subject to the 80% Investment Policy requirement would be required to report: whether an individual portfolio investment (including a derivatives instrument) is included in the fund's 80% Investment Policy basket; the total value of a fund's 80% Investment Policy basket as a percentage of the fund's total assets; and the number of days during the reporting period[36] that the fund's 80% Investment Policy basket fell below 80% of the fund's assets, if applicable. The SEC stated that it was not proposing related reporting requirements for BDCs or money market funds.[37]

Generally, information reported on Form N-PORT for the third month of a fund's fiscal quarter is publicly available upon filing while the information reported for the other two months of the quarter is not. The SEC stated that the three proposed reporting items would follow the same approach and be publicly available for the third month of a fund's quarter. The SEC provided several rationales for the proposed reporting requirements, namely, to enhance the SEC's ability to evaluate a fund's compliance with the Names Rule and to provide additional information to investors regarding a fund's investment practices and compliance with its 80% Investment Policy. However, the SEC asked for comments on whether any of the information should not be made publicly available.

Notice Requirement

The proposed amendments would impact Notices in several ways, including content and delivery. As mentioned above, the Names Rule currently requires 60 days' notice to shareholders of changes in a fund's non-fundamental 80% Investment Policy. The proposed amendments would retain the requirement that Notice must be provided (except in the case of fundamental 80% Investment Policy changes, which are subject to shareholder approval) but also would require a fund to describe any related changes to the fund's name in the Notice. Recognizing that current SEC guidance permits the electronic delivery of Notices and the increasing use of electronic delivery methods for regulatory materials, the Names Rule Release explains that the proposed amendments are also intended to provide greater clarity as to how the Names Rule's Notice requirements translate to electronic delivery, including by specifying that the prominent statement highlighting that the Notice involves a change in a fund's investment policy would have to appear in the subject line of any Notice that is delivered by email. The proposed rule would also clarify what it means for the Notice to be provided "separately from any other document."[38]

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36 The SEC requested comment on whether the look-back period for reporting the number of days a fund fell below its 80% Investment Policy should be three months instead of one month.

37 The SEC noted that BDCs report financial statement information using iXBRL and money market funds report information on Form N-MFP. Both of these have reporting requirements that would allow users to analyze portfolio holdings to determine a fund's compliance with its 80% Investment Policy, but, notably, there would be no reporting related to a money market fund's or BDC's daily compliance with its 80% Investment Policy. The SEC also noted that BDCs and money market funds are subject to additional portfolio composition requirements, and that in light of this additional regulation and the existing reporting requirements, the SEC stated it did not believe any additional requirements are necessary.

38 Although the "separately from any other document" requirement is phrased differently than the current requirement, the proposal is intended to be "functionally the same as the current rule's requirement."

Derivatives

The proposed amendments also address the valuation of derivatives instruments[39] for purposes of determining compliance with a fund's 80% Investment Policy, as well as the derivatives instruments that a fund may include in its 80% Investment Policy basket.

The proposed amendments would require a fund to calculate its assets, for purposes of complying with the fund's 80% Investment Policy, by:

- valuing each derivatives instrument for both the numerator and the denominator in the 80% Investment Policy calculation using its notional amount (instead of its market value);
- reducing the value of its assets by excluding "cash and cash equivalents"[40] up to the notional amounts of the derivatives instrument(s); and
- adjusting the notional value by converting interest rate derivatives instruments to their 10-year bond equivalents and delta adjusting the notional amounts of options contracts.

The SEC noted that, for most derivatives instruments, the notional amount effectively serves as a measure of the fund's investment exposure to the underlying reference assets or metric.

The SEC explained that the requirement to deduct certain cash and cash equivalents from a fund's assets is meant to prevent overstatement of the scale of the fund's market exposure obtained through the derivatives instruments (*i.e.*, including these items as assets would effectively "double-count" the fund's exposure). The SEC also provided an example that clarifies that including the cash and cash equivalents in the fund's assets may cause the fund not to be in compliance with the 80% Investment Policy requirement even though, economically, the fund may be achieving an investment exposure akin to investing in the relevant securities directly.

