

Investment Management & Funds Regulatory Update - January 2025

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In this issue, we discuss recent developments regarding enforcement of the Corporate Transparency Act, and the SEC staff's updated FAQs regarding the Names Rule under the Investment Company Act.

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Rules and regulations

Enforcement of Corporate Transparency Act remains enjoined pursuant to separate nationwide injunction, despite recent U.S. Supreme Court decision

On January 23, 2025, the Supreme Court granted the government's motion to stay a nationwide injunction on enforcement of the Corporate Transparency Act (CTA) that was issued by the U.S. District Court of the Eastern District of Texas in *Texas Top Cop Shop, Inc. v. Garland*. However, on January 7, 2025, another judge in the Eastern District of Texas issued a separate nationwide injunction of the CTA and the Beneficial Ownership Information Reporting Rule (BOI Reporting Rule) in *Smith v. U.S. Department of the Treasury*.

The Financial Crimes Enforcement Network (FinCEN) issued an alert on January 24, 2025, acknowledging the separate nationwide injunction and, most importantly, confirming that reporting companies are not currently required to file beneficial ownership information with FinCEN despite the Supreme Court's action in *Texas Top Cop Shop*. Please see our recent [client update](#) for more information on this topic.

SEC staff issues updated FAQs regarding the Names Rule under the Investment Company Act

The staff of the SEC's Division of Investment Management recently issued updated [Frequently Asked Questions](#) (the 2025 FAQs) pertaining to rule 35d-1 under the Investment Company Act (the Names Rule), which modified prior FAQs issued on this topic in 2001 (the 2001 FAQs). This update was necessitated by the SEC's adoption of amendments to the Names Rule in 2023 (the 2023 Amendments). In its 2025 FAQs, the staff withdrew numerous questions from its prior 2001 FAQs and retained others. The questions that were retained are discussed below.

Adoption of 80% investment policy

As described in the 2025 FAQs, the Names Rule requires funds whose names suggest a focus in a particular type of investment, or in investments in a particular industry or geography, to adopt a policy to invest at least 80% of the value of their assets in the type of investment, industry, country, or geography suggested by their names (the 80% investment policy requirement). The 2023 Amendments broadened the scope of the original 80% investment policy requirement to include fund names with terms suggesting that the relevant funds focused on investments that had, or investments whose issuers had, particular characteristics.

- **Question:** "If a fund wishes to adopt or revise a fundamental 80% investment policy to comply with rule 35d-1, as amended in 2023, does the fund need to obtain shareholder approval?"

Similar to its response in the 2001 FAQs, the staff's response stated that no shareholder approval is required unless the adoption of a new fundamental policy or revision of an existing fundamental policy constitutes a deviation from an existing fundamental policy that requires shareholder approval under Section 13(a)(3) of the Investment Company Act. The staff's response also mentions that funds should consider whether factors outside the Investment Company Act, such as state law or the fund's charter or by-laws, would require shareholder approval to adopt or revise a fundamental 80% investment policy.

Tax-exempt funds

As noted in the 2025 FAQs, the Names Rule requires funds whose names suggest that their distributions are exempt from federal income tax, or from both federal and state income tax, to adopt an 80% investment policy based on an assets test or an income test.

The questions the staff addressed are as follows:

- **Question:** "How does rule 35d-1 apply to single-state tax-exempt funds? Are single-state tax-exempt funds required to satisfy the 80% investment requirement only with securities of issuers located in the named state?"

Similar to its response in the 2001 FAQs, the staff's response noted that:

- A fund with a name suggesting that its distributions are exempt from both federal and state income tax (e.g., the "Maryland Tax-Exempt Fund") must have a fundamental policy to invest, under normal circumstances, either: "(i) at least 80% of the value of its assets in investments the income from which is exempt from both federal income tax and the income tax of the named state, or (ii) its assets so that at least 80% of the income that it distributes will be exempt from both federal income tax and the income tax of the named state."
 - "A single-state tax-exempt fund may include a security of an issuer located outside of the named state in the fund's 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state."
- **Question:** "Are funds with the term 'municipal' in their names treated like tax-exempt funds under rule 35d-1(a)(3)?"

