Morgan Lewis | Report

NAMES RULE AMENDMENTS WILL REQUIRE CHANGES FOR CERTAIN FUNDS

October 2023

www.morganlewis.com

NAMES RULE AMENDMENTS WILL REQUIRE CHANGES FOR CERTAIN FUNDS

On September 20, 2023, in a 4-1 vote, the US Securities and Exchange Commission (SEC) adopted amendments (the Amendments) to the rule governing fund names, which impose new disclosure, compliance, reporting, and recordkeeping requirements on certain funds.

The Amendments[1] expand the scope of Rule 35d-1 (the Names Rule) under the Investment Company Act of 1940 (the 1940 Act) to apply to any fund name that includes terms that suggest a focus in investments that have, or investments whose issuers have, "particular characteristics" and will require an 80% investment policy for such funds. The Amendments also include new compliance and reporting requirements regarding departures from 80% investment policies as well as substantial recordkeeping requirements.

- Many funds not currently subject to the requirements of the Names Rule will now be required to adopt 80% investment policies and be subject to substantial ongoing compliance requirements.
- As a result of new Names Rule–related public reporting on Form N-PORT required by the Amendments, SEC staff will have unprecedented visibility into funds' compliance with the requirements of the Names Rule.
- Environmental, social, and governance (ESG) terms in a fund name will generally require the adoption of an 80% investment policy, but ESG terms indicating a portfolio-level overlay may not.
- Fund boards and fund managers will need to oversee significant changes to fund lineups and the implementation of new disclosure, compliance, and recordkeeping requirements.

Most funds will be required to be in compliance with the Amendments by the end of 2025, with smaller entities having an additional six months to comply.

BACKGROUND

Section 35(d) of the 1940 Act prohibits a registered investment company from adopting as part of its name any word or words that the SEC finds by rule, regulation, or order to be materially deceptive or misleading. The SEC adopted the Names Rule in 2001 to address certain broad categories of names that it believed were likely to mislead investors about a fund's investments and risks. Until now, the Names Rule had not been amended since its adoption.

In recent years, the SEC began considering the need for potential updates to the Names Rule. In March 2020, the SEC published a Request for Comment on Fund Names that sought industry input on a number of aspects of the Names Rule, including the treatment of derivative instruments, challenges presented by index funds, and funds that have investment mandates requiring qualitative assessments or judgments (including funds ESG investment strategies).[2] Following its review of industry input received from the Request for Comment, the SEC proposed amendments to the Names Rule in May 2022 (the 2022 Proposal).[3]

[1] Investment Company Names, Rel. No. IC-3500 (Sept. 20, 2023) (Adopting Release).

[2] Request for Comments on Fund Names, Rel. No. IC-33809 (Mar. 2, 2020).

[3] Investment Company Names, Rel. No. IC-34593 (May 25, 2022).

In the Adopting Release, the SEC explained that the Amendments are designed to improve the protections that the Names Rule provides and to respond to the evolution of the fund industry over the last 20 years. Not only have registered fund assets under management nearly quadrupled during that time, but fund investment strategies also have become substantially more diverse. Despite the fact that few SEC enforcement cases involving Section 35(d) have been brought over the prior 20 years, the SEC asserted that industry changes and the SEC staff's experience with the Names Rule necessitates the Amendments.

OVERVIEW OF THE AMENDMENTS

Expansion of Scope

As proposed, the Amendments broaden the scope of the Names Rule to apply to fund names that include terms suggesting that the fund focuses on investments that have, or whose issuers have, "*particular characteristics*"—which will include terms such as "growth" and "value" as well as terms related to ESG or sustainability.

Names Suggesting an Investment Focus

The Amendments eliminate the distinction between investment type and investment strategy under the current Names Rule by requiring funds to adopt an 80% investment policy with respect to terms in their names suggesting the fund focuses on investments with "particular characteristics," regardless of whether such terms also connote an investment strategy.

Although the Amendments do not define "particular characteristics," the SEC clarified in the Adopting Release that this phrase includes any feature, quality, or attribute of an investment or issuer and provided a nonexclusive list of terms covered by the Amendments, including "value," "growth," "ESG," and other ESG-related terms (e.g., "sustainable," "socially responsible").