Regarding the adjustment requirements for interest rate derivatives instruments and options contracts, the SEC noted that these requirements are designed to result in adjusted notional amounts that better represent a fund's exposure to interest rate changes and to provide for a more tailored notional amount that better reflects the exposure that an option creates to the underlying reference asset, respectively.

Additionally, the proposed amendments provide that, in addition to any derivatives instrument that the fund includes in its 80% Investment Policy basket because it provides investment exposure to the investments suggested by the fund's name, a fund may include in its 80% Investment Policy basket a derivatives instrument that provides investment exposure to one or more of the market risk factors associated with the investments suggested by the fund's name. The SEC explained that absent this provision, a fund that uses derivatives instruments to hedge exposures or to obtain exposure to market risk factors associated with the fund's investments (*e.g.*, interest rate risk, credit spread risk, and foreign currency risk) may fall out of compliance with its 80% Investment Policy.

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39 "Derivatives instrument" would be defined to mean any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument. The definition would not specifically include physical short sales, and the SEC requested comment on whether the Names Rule should address the valuation of physical short sales and, if so, how they should be valued.

40 The Names Rule would not define the term cash and cash equivalents, but the SEC cross-referenced a statement in the adopting release for Rule 18f-4 under the Investment Company Act (*i.e.*, the derivatives rule) that items commonly considered to be cash equivalents include Treasury bills, agency securities, bank deposits, commercial paper, and shares of money market funds.

The SEC asked for comments on the proposed valuation approach for derivatives instruments. For example, the SEC asked whether there are circumstances in which the use of market values would be more appropriate than that of notional values and whether the use of notional amounts should be restricted in cases where investors place importance on the fund holding the underlying assets, as opposed to cases where investors place importance on the exposures that the fund's investments create (*e.g.*, ESG-focused funds). Industry participants may want to carefully consider the implications of the proposed approach on their funds' compliance with their respective 80% Investment Policy.

Unlisted Closed-End Funds, BDCs and UITs

For Unlisted Funds, the proposed amendments would require any 80% Investment Policy to be a fundamental investment policy, which requires shareholder approval to change. As discussed above, this would represent a significant departure from the regime under the Names Rule currently in effect, which in most cases provides registrants with flexibility to decide whether an 80% Investment Policy is subject to change only upon a shareholder vote or pursuant to Notice, in accordance with the Names Rule. In the Names Rule Release, the SEC stated that, in its view, shareholder approval should be necessary to change an Unlisted Fund's 80% Investment Policy because shareholders do not have an effective way to exit the Unlisted Fund within the 60-day notice period permitted under the currently-effective version of the Names Rule. The SEC requested comment on this aspect of the proposed amendments, including: whether this requirement should be expanded to apply to other types of funds; whether there are any Unlisted Funds for which the policy considerations underlying this proposal would not apply; whether the proposed amendment should be replaced with a longer notice period for 80% Investment Policy changes; and whether other factors should drive the SEC's assessment of whether Unlisted Funds' 80% Investment Policies should be required to be fundamental.

Additionally, the proposed amendments would except a UIT from the 80% Investment Policy requirement if the UIT existed before the adoption of any proposed amendments (unless the UIT has already adopted or was required to adopt such a policy at the time of initial deposit of securities).[41] This provision is consistent with current UIT exceptions under the Names Rule. The SEC requested comment on this aspect of the proposed amendments, including whether it is appropriate to except UITs and what the impact would be to UITs if they were not excepted.

Recordkeeping Requirements

The proposed amendments also include recordkeeping requirements related to the 80% Investment Policy requirement both for funds required to adopt an 80% Investment Policy and funds not required to adopt such a policy under the amended Names Rule. The SEC noted that the current Names Rule and other general recordkeeping requirements do not require any specific recordkeeping related to Names Rule compliance.

Under the proposal, funds required to adopt an 80% Investment Policy would be required to document their compliance with the Names Rule by maintaining written records of:

- portfolio investments included in a fund's 80% Investment Policy basket as well as the basis for including such investments in the basket;
- the value of a fund's 80% Investment Policy basket as a percentage of the fund's assets;

41 The proposed amendments also exempt UITs from the recordkeeping requirement if the UIT pre-dates the adoption of any amendments.

