

Latham & Watkins [Environmental, Social & Governance, Investment Funds, and Financial Regulatory Practices](#)

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## SEC Adopts Changes to Names Rule for Registered Funds

*The amendments aim to modernize the Names Rule and promote investor protection objectives by ensuring that a fund's portfolio of holdings aligns with its name.*

### Key Points:

- Registered investment companies whose names suggest a focus on a particular type of investment must invest at least 80% of the value of their assets in those investments.
- The scope of applicability of the 80% investment policy requirement now includes registered funds with names that suggest the fund focuses on investments/issuers with particular characteristics, including ESG.
- Any terms used in a fund's name that suggest an investment focus must be consistent with their plain English meanings or established industry use.
- The updated Names Rule is substantially similar to the 2022 [proposal](#) (covered in this [Client Alert](#)), with certain key differences discussed further in this Client Alert. Notably, the final rule does not state that ESG terminology in a fund name would automatically be considered materially deceptive or misleading if such ESG factors are equal but not greater than other investment factors.
- Like the 2022 proposal, the final rule does not specifically regulate private funds but may indicate the SEC Staff's view of "best practice" for private funds.

The US Securities and Exchange Commission (the SEC or the Commission) has adopted [amendments](#) to Rule 35d-1 under the Investment Company Act governing naming conventions for registered funds (the Names Rule). The SEC estimates that the percentage of registered funds subject to the rule will increase from 60% to 76% under the new Names Rule.

### The Updated Names Rule

The Names Rule prohibits registered funds from using "materially deceptive or misleading" names.<sup>1</sup> Specifically, it requires a registered investment company or business development company with a name that suggests it focuses on a particular type of investment or investments in a particular industry, country, or geographic region, or that it suggests certain tax treatment, to invest at least 80% of its assets consistent with its name (the 80% investment policy requirement or the 80% requirement).

The amendments broaden the scope of the 80% investment policy requirement to apply to any registered fund name with terms that suggest the registered fund focuses on investments that have, or

investments whose issuers have, particular characteristics or a thematic investment focus. This expanded requirement includes registered fund names that indicate the registered fund's investment decisions incorporate one or more ESG factors. ESG terms that trigger the 80% requirement — if they describe ESG factors that may be considered when making an investment decision — include, for example, “ESG,” “sustainable,” “green,” “socially responsible,” “ethical,” “impact,” and “good governance.” According to the SEC, “[t]he breadth of ESG-related terms, as well as evolving investor expectations around terms like ‘sustainable’ or ‘socially responsible,’ compound the possibility of investor confusion and potential ‘greenwashing’ in fund names.”

The amendments also include in the 80% requirement registered fund names with terms such as “growth” or “value,” that according to the SEC “communicate to investors the particular characteristics of investments that will make up the fund’s portfolio.” Prior to the amendments, these were considered investment strategies and therefore not within scope of the 80% requirement. However, the final rule omits the proposal that the 80% requirement be applied to funds that employ terms like terms like “global” and “international” (without an additional term that suggests an investment focus such as “fixed income” or “growth”), because “[t]hese terms describe a fund’s approach to constructing a portfolio, but do not communicate the composition of the fund’s portfolio with any particularity ... and therefore on their own suggest no particular investment focus.”

### Key Amendments to the Names Rule

- **Expanded Scope:** The amendments broaden the scope of the 80% investment policy requirement to apply to any registered fund name with terms that suggest particular characteristics or a thematic investment focus, including ESG-related terms.
- **Prospectus Disclosure Requirements:** Registered funds must define the terms used in its name in its prospectus, as well as delineate the criteria the fund uses to select the investments that the term describes.
- **Plain English Usage:** The terms used in a registered fund’s name that suggest an investment focus or that the fund is tax-exempt must be consistent with those terms’ plain English meanings or established industry use. However, portfolio managers may ascribe their own “reasonable” definitions for employed terms and retain the “flexibility” to determine the criteria employed to choose investments in line with those terms.
- **Return to Compliance:** Registered funds must invest in accordance with the 80% investment policy requirement in normal circumstances. Portfolios, however, may shift over time (either because of inadvertent portfolio “drift” or intentional departures). In normal circumstances, a fund must come back into compliance with the 80% requirement as soon as reasonably practicable and in all circumstances within 90 consecutive days of the fund’s identification that the requirements are no longer met. In other-than-normal circumstances, the time limit to come back into compliance would be 90 consecutive days from the initial departure. This amendment extends the 2022 proposal’s 30-day timeframe.