Additionally, the Amendments will cover terms in a fund's name that reference a thematic investment focus, such as terms suggesting political, economic, or historical themes (e.g., "biothreat," "big data," "post-Corona") as well as demographic characteristics (e.g., "millennial," "Gen Z").

These new requirements represent a significant expansion of the Names Rule and current market practices. Currently, terms suggesting an investment strategy (as opposed to an investment type such as "equity" or "fixed income" securities) are not subject to the Names Rule's 80% investment policy requirement.[4]

The SEC acknowledged that not all names falling within the broadened scope of the Amendments will have precise definitions or standardized, objective criteria. Accordingly, the Amendments intend to provide fund managers with flexibility in ascribing "reasonable definitions" for the terms used in a fund's name, provided that each definition is consistent with the plain English or established industry use of the term.

If a fund's name suggests an investment focus that has multiple elements (e.g., Technology and Growth Fund), the fund's 80% investment policy must address each of those elements. However, the SEC stated that a fund will have reasonable discretion in specifying how the fund's investments will incorporate each element. For example, in the case of the aforementioned "Technology and Growth Fund," the fund could

[4] The SEC staff, however, has applied the Names Rule expansively, particularly in connection with fund disclosure reviews, including with respect to ESG-related terms.

have an investment policy providing that each security included in its 80% basket must be both in the technology sector and meet the fund's growth criteria or, alternatively, have an investment policy providing that 80% of the value of the fund's assets will be invested in a mix of technology sector investments and growth investments, with no minimum or maximum investment requirements specified for either category.

Names That Do Not Suggest an Investment Focus

The Amendments do not require a fund to adopt an 80% investment policy with respect to terms that reference characteristics of the fund's portfolio as a whole (i.e., terms that do not communicate the particular characteristics of investments making up the fund's portfolio).[5] The Amendments identify three nonexclusive examples of terms that describe a fund's portfolio as a whole and for which an 80% investment policy would not be required:

1. Terms suggesting a portfolio-wide result (e.g., "real return," "intermediate term," "balanced," "managed risk")
2. Terms referencing a particular investment technique (e.g., "long/short," "hedged")
3. Terms referencing asset allocations that evolve over time (e.g., retirement target-date funds, "sector rotation" funds)

Additionally, the Adopting Release clarified that fund names including the terms "global" or "international" (absent another term suggesting an investment focus) will not require an 80% investment policy under the Amendments. The SEC explained that an 80% investment policy would not be required because these terms articulate a fund's approach to constructing a portfolio and do not communicate the composition of a fund's portfolio with any particularity, and, therefore, such terms on their own suggest no investment focus (in contrast to terms such as "Europe" or "Japan").

Relatedly, terms indicating that a fund uses a negative or exclusionary screening process for selecting portfolio investments (e.g., "fossil fuel–free") would not require an 80% investment policy because these terms indicate investments *excluded* from the portfolio rather than the portfolio's investment focus.

The Amendments will not apply the 80% investment policy requirement to investment strategies that are solely executed on a relative basis at the portfolio level, provided that the fund includes terms in its name to signal this approach to investors. To illustrate this, the Adopting Release referenced ESG "uplift" funds, which typically begin with a given universe of investments and do not add new investments to this universe, but systematically overweight or underweight investments within the given universe based on ESG criteria.

Such funds typically attempt to achieve a more favorable ESG profile at an aggregate fund level as compared to the benchmark or investment universe. In such circumstances, the SEC noted that these funds are investing on a relative basis at the portfolio level rather than focusing their investments in companies that exhibit strong ESG characteristics. As such, these funds would not be required to adopt an 80% investment policy with respect to terms indicating this type of strategy in their names (e.g., "ESG Aware").

---

[5] Fund names falling outside the scope of the Amendments will, nonetheless, remain subject to Section 35(d)'s prohibition on materially misleading or deceptive names along with the anti-fraud provisions of the federal securities laws regarding disclosures to investors.

Defining Terms Used in Fund Names

The Amendments require that any fund with an 80% investment policy must define the terms used in its name in its prospectus disclosure. Funds must also include the specific criteria used to select investments that the term(s) describe, if any. For funds registered on Form N-1A, this disclosure is required to be located in both Item 4 and Item 9 investment strategy disclosure.

The terms requiring definitions include any word or phrase in a fund's name, outside of trade names of the fund or its adviser, related to the fund's investment focus or strategies. The SEC stated in the Adopting Release that this requirement is intended to codify industry best practices surrounding these disclosures. This information must also be tagged in iXBRL.