- reasons for and the dates of departures from a fund's 80% Investment Policy; and
- Notices sent to shareholders under the Names Rule.

A majority of these records relate to items captured by the proposed reporting requirements under Form N-PORT, which are discussed above.

For funds that are not required to adopt an 80% Investment Policy, the proposed amendments would require a written record documenting why the fund determined that an 80% Investment Policy is not required. The SEC also requested comment on whether a fund's board or chief compliance officer should be required to make such a determination or at least approve a finding that a fund is not required to adopt an 80% Investment Policy.

The proposed amendments would require that such records be maintained for a minimum of six years from the creation of the record or, in the case of funds without an 80% Investment Policy, from the fund's last use of its name. Additionally, for funds with 80% Investment Policies, the Names Rule Release noted that the SEC was not specifying any requirements as to the frequency of creation of records and that it expects the frequency to vary based on the type of record. For example, the SEC noted that records regarding portfolio investments may be made daily based on investment activity and that the creation of certain records would likely be automated.

Key Dates and Timing

The SEC proposed a one-year transition period for funds to comply with the proposed amendments. If adopted, the proposed amendments to the Names Rule would become effective one year following publication of the final amendments in the Federal Register. Given the breadth and depth of the proposed amendments to the Names Rule and their likely impact and costs on existing and new registered funds, it is important for interested stakeholders to review carefully the proposal, to start assessing the impact of the amendments if adopted as proposed, and to consider whether to share comments with the SEC during the period for comments.

Comments on the SEC's proposal are due by August 16, 2022.

Appendix A – Comparison of Proposed and Current Names Rule

§270.35d-1 Investment company names.

(a) *Materially deceptive and misleading fund names.* For purposes of section 35(d) of the Act (15 U.S.C. 80a-34(d)), a materially deceptive and misleading name of a Fund includes:

(1) *Names suggesting guarantee or approval by the United States government.* A name suggesting that the Fund or the securities issued by it are guaranteed, sponsored, recommended, or approved by the United States government or any United States government agency or instrumentality, including any name that uses the words "guaranteed" or "insured" or similar terms in conjunction with the words "United States" or "U.S. government."

(2) *Names suggesting an investment* ~~in certain investments or industries~~*focus.* A name that includes terms suggesting that the Fund focuses its investments in: a particular type of investment or investments~~, or in investments in~~; a particular industry or group of industries; particular countries or geographic regions; or investments that have, or whose issuers have, particular characteristics (*e.g.,* a name with terms such as "growth" or "value," or terms indicating that the fund's investment decisions incorporate one or more ESG factors), unless:

(i) The Fund has adopted a policy to invest, except under ~~normal~~the circumstances provided in paragraph (b)(1) of this section, at least 80% of the value of its assets ~~in the particular type of investments, or~~ in investments in ~~the particular industry or industries,~~ accordance with the investment focus that the fund's name suggests. For a name suggesting that the fund focuses its investments in a particular country or geographic region, investments that are in accordance with the investment focus that the fund's name suggests are investments that are tied economically to the particular country or geographic region suggested by ~~the Fund's~~its name; ~~and~~

(ii) ~~Either the~~The policy described in paragraph (a)(2)(i) of this section is a fundamental policy ~~under section 8(b)(3) of the Act (15 U.S.C. 80a-8(b)(3))~~, or the Fund has adopted a policy to provide the Fund's shareholders with at least 60 days prior notice of any change in the policy described in paragraph (a)(2)(i) of this section, and any change in the fund's name that accompanies the change, that meets the ~~requirements~~provisions of paragraph (~~c~~e) of this section. If the fund is a closed-end company or business development company, and the fund does not have shares that are listed on a national securities exchange, the fund's policy is a fundamental policy; and

(iii) Any terms used in the fund's name that suggest that the fund focuses its investments as described in paragraph (a)(2)(i) are consistent with those terms' plain English meaning or established industry use.