Under the final rule, registered funds are also permitted to depart temporarily from the 80% requirement in connection with a reorganization (no return timeframe specified), a fund launch (departure not to exceed 180 consecutive days), or when a notice of a change in a fund’s policy in certain circumstances has been provided to shareholders.

- **Quarterly Review:** A registered fund must review the treatment of portfolio assets under its 80% requirement at least quarterly. This change softens from the 2022 proposal's assumed continual review.
- **Application to Derivatives:** A registered fund would be able to include a derivatives instrument in its 80% basket if it provided investment exposure to one or more market risk factors associated with the investments suggested by the fund's name. Notably, this change differs from the 2022 proposal in that derivatives that hedge the currency risk associated with a fund's foreign currency-denominated investments must be excluded from the calculation of the fund's assets or the fund's 80% basket when determining if the fund is complying with its 80% requirement.
- **Derivative Valuation:** A registered fund must generally use a derivatives instrument's notional amount (rather than its market value) when determining its compliance with the 80% investment policy requirement, "because a derivative instrument's market value may bear no relation to the investment exposure that the derivatives instrument creates."
- **No Safe Harbor:** A registered fund name may be materially deceptive or misleading even if the fund complies with the 80% requirement, i.e., compliance with the Names Rule's 80% requirement does not create a safe harbor for registered fund names. According to the SEC, "[t]he prohibitions of section 35(d) and the anti-fraud provisions of the Federal securities laws regarding disclosures to investors continue to apply to funds notwithstanding their compliance with the names rule," and written compliance policies and procedures must be implemented to prevent any such violations.
- **Recordkeeping:** A registered fund must maintain written records documenting compliance with the 80% requirement, with a six-year retention period. Unlike in the 2022 proposal, funds that do not adopt an 80% investment policy requirement are not required to maintain a written record of their analysis that the policy is not required under the Names Rule.
- **Form N-PORT Reporting:** New reporting items on Form N-PORT regarding (1) whether each portfolio investment is included in the fund's 80% basket; (2) the value of the fund's 80% basket, as a percentage of the value of the fund's assets; and (3) the definitions of terms used in the name and any selection criteria associated with these terms. Unlike in the 2022 proposal, registered funds must report information for the third month of each calendar quarter instead of monthly and report the definitions of terms used in a fund's name, but need not report the number of days that the value of the fund's 80% basket fell below 80% of the value of the fund's total assets during the reporting period.
- **Unit Investment Trusts (UITs):** UITs benefit from certain exceptions, unless a UIT has already adopted, or needed to adopt, an 80% requirement under the current rule. Unlike in the 2022 proposal, the proposed exceptions for UITs provide that the 80% investment policy and recordkeeping requirements will apply only at the initial deposit and not on an ongoing basis.
- **Shareholder Approval:** A BDC or a registered closed-end fund that is (1) not listed on a national securities exchange and (2) subject to the 80% investment policy requirement, would have to make its 80% investment policy a fundamental policy, meaning that changes to its 80% investment policy would necessitate shareholder approval. However, unlike in the 2022 proposal, a vote is not required if (i) the fund conducts a tender or repurchase offer in advance of the change; (ii) the fund provides at least 60 days' notice of any change in the policy in

advance of the offer; (iii) the offer is not oversubscribed; and (iv) the fund purchases shares at their net asset value.

- **Shareholder Notice:** Registered funds must notify shareholders upon a change in their 80% requirement, as well as a change to a fund's name that accompanies such policy change.
- **Notice Requirement:** Registered funds that use electronic delivery methods to provide information to shareholders must comply with additional specificity about the content and delivery of the notice.

### Key Compliance Dates

The amendments to the Names Rule will become effective on December 11, 2023, 60 days after publication in the [Federal Register](#).

Fund groups with net assets of \$1 billion or more will have 24 months to comply with the amendments, and fund groups with net assets of less than \$1 billion will have 30 months to comply.

### The Commissioners Weigh In

The commission voted 4-1 to adopt the amendments to the Names Rule, and each released a statement justifying their support (or lack thereof) for the amendments.