In defining terms used in their names, funds will be required, as proposed, to use "reasonable definitions." These definitions must not be inconsistent with terms' plain English meaning or established industry usage. The Adopting Release included some examples and guidance on how to apply these requirements, including a nonexhaustive list of possible sources to determine what "established industry usage" might mean. Such sources include the dictionary, prior public disclosures, industry codes or classifications, and/or a colloquial understanding of a term.

Investments Included in a Fund's 80% Basket

For purposes of determining whether a particular investment qualifies for inclusion in a fund's 80% basket, the Amendments require there to be a "reasonable nexus" between such investment and the investment focus suggested by the fund's name; however, fund managers will have flexibility to determine what constitutes a reasonable nexus.

Although the SEC declined to provide an exhaustive list of circumstances in which a nexus would exist between an investment and the particular investment focus of a fund, it did clarify that it would generally be reasonable for a fund to determine that a nexus exists between certain securities and a given industry if the securities are issued by companies that derive more than 50% of their revenue or income from, or own significant assets in, that industry.

The SEC also recognized that there may be instances where this percentage could be smaller (e.g., where a large company is a dominant firm in a given industry).[6] Conversely, the SEC noted that the use of text analytics to assign issuers to industries based on the frequency of particular terms in an issuer's disclosures is not, by itself, sufficient to create a reasonable nexus.[7]

The SEC also clarified that funds of funds or other acquiring funds can include the entire value of an investment in an appropriate acquired fund when calculating compliance with an 80% investment policy without looking through to the acquired fund's underlying investments, provided that the acquired fund has an 80% investment policy corresponding to that of the acquiring fund. The SEC noted, however, that

[6] While the "50% of revenue" test is a position that SEC staff has long accepted for establishing a nexus, suggesting that a large company has a nexus to a given industry solely because it is a "dominant firm in that industry" has, heretofore, generally been rejected by the staff.

[7] Funds may still use text analytics and other advanced language processing technologies to aid in a determination that a nexus exists between a given security and the investment focus of a fund if the analysis goes beyond the frequency with which a word or phrase appears in a document.

it would be unreasonable to take this approach when the acquiring fund knows the underlying fund is not investing consistent with the acquiring fund's investment focus.[8]

TEMPORARY DEPARTURES FROM THE 80% INVESTMENT POLICY

Quarterly Review Requirement

Consistent with the current Names Rule, the Amendments require funds to be in compliance with their 80% investment policies "under normal circumstances." The Amendments will now also require funds to assess their portfolios' compliance with their 80% investment policies at least quarterly. Where a deviation is identified during a quarterly review, the Amendments specify timeframes—generally 90 days—within which a fund must return to compliance with its policy.

This quarterly review requirement and 90-day grace period are much less onerous than the continual, and potentially daily, compliance testing that funds would have had to implement under the 2022 Proposal, which also would have permitted funds to depart from their 80% investment policies only under certain specified circumstances (as discussed in more detail below) and typically for only 30 days. Despite the longer period for returning to compliance in the Amendments, however, funds will still need to implement some amount of monitoring beyond the quarterly review mandated by the Amendments in order to comply with the temporary departures requirements.

Time-of-Investment Test

The Amendments retain the current Names Rule's time-of-investment test, which requires a fund to determine whether a security is within its 80% basket at the time of investment and whether the fund's portfolio would still be in compliance with its 80% investment policy after the acquisition. For purposes of the new quarterly review requirement, investments that are included in a fund's 80% basket at the time of investment will continue to be considered part of the 80% basket unless the fund determines otherwise.

"Under Normal Circumstances" Requirement

The Amendments retain the current Names Rule's requirement that a fund invest in accordance with its 80% investment policy "under normal circumstances." Funds may only depart from their 80% investment policies in other-than-normal circumstances, subject to a facts and circumstances test. The 2022 Proposal would have permitted funds to depart from their 80% investment policies only under certain specified circumstances (e.g., market fluctuations, large cash inflows/outflows).

Notably, funds will have flexibility under the Amendments to determine what constitutes other-than-normal circumstances. In the Adopting Release, the SEC clarified that such circumstances could include, *but are not limited to*, temporary defensive positions to avoid losses in response to adverse market, economic, political, or other conditions, as well as the other circumstances specified in the 2022 Proposal.[9] This flexibility is intended to address industry concerns that the 2022 Proposal was overly prescriptive.