Similar to its response in the 2001 FAQs, the staff's response stated that:

- Yes, in the staff's view, the terms "municipal" and "municipal bond" in a fund's name suggest that the fund's distributions are exempt from income tax, and therefore such funds would be expected to comply with rule 35d-1(a)(3).

- In the staff's view, "funds using the term 'municipal' rather than 'tax-exempt' may count securities that generate income subject to the alternative minimum tax toward the 80% investment requirement, while funds that use the term 'tax-exempt' may not."

Specific terms commonly used in fund names

As noted above, the 2023 Amendments expanded the scope of the 80% investment policy requirement to cover names that include terms suggesting that funds focus on investments that have, or whose issuers have, particular characteristics.

The questions the staff addressed are as follows:

- **Question:** "How does rule 35d-1 apply to a fund that uses the term 'high-yield' in its name?"

Similar to its response in the 2001 FAQs, the staff's response stated that a fund with the term "high-yield" in its name generally would need to adopt an 80% investment policy under rule 35d-1(a)(2).

The staff also clarified its view regarding funds that use the term "high-yield" in conjunction with the term "municipal," "tax-exempt," or similar terms in their names. The staff noted that such view is consistent with its response in the 2001 FAQs regarding names that use the term "high-yield" in conjunction with terms such as "municipal" or "tax-exempt." As noted in the staff's response, because the market for below-investment grade municipal bonds is smaller and relatively less liquid than the market for below-investment grade taxable bonds, tax-free high-yield bond funds have historically invested in more higher grade bonds than taxable high-yield funds. The staff's response stated that although a fund that uses the term "high-yield" in conjunction with "municipal," "tax-exempt," or similar terms in its name would need to adopt an 80% policy to invest in "municipal" or "tax-exempt" securities, "the staff would not object if, in light of this specific historical practice for high-yield municipal funds, such a fund were to invest less than 80% of the value of its assets in bonds that meet the fund's high-yield rating criteria." The staff noted that such fund would, however, continue to be subject to the prohibition on materially deceptive or misleading names under section 35(d) of the Investment Company Act, and anti-fraud provisions under the Federal securities laws regarding disclosures to investors.

- **Question:** "Does rule 35d-1 apply to a fund that uses the term 'tax-sensitive' (or a similar term) in its name?"

Similar to its response in the 2001 FAQs, the staff's response stated that the use of the term "tax-sensitive" (or a similar term) in a fund's name would not require the fund to adopt an 80% investment policy. In the staff's view, the term "tax-sensitive" (as well as similar terms such as "tax-efficient," "tax-advantaged," "tax-managed," and "tax aware") references the overall characteristics of the fund's portfolio and objectives "without communicating to investors the particular characteristics of the investments that will make up the fund's portfolio."

The staff noted that such fund would, however, continue to be subject to the prohibition on materially deceptive or misleading names under section 35(d) of the Investment Company Act, and anti-fraud provisions under the Federal securities laws regarding disclosures to investors.

- **Question:** "How does rule 35d-1 apply to a fund that uses the term 'income' in its name?"

In the staff's view, when the term "income" in a fund's name does not refer to "fixed income" securities, then such term generally suggests the fund's emphasis on the achievement of current income as a portfolio-wide result. The staff's response noted that in these circumstances, the use of the term "income" would not, on its own, require the fund to adopt an 80% investment policy.

- **Question:** "A fund that uses the term 'money market' in its name must invest solely in eligible securities and meet other investment requirements under rule 2a-7, in order for its name not to be deemed materially deceptive or misleading within the meaning of section 35(d) of the Investment Company Act. Is a fund that uses the term "money market" in its name also required to comply with rule 35d-1?"

Similar to its response in the 2001 FAQs, the staff's response noted that, as an example, a fund calling itself the "XYZ U.S. Treasury Money Market Fund" would need to adopt a policy to invest at least 80% of the value of its assets in U.S. Treasury securities. However, the staff's response noted that a generic money market fund with a name suggesting that it invests in money market instruments generally (e.g., the "XYZ Money Market Fund") would not need to adopt an 80% investment policy because rule 2a-7, in any event, would require the fund to invest solely in eligible securities.

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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