- Chairman Gary Gensler [supported](#) the amendments, stating that “truth in advertising promotes fund integrity on behalf of fund investors.”
- Commissioner Caroline A. Crenshaw [supported](#) the amendments, stating that they “are common sense changes that protect investors by ensuring that a fund says what it means, and means what it says.” She also noted that the final rule affirms the SEC’s stance that “technical compliance with the Names Rule does not exempt a fund from its overarching obligation not to mislead investors with its name.”
- Commissioner Jaime Lizárraga [supported](#) the amendments, stating that they “go to the heart of [the SEC’s] investor protection mission” and “strengthen protections for nearly 121 million retail investors.”
- Commissioner Hester M. Peirce [supported](#) the amendments, highlighting that the final rule “clearly gives fund managers the authority to define the terms used in the funds’ names” and that the SEC “is acknowledging that there can be multiple reasonable definitions for the same term.” She did, however, note her concerns “about the cost, the potential ambiguities around what is covered and what is not[,] and the absence of an option for fund boards to extend the 90-day departure.” She also included a list of thoughtful questions regarding rule implementation.
- Commissioner Mark T. Uyeda [dissented](#), stating that the adopted amendments “will entail significant compliance costs for funds to implement . . . which ultimately will be borne by investors.” He also expressed concern regarding the “potential lack of transparency” regarding SEC Staff’s administration of the rule. To ameliorate that concern, he called on the Staff to “publicly release guidance, tools, or training materials that might shed light on how the Staff will maintain internal consistency in the rule’s application.”

## ESG Analysis and Takeaways

Several commenters urged the SEC not to expand the Names Rule to explicitly cover ESG funds given how expansive the E, the S, and the G can be. However, the SEC concluded in its adopting release that funds with ESG-related terms in their names present unique challenges that should be addressed by the Names Rule. The SEC seemed to rest its decision on the fact that investor interest in, and funds that offer, ESG strategies have rapidly increased in recent years. The SEC elaborated that the breadth of ESG-related terms, as well as evolving investor expectations around terms like “sustainable,” “green,” and “socially responsible,” compound the possibility of investor confusion and potential “greenwashing” in fund names. As a result, the SEC noted that the use of ESG terminology in fund names could be materially deceptive or misleading without definition. Moreover, the SEC concluded that there is not a principled basis to treat ESG terms differently than other terms that have the potential to be materially deceptive and misleading, as suggested by a few commenters that requested a purely disclosure-based framework for funds that use ESG terms in their name.

In a departure from the proposed rule, the final rule does not include an effective bar on the use of ESG terminology in the names of “integration funds.” The proposed rule defined integration funds as those that consider one or more ESG factors alongside other non-ESG factors, but where those ESG factors are generally no more significant than other factors in the investment selection process. While the proposal included a provision that the name of an integration fund would be considered materially deceptive or misleading if the name indicated that the fund’s investment decisions incorporate one or more ESG factors, this was not ultimately included in the final rule. However, the 80% rule and requirement for the name to be reasonably defined would still apply to any such names.

The approach to naming conventions also has the potential to create tension for funds that are seeking to attract investors from several jurisdictions, particularly if jurisdictions have competing approaches to defining certain terms, such as under the increasing number of sustainable taxonomies. For example, in the EU, the European Securities and Markets Authority has consulted on proposals to restrict ESG and sustainability-related terms in the naming of funds in order to tackle greenwashing concerns. Under these proposals, if a fund has any ESG-related words in its name, a minimum of 80% of its investments should be used to meet the fund’s environmental or social characteristics or sustainable investment objectives in accordance with the binding elements of the investment strategy as disclosed in the pre-contractual and periodic reports applicable to Article 8 and 9 funds under the Sustainable Finance Disclosure Regulation (SFDR).

While this 80% threshold could parallel the threshold under the amended Names Rule, an additional threshold is also proposed if a fund uses the word “sustainable” or any other sustainability-related term in its name. This would mean that within the 80% threshold, funds using sustainability-related terms in their name would need to ensure that at least 50% of investments met the “sustainable investment” definition under SFDR. On the basis of these proposals, investments in the 50% minimum proportion would be subject to the SFDR “sustainable investment” test, including the “do no significant harm” assessment, meaning they would need to consider a double materiality lens. We discuss this proposal further [here](#).

In the UK, the Financial Conduct Authority (FCA) set out in a [Dear AFM Chair](#) letter its expectation that authorized investment funds with references to ESG (or related terms) in the fund’s name should reflect fairly the materiality of ESG/sustainability considerations to the objectives and/or investment policy and strategy of the fund. The FCA emphasizes that using “ESG,” “green,” “sustainable,” “responsible,” “ethical,” “impact,” or related terms in a fund’s name could be misleading unless the fund pursues ESG/sustainability characteristics, themes, or outcomes in a way that is substantive and material to the fund’s objectives, investment policy, and strategy. This position will be further reinforced once the

UK Sustainability Disclosure Requirements and investment labels regime takes effect (we provide details on this [here](#)), further adding to the patchwork of rules that firms must navigate.

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**Endnotes**

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<sup>1</sup> 17 C.F.R. § 270.35d-1.