---

[8] The SEC also clarified that an acquiring fund is not required to continuously monitor the investments of the underlying fund for purposes of compliance with the Amendments.

[9] Under the 2022 Proposal, temporary departures would have been permitted only (1) as a result of market fluctuations or other circumstances where the temporary departure is not caused by the fund's purchase or sale of a security or the fund's entering into an investment; (2) to address unusually large cash inflows or unusually large redemptions; (3) to take a position in cash and cash equivalents or

Morgan Lewis

As discussed further below, when a fund deviates from its 80% investment policy due to other-than-normal circumstances, the fund must maintain a record documenting the date of the departure and the reason for the departure. In the Adopting Release, the SEC cautioned that if a fund deviates frequently from its 80% investment policy in purportedly other than-normal circumstances, this could suggest that those circumstances are in fact "normal" and raise questions about the fund's name under Section 35(d).

Timeline for Returning to Compliance

The Amendments generally require a fund to come back into compliance within 90 days, as measured from (1) the time that the fund identifies a departure from its 80% investment policy (as part of its required quarterly review or otherwise) or (2) the time the fund initially departs, in other-than-normal circumstances, from its 80% investment policy.

In the case of portfolio drift, however, the SEC expects funds to come back into compliance with their 80% investment policies *as soon as reasonably practicable*, with 90 days being the outer limit. The SEC believes that most temporary departures caused by portfolio drift (including inadvertent drift identified during the required quarterly reviews) could be remedied in "substantially less" time than 90 days.

For new funds, the Amendments allow a fund to depart from its 80% investment policy for a period of up to 180 consecutive days starting the day the fund commences operations. The Amendments do not limit the time of departures associated with fund reorganizations.

In all circumstances, and consistent with the current Names Rule, where a fund identifies that its 80% investment policy is no longer met, the fund must make future investments in a manner that will bring the fund into compliance with its 80% investment policy.

The SEC also noted that a fund could seek exemptive relief under Section 6(c) of the 1940 Act in circumstances where it would be appropriate for the fund to depart from its 80% investment policy for a period beyond 90 days, provided the relief is necessary or appropriate, in the public interest, and consistent with the protection of investors.[10]

TREATMENT OF DERIVATIVES

The Amendments also address the treatment of derivatives instruments[11] in assessing a fund's compliance under the Names Rule. In particular, the Amendments cover (1) the valuation of derivatives instruments for purposes of determining compliance with a fund's 80% investment policy and (2) the

---

government securities to avoid losses in response to market, economic, political, or other conditions; or (4) to reposition or liquidate a fund's assets in connection with a reorganization, to launch the fund, or when notice in the fund's 80% investment policy has been provided to fund shareholders at least 60 days before the change pursuant to the Names Rule.

[10] For example, the SEC stated that a fund could consider seeking exemptive relief when the fund anticipates resolving the departure from its 80% investment policy, but cannot do so within 90 days. Notably, the SEC does not discuss the practicality of obtaining exemptive relief from the SEC within such a 90-day period.

[11] The Amendments define "derivatives instrument" as "any swap, security based-swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument." This is consistent with the first prong of the definition of "derivatives transaction" under Rule 18f-4 under the 1940 Act but, unlike Rule 18f-4, does not extend to short sales, which are separately addressed under the Amendments.

derivatives that a fund may include in its 80% basket. The SEC explained in the Adopting Release that these Amendments were designed to better reflect the investment exposure that derivatives instruments create and to provide a clear and consistent approach to derivatives valuation for purposes of complying with the Names Rule.

