

Regulatory Alert

Regulatory Insights for Financial Services

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Names Rule: SEC Final Amendments

KPMG Insights:

SEC amends the Names Rule to prevent deceptive and misleading fund names. Key features of the final amendments include:

- **Truth in Advertising:** ‘Call it what it is’
- **What’s in the Fund Matters:** Align fund’s portfolio to its name
- **Protect Investors:** From misleading, deceptive, false claims and “greenwashing”
- **Define & Disclose It:** Update prospectus, reporting and recordkeeping

The Securities and Exchange Commission (SEC) issues [final rule amendments](#) to Section 35d-1 of the Investment Company Act of 1940, commonly referred to as the fund “Names Rule”, with the goal of preventing fund names from misrepresenting a fund’s investments and risks.

The final amendments, which impact registered investment companies and business development companies (BDCs), together “funds”, are being adopted substantially as proposed (see KPMG Regulatory Alert, [here](#))

Investment Company Names

80 Percent Investment Policy Requirement: The Names Rule’s existing 80 percent investment policy requirement requires funds whose names suggest a focus on particular investments, industries, or geographical regions to invest at least 80 percent of their fund assets in the type of investment, industry, or geographic region suggested by the fund name.

The amendments expand application of this requirement to include any fund name with terms suggesting that the fund focuses in investments that have, or whose issuers have, particular characteristics (e.g., terms like “growth” or “value”) or that reference a thematic investment focus (e.g., terms

related to one or more ESG factors such as “sustainable” or “socially responsible”).

Temporary Departures from the 80 Percent Investment Policy:

The final amendments retain the Names Rule’s existing requirements for funds to comply with their 80 percent investment policy “under normal circumstances” and at the time they invest assets (“time-of-investment test”).

The final amendments also:

- Introduce a new requirement that funds review their portfolio assets subject to the 80 percent investment requirement at least quarterly to determine if the fund’s investments continue to be consistent with the fund’s 80 percent investment policy.
- Allow for funds to depart from the 80 percent requirements for a period of time, generally ninety (90) days (as opposed to the proposed thirty (30) day period), either as identified by the fund in its quarterly review, or intentionally in “other-than-normal circumstances”, before reestablishing compliance.
 - Under the final amendments funds are permitted to temporarily depart from the 80 percent investment requirement in connection with a reorganization (for

which the final rule does not specify a required time frame for accompanying temporary departures) or a fund launch (departure not to exceed the period of 180 consecutive days) or when a notice of a change in a fund's policy in certain circumstances has been provided to fund shareholders.

Derivatives: The final amendments will require a fund with derivatives holdings to use the derivatives' notional amount, rather than their market value, for the purpose of calculating and determining the fund's compliance with the 80 percent investment policy. In a change from the proposal, funds will be:

- Required to exclude from the calculation certain derivatives that hedge the current risk associated with a fund's foreign-currency denominated investment. These derivatives therefore will not be included in the calculation of the fund's assets or the fund's 80% basket when determining if the fund is complying with its 80% investment policy.
- Permitted, when determining compliance with its 80 percent investment policy, to deduct cash and cash equivalents and U.S. Treasury securities with remaining maturities of one year or less from assets (i.e., the denominator in the 80 percent calculation), up to the notional amounts of the fund's derivatives instruments.
- Permitted to exclude any closed-out derivatives positions when calculating assets for purposes of determining compliance with its 80 percent investment policy, if those positions result in no credit or market exposure to the fund.

Unlisted closed-end funds and BDCs: The final amendments generally prohibit registered closed-end funds or BDCs whose shares are not listed on a national securities exchange from changing their 80 percent investment policy without a shareholder vote. This prohibition is intended to "ensure that such fund investors could vote on a change in investment policy given their limited options to exit their investments prior to the change."

However, in a change from the proposal, the final amendments do permit these funds to make changes to their 80 percent investment policies without a shareholder vote if:

- The fund conducts a tender or repurchase offer in advance of the change,

- The fund provides at least sixty (60) days' notice of any change in the policy in advance of the offer.
- The offer is not oversubscribed.
- The fund purchases shares at their net asset value (NAV).

Enhanced prospectus disclosure, reporting, and recordkeeping: The amendments will:

- Update funds' prospectus disclosure requirements to require those with 80 percent investment policies to define the terms used in their names, including the criteria used to select the investments that the terms describe.
- Require that any terms used in funds' names that suggest an investment focus, or that funds' distributions are tax-exempt, must be consistent with those terms' "Plain English" meaning or established industry use.
- Revise Form N-PORT reporting to enhance transparency regarding how funds' investments reflect their investment focus as required under the rule, as well as a new reporting requirement to include the definitions of terms used in the fund's name.
- Include new recordkeeping provisions related to a fund's compliance with the Names Rule's requirements.

Notice requirements: The amendments retain the existing Names Rule requirement that, unless the 80 percent investment policy is a fundamental policy of the fund, sixty (60) days' notice must be provided to fund shareholders of any change in the fund's 80 percent investment policy. The amendments also update notice requirements for funds that use electronic delivery to provide information to their shareholders and provide additional specificity about the content and delivery of the notice.

Effective Date and Compliance Period. The final amendments will become effective sixty (60) days after publication in the Federal Register. Compliance with the final amendments will be tiered:

- Fund groups with net assets of \$1 billion or more will have 24 months following the effective date to comply with the amendments.
- Fund groups with net assets of less than \$1 billion will have 30 months following the effective date to comply.

Pending Action. The SEC notes that the final amendments do not adopt one aspect of the original proposal that sought to

address the use of ESG-related terms in the names of ESG “integration funds”, which would have been defined as “materially deceptive and misleading” if the fund name includes terms indicating that the fund’s investment decisions incorporate one or more ESG factors but those factors are considered along with, but not more significantly than, other investment factors. SEC states that it is still reviewing public

comments on this aspect of the proposal and that it remains under consideration.

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