# SEC Amendments to Investment Company Act “Names Rule”

**Introduction**

On September 20, 2023, the U.S. Securities and Exchange Commission (the “SEC”), adopted amendments to rule 35d-1 under the Investment Company Act of 1940, commonly known as the “Names Rule.”[1]

The Names Rule applies to the names of registered investment companies and business development companies (“BDCs”). The SEC stated that the “amendments modernize and enhance the Names Rule and other names-related regulatory requirements to further the Commission’s investor protection goals and to address the developments in the fund industry in the approximately 20 years since the rule was adopted.”[2] SEC Chair Gary Gensler remarked that the “final rules help ensure that a fund’s portfolio aligns with a fund’s name. Such truth in advertising promotes fund integrity on behalf of fund investors.”[3] The SEC pointed to an increase in fund assets under management and the proliferation of diverse fund strategies, such as those with thematic and environmental, social, or governance (“ESG”) related objectives, as the catalyst for the amendments to the Names Rule.[4]

**Expansion of the 80% Investment Policy Requirement**

The amendments to the Names Rule expand the current 80% investment policy requirement to apply to any fund name with terms suggesting that the fund focuses on investments that have, or investments whose issuers have, particular characteristics. While the SEC declined to define “particular characteristics” in the rule, the Adopting Release indicates an expansive view “that this term will be adequately understood to mean any feature, quality, or attribute.”[5] Given the expansive view of “particular characteristics” that would require an 80% investment policy, we recommend that funds begin evaluating not only their current holdings against the rule’s requirements but also their projections, models, contingency plans, and other foreseeable future holdings. As discussed below, registered funds will have limited ability to diverge from the 80% requirement.

We also encourage funds to think carefully about ESG – or potential ESG – descriptors appearing in their names. While SEC concerns over misleading indications of ESG characteristics – so called “green washing” – were clear motivators for the applicability of the rule to “particular characteristics”, the contours of what would constitute “ESG characteristics” has not been prescribed in the amended rule. Crafting an 80% policy for such characteristics could prove challenging, particularly given that ESG occupies an evolving area of the regulatory landscape.

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[1] Investment Company Names, Release No. 33-11238; 34-98438 (Sept. 20, 2023) (“Adopting Release”).

[2] SEC Press Release, *SEC Adopts Rule Enhancements to Prevent Misleading or Deceptive Investment Fund Names*, available at https://www.sec.gov/news/press-release/2023-188?utm_medium=email&utm_source=govdelivery.

[3] *Id.*

[4] Adopting Release, at 31.

[5] Adopting Release, at 30.

In the adopting release, the SEC acknowledged that "some commentators expressed concerns about the perceived vagueness associated with the 'particular characteristics' language in the proposed rule," but adopted the amendments as proposed and provided examples of names that would fall under the scope of the amended rule.[6] Examples of names falling under the expanded scope include names with terms such as "growth" or "value," or terms indicating that the fund's investment decisions incorporate one or more ESG factors. Additionally, the amendments retain the Names Rule's current requirements for a fund to invest in accordance with its 80% investment policy under normal circumstances, and for the 80% investment requirement to apply at the time a fund invests its assets. Notably, the amendments add a new provision to the Names Rule that requires a fund to review its portfolio assets' inclusion in its 80% allocation at least quarterly. To address the rule's application to derivatives instruments, the amendments will require funds with derivates in their 80% allocation to use a derivatives instrument's notional amount to determine the fund's compliance with its 80% investment policy.

A fund that departs from the 80% investment requirement will now have 90 days to get back into compliance, which is a change from the proposal which would have imposed a 30-day requirement. The amendments do allow funds to invest less than 80% of their assets in the 80% allocation bucket temporarily in order to reposition or liquidate assets in connection with a reorganization or launch of a fund. For fund launches, the funds will have a temporary period to depart from the 80% investment requirement that is not to exceed 180 consecutive days starting from the day the fund commences operations. The final rule amendments do not limit the time of departures associated with fund reorganizations.

The amendments also prohibit unlisted registered closed end-funds or BDCs that are required to adopt an 80% investment policy from changing that policy without a shareholder vote. However, an unlisted registered closed-end fund or BDC may change their 80% investment policy without a shareholder vote if: (i) the fund conducts a tender or repurchase offer with at least 60 days' prior notice of the policy change, (ii) that offer is not oversubscribed, and (iii) the fund purchases shares at their net asset value.

## **Modernization of Notice Requirement**

Consistent with the current rule, the amendments continue to require that, unless a fund's 80% investment policy is a fundamental policy, 60 days' notice must be provided to shareholders of any change in the fund's 80% investment policy. Additionally, notices must describe any change in the fund's name. The amendments require that the notice describe: (i) the fund's 80% investment policy, (ii) the nature of the change to the 80% investment policy, (iii) the fund's old and new names, and (iv) the effective date of any investment policy and/or name changes. For notices provided electronically, the amendments require that a legend appear in the subject line of the email communication that reads: "Important Notice Regarding Change in Investment Policy [and Name]". The amended rule also clarifies that funds are not permitted to post notices to their websites as an alternative to sending the notice directly to shareholders.

## **Enhanced Prospectus Disclosure and Plain English Requirement**

The amendments will require a fund to define the terms used in its name, including the criteria the fund uses to select the investments that the term describes. The SEC noted in the Adopting Release that the

[6] Adopting Release, at 29.

amendments provide flexibility for fund managers to "ascribe reasonable definitions for the terms used in a fund's name" as well as the criteria used to select investments that the term describes. Any terms used in the fund's name that suggest either an investment focus, or that the fund's distributions are tax-exempt, must be consistent with those terms' plain English meaning or established industry use. "Investment focus" is broadly defined, and we recommend firms begin reviewing names to determine what changes may be needed to bring a fund's prospectus in line with the amended rule prior to the relevant compliance date. [7]

**Form N-Port Reporting Requirements**

For the third month of every quarter, funds will have to report the following items on Form N-Port:

- the value of the fund's 80% allocation bucket;
- whether an investment is included in the fund's 80% allocation bucket; and
- the definitions of terms used in the fund's name.

**Effective Date and Compliance**

The Names Rule amendments will become effective 60 days after publication in the Federal Register. Funds with net assets of $1 billion or more will have 24 months following the effective date to comply with the amendments. Funds with net assets of less than $1 billion will have 30 months following the effective date to comply.

The adopting release is available here and a fact sheet from the SEC is available here. Alston & Bird lawyers are available to address any questions you may have regarding these amendments. For more information, please contact the Alston & Bird lawyer with whom you usually work or any of the members of the Alston & Bird Investment Funds team.

[7] The Adopting Release notes that "investment focus means a focus is in a particular type of investment or investments, a particular industry or group of industries, particular countries or geographic regions, or investments that have, or whose issuers have, particular characteristics." *Id.* at 23.

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