Valuation of Derivatives

- *Notional Amounts Required*. Under the Amendments, a fund will be required to use notional amounts to value derivatives instruments in assessing whether it has invested 80% of its assets in accordance with the investment focus that the fund's name suggests.[12] This is a change from the current SEC staff position that requires funds to use market value for purposes of assessing compliance with the Names Rule. In the Adopting Release, the SEC contended that using market value for purposes of assessing Names Rule compliance could prevent a fund from using a name that effectively communicates its investments or could result in a fund being in compliance with its 80% investment policy despite having significant exposure to investments that are not suggested by the fund's name.
- *Calculating Notional Amounts*. Under the Amendments, a fund calculating notional amounts for purposes of determining compliance with the Names Rule will be required to convert interest rate derivatives to their 10-year bond equivalents.[13] With respect to options, a fund will be required to delta adjust an option by multiplying the option's unadjusted notional amount by the option's delta (i.e., the ratio of change in the value of the option to the change in value of the asset into which the option is convertible).
- *Currency Hedging Exclusion*. The Amendments require a fund to exclude from its calculation of the fund's assets, in determining compliance with the Names Rule (i.e., the denominator in the 80% calculation), certain derivatives that hedge currency risks associated with one or more specific foreign currency–denominated equity or fixed-income investments held by the fund. This is a change from the 2022 Proposal and requires a fund to exclude a currency derivative if (1) it is entered into and maintained by the fund for hedging purposes and (2) the notional amounts of the derivatives do not exceed the value of the hedged investments (or the par value thereof, in the case of fixed-income investments) by more than 10%.
- *Permitted Deductions from Assets*. In addition to the required adjustments and exclusions discussed above, the Amendments permit (but do not require) a fund, in determining compliance with its 80% investment policy, to:
    - Deduct cash and cash equivalents[14] and US Treasury securities with remaining maturities of one year or less from assets, up to the notional amounts of the fund's derivatives instruments; and

---

[12] Footnote 247 in the Adopting Release states, among other things, that the SEC believes "the term 'notional amount' . . . is understood by market participants and used as a means to reflect the market exposure a derivative creates—meaning, for example, that if a derivative provides a return based on the leveraged performance of a reference asset, the notional amount must reflect the application of the leverage factor."

[13] The SEC noted in the Adopting Release that one way to convert an interest rate derivative into its 10-year bond equivalent is to multiply the derivative's unadjusted notional amount by the ratio of the derivative's duration and the duration of the reference security.

[14] The SEC has stated that items commonly considered to be "cash equivalents" include certain Treasury bills, agency securities, bank deposits, commercial paper, and shares of money market funds. The US Generally Accepted Accounting Principles (GAAP) define "cash equivalents" as short-term, highly liquid investments that are readily convertible to known amounts of cash and that are so near their maturity

    - Exclude closed-out derivatives positions when calculating assets, if those positions result in no credit or market exposure to the fund.
- *Treatment of Short Positions and Physical Short Sales.* Consistent with the approach discussed above and with the 2022 Proposal, if a fund uses derivatives instruments to obtain exposure to short positions, the fund would be required to value the derivatives instruments' using their notional amounts. In a change from the 2022 Proposal, the Amendments will require a fund to value each physical short position using the value of the asset sold short.

Derivatives Instruments Included in the 80% Basket

In addition to any derivatives instruments that provide investment exposure to investments suggested by the fund's name, the Amendments allow for a fund to include in its 80% basket any derivatives instruments that facilitate the fund's investment in securities suggested by the fund's name by increasing or decreasing the fund's exposure to one or more of the market risk factors associated with the investment focus suggested by the fund's name.

The Adopting Release acknowledged that some funds use derivatives to hedge exposures or obtain exposure to market risk factors associated with the fund's investments (e.g., interest rate risk, credit spread risk). The SEC explained that since such derivatives may have very high notional amounts, if the Names Rule did not allow funds to treat the notional amounts of those derivatives as investments that reflect the fund's investment focus, the notional amounts could cause a fund to fall out of compliance with its 80% investment policy.

The Adopting Release included guidance to help funds determine whether a derivatives instrument provides investment exposure to one or more of the market risk factors associated with investments suggested by the fund's name. In particular, the Adopting Release stated that funds should generally consider whether the derivative provides investment exposure to any explicit input that the fund uses to value its assets in its 80% basket, where a change in that input would change the value of the asset.

As an example, the SEC noted that prepayment is an explicit risk factor in the price of a mortgage security and it would generally be appropriate for a fund whose name indicates a focus on mortgage securities to include derivatives in its 80% basket that manage the prepayment risk of such securities.

UNLISTED REGISTERED CLOSED-END FUNDS AND BUSINESS DEVELOPMENT COMPANIES

Registered closed-end funds and business development companies (BDCs) whose shares are not listed on a national securities exchange (together, unlisted funds) have additional provisions to comply with under the Amendments. The SEC reasoned that unlisted funds should be treated differently because, unlike other funds subject to the Names Rule, shareholders of unlisted funds generally have no easy recourse, such as the ability to redeem or sell shares, if an unlisted fund changes its investment policy and the investment focus that the fund's name indicates.

