

SEC adopts amendments to Investment Company Act “names rule”

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The amendments broaden the scope of the requirement for registered investment companies and business development companies (BDCs) to adopt a policy to invest at least 80% of the value of their assets in accordance with the investment focus that a fund’s name suggests.

In a [September 20 release](#), the Securities and Exchange Commission (SEC) adopted amendments to Rule 35d-1 under the Investment Company Act of 1940, as amended (Names Rule), which addresses names of registered investment companies and BDCs (together, funds) that the SEC believes are likely to mislead investors about a fund’s investments and risks. The amendments are designed to modernize and enhance the Names Rule, as well as related disclosure and reporting requirements, to further the SEC’s investor protection goals and to address developments in the fund industry since the adoption of the Names Rule in 2001.

Expansion of the 80% investment policy requirement

The Names Rule currently requires funds whose names suggest a focus in a particular type of investment, or investments in a particular industry or geographic region, to adopt a policy to invest at least 80% of the value of their assets in those investments (80% investment policy). The amendments apply the 80% investment policy requirement to any fund name with terms suggesting that the fund focuses in 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 environmental, social, or governance (ESG) factors).

Temporary departures from an 80% investment policy

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 policy to apply at the time that a fund invests its assets. The amendments also include a new requirement that a fund review its portfolio assets’ inclusion in its “80% basket” at least quarterly, and the amendments provide specific time frames – generally 90 days – for getting back into compliance if a fund departs from its 80% investment policy.

Derivatives

The amendments generally require funds to use a derivative’s notional value, as opposed to market value, for the purpose of determining compliance with an 80% investment policy. The amendments include a limited modification to this approach that excludes certain currency hedges from the Names Rule compliance calculation.

Unlisted registered closed-end funds and BDCs

The amendments generally prohibit a registered closed-end fund or BDC whose shares are not listed on a national securities exchange from changing its 80% investment policy without a shareholder vote. However, the amendments generally permit such a fund to make changes to its 80% investment policy without a shareholder vote if the fund conducts a tender or repurchase offer in advance of the change.

Enhanced prospectus disclosure

The amendments require a fund with an 80% investment policy to define in its prospectus the terms used in its name, including the criteria that the fund uses to select the investments that the term describes.

Plain English requirements

The amendments require that any terms used in a fund's name that suggest 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.

Modernization of notice requirement

The amendments retain the Names Rule's current requirement that, unless a fund's 80% investment policy is a fundamental policy, 60 days' notice must be provided to fund shareholders of any change in the fund's 80% investment policy. The amendments update the notice requirement to expressly address funds' use of electronic delivery and incorporate additional specificity about the content and delivery of the notice.

Form N-PORT reporting requirements

The amendments require funds to report on Form N-PORT the value of the fund's 80% basket, whether an investment is included in the fund's 80% basket, and the definitions of terms used in the fund's name.

Compliance dates

The amendments will become effective 60 days after publication in the Federal Register. Fund groups with net assets of \$1 billion or more will have 24 months from the effective date to comply with the amendments, and fund groups with net assets of less than \$1 billion will have 30 months from the effective date to comply.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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