~~(3) Names suggesting investment in certain countries or geographic regions. A name suggesting that the Fund focuses its investments in a particular country or geographic region, unless:~~

~~(i) The Fund has adopted a policy to invest, under normal circumstances, at least 80% of the value of its Assets in investments that are tied economically to the particular country or geographic region suggested by its name;~~

~~(ii) The Fund discloses in its prospectus the specific criteria used by the Fund to select these investments; and~~

~~(iii) Either the policy described in paragraph (a)(3)(i) of this section is a fundamental policy under section 8(b)(3) of the Act (15 U.S.C. 80a-8(b)(3)), or the Fund has adopted a policy to provide the Fund's shareholders with at least 60 days prior notice of any change in the policy described in paragraph (a)(3)(i) of this section that meets the requirements of paragraph (c) of this section.~~

(43) *Tax-exempt Funds.* A name suggesting that the Fund's distributions are exempt from federal income tax or from both federal and state income tax, unless ~~the Fund has adopted a fundamental policy under section 8(b)(3) of the Act (15 U.S.C. 80a-8(b)(3))~~:

(i) The fund has adopted a fundamental policy:

(~~i~~A) To invest, except under ~~normal~~the circumstances provided in paragraph (b)(1) of this section, at least 80% of the value of its assets in investments the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; or

(~~ii~~B) To invest, except under ~~normal~~the circumstances provided in paragraph (b)(1) of this section, its assets so that at least 80% of the income that it distributes will be exempt, as applicable, from federal income tax or from both federal and state income tax~~.~~; and

~~(b) The requirements of paragraphs (a)(2) through (a)(4) of this section apply at the time a Fund invests its Assets, except that these requirements shall not apply to any unit investment trust (as defined in section 4(2) of the Act (15 U.S.C. 80a-4(2))) that has made an initial deposit of securities prior to July 31, 2002. If, subsequent to an investment, these requirements are no longer met, the Fund's future investments must be made in a manner that will bring the Fund into compliance with those paragraphs.~~

(ii) Any terms used in the fund's name that suggest that the fund invests its assets as described in paragraph (a)(3)(i) are consistent with those terms' plain English meaning or established industry use.

(b) *Operation of policies and related recordkeeping.*

(1) A fund may temporarily invest less than 80% of the value of its assets in accordance with the fund's investment focus as otherwise required by paragraphs (a)(2)(i) or (a)(3)(i) of this section in the circumstances described in paragraphs (b)(1)(i)-(iv) of this section, provided the fund brings its investments into compliance with paragraphs (a)(2)(i) or (a)(3)(i) as soon as reasonably practicable:

(i) As a result of market fluctuations, or other circumstances where the temporary departure is not caused by the fund's purchase or sale of a security or the fund's entering into or exiting an investment, for no more than 30 consecutive days;

(ii) To address unusually large cash inflows or unusually large redemptions, for no more than 30 consecutive days;

(iii) To take a position in cash and cash equivalents, or government securities as defined in section 2(a)(16) of the Act, to avoid losses in response to adverse market, economic, political, or other conditions, for no more than 30 consecutive days; or

(iv) To reposition or liquidate the fund's assets in connection with a reorganization, to launch the fund, or when notice of a change in a fund's policy as described in paragraph (a)(2)(ii) has been provided to fund shareholders.

(2) For the purpose of determining the fund's compliance with an investment policy adopted under paragraph (a)(2)(i) or (a)(3)(i)(A), in addition to any derivatives instrument that the fund includes in its 80% basket because the derivatives instrument provides investment exposure to investments suggested by the fund's name, a fund may include in its 80% basket a derivatives instrument that provides investment exposure to one or more of the market risk factors associated with investments suggested by the fund's name.

(3) A fund must maintain written records documenting either its compliance under paragraphs (a) and (b) of this section or, if the fund does not adopt a policy under paragraphs (a)(2)(i) and (a)(3)(i) of this section, a written record of the fund's analysis that such a policy is not required under these paragraphs. Written records documenting the fund's compliance under paragraphs (a) and (b) of this section include: the fund's record of which investments are included in the fund's 80% basket and the basis for including each such investment in the fund's 80% basket; the value of the fund's 80% basket, as a percentage of the value of the fund's assets; the reasons, pursuant to paragraphs (b)(1)-(2), for any departures from the policies described in paragraphs (a)(2)(i) and (a)(3)(i); the dates of any departures from the policies described in paragraphs (a)(2)(i) and (a)(3)(i); and any notice sent to the fund's shareholders pursuant to paragraph (e). Written records documenting the fund's compliance under paragraphs (a) and (b) must be maintained for a period of not less than six years following the creation of each required record (or, in the case of notices, following the date the notice was sent), the first two years in an easily accessible place. The written record made by a fund that does not adopt a policy under paragraphs (a)(2)(i) and (a)(3)(i) of this section must be maintained in an easily accessible place for a period of not less than six years following the fund's last use of its name.