Consistent with the 2022 Proposal, under the Amendments unlisted funds that are required to adopt 80% investment policies will be prohibited from changing their policies unless a change is approved by a vote

---

that they present insignificant risk of changes in value due to changes in interest rates. Generally, only investments with original maturities of three months or less qualify under the GAAP definition.

of the majority of the outstanding voting securities of a fund. That being said, the Amendments include an exception to this provision that was not part of the 2022 Proposal.

Under the exception, an unlisted fund is permitted to make changes to its 80% investment policy without a shareholder vote if (1) the fund conducts a tender or repurchase offer in advance of the change, (2) the fund provides at least 60 days' prior notice of any change in the policy in advance of that offer, (3) that offer is not oversubscribed, and (4) the fund purchases shares at their net asset value. The SEC highlighted that this exception gives shareholders the opportunity to exit an unlisted fund prior to the fund's change in investment policy.

The SEC also emphasized that this exception provides flexibility for fund managers to balance the risk of oversubscription, and the need to have a special shareholder meeting to vote on an investment policy change, against the amount of liquidity the fund is willing to provide to shareholders via a tender offer or repurchase offer.

NO SAFE HARBOR

The Amendments include a new provision that provides that a fund's name may be materially deceptive or misleading under Section 35(d) of the 1940 Act even if the fund adopts and implements an 80% investment policy and otherwise complies with that policy. The SEC has previously stated that the Names Rule's 80% investment policy requirement is not intended to create a safe harbor from liability under Section 35(d) for materially deceptive or misleading fund names, and the new provision codifies that position.

The Adopting Release included some examples of circumstances in which, in the SEC's view, the name of a fund would be materially deceptive or misleading even if the fund otherwise complied with its 80% investment policy. Such examples include the following:

- A fund makes a substantial investment that is "antithetical" to the fund's investment focus
- A fund invests in a way such that the source of a substantial portion of the fund's risks or returns is materially different from that which an investor reasonably would expect based on the fund's name (e.g., a "green energy and fossil fuel–free" fund making a substantial investment in an issuer with fossil fuel reserves; a "conservative income bond" fund using the 20% basket to invest in highly volatile equity securities that introduce significant volatility to a fund that investors would expect to have lower levels of volatility associated with lower-yielding bonds)
- A fund uses its 20% basket to invest in assets that are materially inconsistent with the investment focus or risk profile reflected by the fund's name
- A fund is perpetually out of compliance with its 80% investment policy on account of temporary departures, even if each temporary departure is permissible under the Names Rule
- An acquiring fund is aware that an underlying fund has changed its investments such that the underlying fund is not following the acquiring fund's investment focus, and the acquiring fund continues to include the value of the investment in the underlying fund in its 80% basket
- A fund is invested 80% or more in an index included in the fund's name and a meaningful nexus does not exist between the components of the underlying index and the investment focus suggested by the index's name

With respect to index funds, the Adopting Release recommended that such funds adopt and implement written policies and procedures reasonably designed to ensure that indexes chosen by a fund do not have materially misleading or deceptive names themselves. The SEC also confirmed in the Adopting Release that the terms in a market index referenced in an index fund's name would not be subject to a separate

80% investment policy test in addition to the fund's policy to invest at least 80% of its assets in the index's components required under the Names Rule.[15]

MODERNIZATION OF NAMES RULE NOTICE REQUIREMENTS

As amended, the Names Rule will continue to require that, unless a fund's 80% investment policy is a fundamental policy, notice must be provided to shareholders of any change in the fund's 80% investment policy. The release includes several enhancements to the shareholder notification requirement. To start, the Amendments clarify the requirement that notice of an 80% investment policy change must be delivered separately from any other documents.

The current requirement to include a prominent statement that a notice includes a change in investment policy must also indicate a change in the fund's name as well, if applicable. Going forward, this statement must be included on an envelope for notices delivered via mail and in the subject line of emails for electronically delivered notices. The Amendments enhance the required content of notices as well. Notices will be required to include a description of the fund's 80% investment policy, the nature of the change to the 80% investment policy, the fund's old and new names, and the effective date of the changes.

