What’s in a Name?

May 27, 2022

By Jim Nash, Managing Director

What’s in a name? It seems that the U.S. Securities and Exchange Commission (the “SEC”) would wholeheartedly disagree with the female protagonist of William Shakespeare’s Romeo and Juliet that a rose by any other name would smell as sweet.

On May 25, 2022, the SEC announced proposed amendments to Rule 35d-1 (the “Names Rule”) under the Investment Company Act of 1940 (the “1940 Act”). The Names Rule was adopted in 2001 and generally requires that if a fund’s name suggests a focus in a particular type of investments, or in investments in a particular industry, or geographic area, the fund must adopt a policy to invest at least 80% of the value of its assets in the type of investments, industry, country, or geographic region suggested by its name. Notably, fund names that incorporated terms such as “growth” or “value” were deemed to connote an investment strategy rather than an investment focus and were therefore excepted from the 80% policy requirement.

In early 2020, the SEC issued a request for public comment regarding whether the Names Rule was effective and if there were viable alternatives that should be considered, noting market and other developments since the rule’s adoption, such as the prevalence of ETFs, use of derivatives, and increased focus on thematic areas. SEC Chair Gary Gensler observed, “A lot has happened in our capital markets in the past two decades. As the fund industry has developed, gaps in the current Names Rule may undermine investor protection. In particular, some funds have claimed that the rule does not apply to them even though their name suggests that investments are selected based on specific criteria or characteristics.”

The proposed amendments will, among other things, expand the scope of the Names Rule’s 80% investment policy to apply to any fund name with terms suggesting the fund focuses in investments that have, or investments whose issuers have, particular characteristics. Further, the proposed amendments will change the requirement that a fund apply the 80% policy at the time of investment in favor of identifying specific circumstances in which a fund could depart from the policy and specific time frames for regaining compliance. The proposed amendments will also change how certain derivative instruments are valued for the purpose of calculating a fund’s 80% bucket and specify which types of derivative instruments a fund could include in its 80% bucket. Of particular note, the proposed amendments indicate that the SEC will find the use of an ESG term in a fund’s name deceptive and misleading if the ESG factor identified by that term was not a determinative factor in deciding to include or exclude any particular investment in the portfolio. Finally, the proposed amendments include changes to reporting on Form N-PORT, the manner of communicating investment policy changes to fund shareholders, recordkeeping of fund compliance with the rule, and would cause unlisted closed-end funds or BDCs to seek shareholder approval prior to making a change to an 80% investment policy.

The public comment period for the proposed amendments will commence on its publication in the Federal Register and remain open for 60 days.