(c) *Effect of compliance with policy adopted under paragraph (a)(2)(i) or (a)(3)(i).* A fund name may be materially deceptive or misleading under section 35(d) of the Act even if the fund adopts and implements a policy under paragraph (a)(2)(i) or (a)(3)(i) of this section and otherwise complies with the requirements of paragraph (a)(2) or (a)(3), as applicable.

(d) *Use of ESG terms in fund names.* If a fund considers one or more ESG factors alongside other, non-ESG factors in its investment decisions, but those 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, the use of terms in the fund's name indicating that the fund's investment decisions incorporate one or more ESG factors is materially deceptive and misleading.

(~~c~~e) *Notice.* A policy to provide a Fund's shareholders with notice of a change in a Fund's ~~investment~~ policy as described in paragraph~~s~~ (a)(2)(ii) ~~and (a)(3)(iii)~~ of this section must provide that:

(1) The notice will be provided in plain English ~~in a separate written document~~separately from any other documents (provided, however, that if the notice is delivered in paper form, it may be provided in the same envelope as other written documents);

(2) The notice will contain the following prominent statement, or similar clear and understandable statement, in bold-face type: "Important Notice Regarding Change in Investment Policy~~";~~ [and Name]", provided that

(i) If the notice is provided in paper form, the statement also will appear on the envelope in which the notice is delivered; and

(ii) If the notice is provided electronically, the statement also will appear on the subject line of the email communication that includes the notice or an equivalent indication of the subject of the communication in other forms of electronic media; and

(3) The ~~statement contained in paragraph (c)(2) of this section also will appear on the envelope in which the notice is delivered or, if the notice is delivered separately from other communications to investors, that the~~

~~statement will appear either on the notice or on the envelope in which the notice is delivered.~~notice must describe, as applicable, the fund's policy adopted under paragraph (a)(2)(i), the nature of the change to the policy, the fund's old and new names, and the effective date of any policy and/or name changes.

(f) *Unit Investment Trusts.* The requirements of paragraphs (a)(2)(i), (a)(3)(i), and (b)(3) shall not apply to any unit investment trust (as defined in section 4(2) of the Act (15 U.S.C. 80a-4(2)) that has made an initial deposit of securities prior to **[FINAL RULE AMENDMENTS' EFFECTIVE DATE]** unless the unit investment trust has already adopted a policy under paragraphs (a)(2) or (a)(3) or was required to adopt such a policy at the time of the initial deposit.

(~~d~~g) *Definitions.* For purposes of this section:

(1) ~~Fund means a registered investment company and any series of~~*80% basket* means investments that are invested in accordance with the investment ~~company~~focus that the fund's name suggests (or as described in paragraph (a)(3)(i)).

(2) *Assets* means net assets, plus the amount of any borrowings for investment purposes. In determining the value of a fund's assets for purposes of this section, a fund must value each derivatives instrument using the instrument's notional amount (which must be converted to 10-year bond equivalents for interest rate derivatives and delta adjusted for options contracts) and reduce the value of its assets by excluding any cash and cash equivalents up to the notional amount of the derivatives instrument(s).

(3) *Derivatives instrument* means any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument.

(4) *ESG* means environmental, social, and/or governance.

(5) *Fund* means a registered investment company or a business development company, including any separate series thereof.

(6) *Fundamental policy* means a policy that a fund adopts under section 8(b)(3) of the Act (15 U.S.C. 80a-8(b)(3)) or, in the case of a business development company, a policy that is changeable only if authorized by the vote of a majority of the outstanding voting securities of the fund.

(7) *Launch* means a period, not to exceed 180 consecutive days, starting from the date the fund commences operations.

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