FORM N-PORT REPORTING

The Amendments include new reporting requirements on Form N-PORT for registered management investment companies and exchange-traded funds organized as unit investment trusts (UITs). These new requirements do not apply to money market funds or BDCs. As proposed, each fund with an 80% investment policy will be required to report on Form N-PORT whether each investment held by the fund is in the fund's 80% basket. Each fund will also be required to report the value of its 80% basket as a percentage of the fund's total assets.

This information will be required to be reported for the third month of every quarter on Form N-PORT (as opposed to monthly reporting of this information, which the 2022 Proposal would have required). In order to provide context for the quantitative information required by the Amendments, funds will also be required to report on Form N-PORT the definition of terms used in a fund's name, along with any specific criteria the fund uses to select the investments that the term(s) describe.

Notably, in a departure from the 2022 Proposal, funds will not be required to report on Form N-PORT the number of days that the value of their 80% basket fell below 80%.

In the Adopting Release, the SEC stated that the new reporting requirements will increase the effectiveness of the SEC's oversight of funds' compliance with the Names Rule and provide investors meaningful information.[16]

---

[15] Conspicuously, the Adopting Release did not suggest a higher standard than the 80% investment policy for index funds. This is in contrast to the 2001 adoption of the current Names Rule, where the SEC stated that index funds "generally would be expected to invest more than 80% of their assets in investments connoted by the applicable index."

[16] In his statement on the Amendments, Commissioner Mark T. Uyeda suggested that the disclosure in Form N-PORT is not for shareholders' benefit, but rather for the benefit of the SEC's examination and enforcement staff.

RECORDKEEPING

The Amendments introduce several new recordkeeping requirements related to compliance with the Names Rule. As proposed, funds with 80% investment policies will be required to maintain records of whether an investment is included in a fund's 80% basket at the time of the investment, the basis for the determination, and the value of the fund's 80% basket at the time of investment. Funds will also be required to maintain records that document the quarterly reviews of their portfolios, including whether each investment is included in the 80% basket, along with the basis for each determination.

Funds will also be required to maintain records of any noncompliance with an 80% investment policy—both departures due to drift identified during quarterly portfolio reviews and departures due to other-than-normal circumstances. These records will be required to document the date on which the departure was identified and the reasons for departure. Lastly, funds will be required to maintain records of any Names Rule–related notices provided to shareholders.

The SEC stated in the Adopting Release that this information will enable SEC staff to better assess compliance with the Names Rule, as amended, including the identification of deficiencies. The SEC also acknowledged that there will be multiple reasonable approaches to documenting the basis for each investment's inclusion in an 80% basket and as such will not prescribe a format for such recordkeeping.

In a departure from the 2022 Proposal, the Amendments do not include a requirement for every fund that does not adopt an 80% investment policy to document the analysis as to why such a policy is not required. The SEC recognized that this provision would not be necessary given the other new requirements contained in the Amendments.

UNIT INVESTMENT TRUSTS

The Amendments will require UITs to comply with the 80% investment policy and recordkeeping requirements only at the time of initial deposit. The 2022 Proposal would have excepted from the requirements only those UITs that had made their initial deposit prior to the effective date of the 2022 Proposal. The SEC modified its approach to UITs in the Amendments in recognition of the nature of how UITs are constructed and marketed, acknowledging that applying ongoing Names Rule requirements to UITs would present operational and legal challenges.

COMPLIANCE DATES

The SEC voted to adopt the Amendments on September 20, 2023. The effective date of the Amendments will be 60 days after publication in the *Federal Register*. At the time of this publication, the Amendments have not yet been published in the *Federal Register*. The compliance date for the Amendments is 24 months following the effective date for larger entities[17] and 30 months following the effective date for smaller entities.[18] Until the exact dates are known, larger fund managers can consider the fourth quarter of 2025 as their estimated compliance date, with smaller entities needing to be in compliance around the second quarter of 2026.

---

[17] "Larger entities" are defined as funds that, together with other investment companies in the same "group of related investment companies," have net assets of $1 billion or more.

[18] The SEC extended the compliance date from the one-year period proposed in the 2022 Proposal.

To the extent substantial changes to funds' names, 80% investment policies, and/or prospectus disclosures are required, funds may want to consider implementing such changes as part of their annual registration statement update process. This could materially truncate the compliance period for funds with certain fiscal year ends.

CONCLUSION

As summarized above, the Amendments include a number of significant changes to the existing Names Rule that will impact many existing and new funds. Funds will likely face several interpretive questions while implementing the new requirements. The Adopting Release included some helpful guidance on this front.

In addition, during the SEC's open meeting[19] at which the Amendments were adopted, Commissioner Hester Peirce asked several questions[20] regarding the application of the Amendments and SEC staff members in attendance provided responses. A transcript of select questions is attached as an appendix to this report and can be found here.

[19] A webcast recording of the open meeting can be found here.

[20] Hester M. Peirce, Commissioner, US Securities and Exchange Commission, Pizza or Pizza? Statement on Investment Company Names (Sept. 20, 2023).

Morgan Lewis

CONTACTS

If you have any questions or would like more information on the issues discussed in this report, please contact any of the following Morgan Lewis lawyers:

Authors		
Lea Anne Copenhefer	+1.617.951.8515	leanne.copenhefer@morganlewis.com
Laura E. Flores	+1.202.373.6101	laura.flores@morganlewis.com
Jeremy B. Kantrowitz	+1.617.341.8458	jeremy.kantrowitz@morganlewis.com
W. John McGuire	+1.202.373.6799	john.mcguire@morganlewis.com
John J. O'Brien	+1.215.963.4969	john.obrien@morganlewis.com
Daniel D. Conroy	+1.215.963.4602	daniel.conroy@morganlewis.com
Jonathan J. Nowakowski	+1.714.830.0640	jonathan.nowakowski@morganlewis.com
Amy C. McDonald	+1.617.341.7810	amy.mcdonald@morganlewis.com
James L. Severs	+1.202.739.5165	james.severs@morganlewis.com
Boston		
Lea Anne Copenhefer	+1.617.951.8515	leanne.copenhefer@morganlewis.com
Barry N. Hurwitz	+1.617.341.8267	barry.hurwitz@morganlewis.com
Roger P. Joseph	+1.617.341.8247	roger.joseph@morganlewis.com
Jeremy B. Kantrowitz	+1.617.341.8458	jeremy.kantrowitz@morganlewis.com
Amy C. McDonald	+1.617.341.7810	amy.mcdonald@morganlewis.com
Paul B. Raymond	+1.617.341.8567	paul.raymond@morganlewis.com
Toby R. Serkin	+1.617.341.8760	toby.serkin@morganlewis.com
Mari Wilson	+1.617.341.8381	mari.wilson@morganlewis.com
New York		
Elizabeth L. Belanger	+1.212.309.6353	elizabeth.belanger@morganlewis.com
Orange County		
Laurie A. Dee	+1.714.830.0679	laurie.dee@morganlewis.com
Jonathan J. Nowakowski	+1.714.830.0640	jonathan.nowakowski@morganlewis.com
Philadelphia		
David W. Freese	+1.215.963.5862	david.freese@morganlewis.com
Sean Graber	+1.215.963.5598	sean.graber@morganlewis.com
Timothy W. Levin	+1.215.963.5037	timothy.levin@morganlewis.com
Christine M. Lombardo	+1.215.963.5012	christine.lombardo@morganlewis.com
John J. O'Brien	+1.215.963.4969	john.obrien@morganlewis.com
Washington, DC		
Mana Behbin	+1.202.373.6599	mana.behbin@morganlewis.com
Magda El-Guindi Rosenbaum	+1.202.373.6091	magda.elguindi-rosenbaum@morganlewis.com
Laura E. Flores	+1.202.373.6101	laura.flores@morganlewis.com
Thomas S. Harman	+1.202.373.6725	thomas.harman@morganlewis.com
Christopher D. Menconi	+1.202.373.6173	christopher.menconi@morganlewis.com
W. John McGuire	+1.202.373.6799	john.mcguire@morganlewis.com
Beau Yanoshik	+1.202.373.6133	beau.yanoshik@morganlewis.com

Morgan Lewis

ABOUT US

Morgan Lewis is recognized for exceptional client service, legal innovation, and commitment to its communities. Our global depth reaches across North America, Asia, Europe, and the Middle East with the collaboration of more than 2,200 lawyers and specialists who provide elite legal services across industry sectors for multinational corporations to startups around the world. For more information about us, please visit www.morganlewis.com.