Investment Management Update

January 2025

SEC's 2025 Names Rule FAQs: Clarifications and Updates

Key Notes:

- A fund does not require shareholder approval to revise its fundamental 80% investment policy if the revision does not deviate from the fund's existing fundamental policy.
- Rule 35d-1 requires single-state tax-exempt funds to adopt an 80% investment policy.
- The SEC staff has withdrawn certain 2001 Names Rule FAQs.

In January 2025, the Division of Investment Management staff published updated responses to frequently asked questions (FAQs) regarding the Securities and Exchange Commission's (SEC) 2023 amendments to Rule 35d-1 under the Investment Company Act of 1940 (Names Rule). This rule addresses potential investor confusion related to investment company names, especially those that may mislead investors about the company's investment focus and associated risks. The 2023 amendments expand the scope of the original rule, which was first adopted in 2001.

In this update, the SEC clarified certain aspects of the amended Names Rule and withdrew specific portions of the original 2001 FAQs. While the new FAQs provide guidance on various issues, they confirm that prior FAQs consistent with the 2023 changes will remain. However, some have been modified to reflect current practices and interpretations.

These FAQs are designed to offer insight into implementing the Names Rule but do not carry the force of law. They are staff interpretations intended solely to guide funds in complying with the updated rule. As such, they do not impose new legal obligations nor alter existing rules, regulations, or laws.

Key Updates and Guidance from the 2025 FAQs

Adoption of an 80% Investment Policy

The 2023 amendments to Rule 35d-1 build on the original 2001 rule by maintaining the requirement for funds with names suggesting a specific investment focus to adopt an "80% investment policy." Under this policy, at least 80% of the fund's assets must be allocated to the investments or sectors indicated by its name. The SEC staff recently issued the following response regarding the 80% investment policy:

> **Q:** *Does a fund need shareholder approval to revise its fundamental 80% investment policy?*
>
> **A:** No. A fund may modify its fundamental policy without requiring shareholder approval unless the revision deviates from the existing fundamental policy. The fund must also consider state law and its charter or bylaws, which may impose additional approval requirements.

Tax-Exempt Funds

The Names Rule has specific provisions for funds with names suggesting tax-exempt distributions from federal and state income tax. These funds are required to adopt an 80% investment policy based on an asset test (funds suggesting a specific investment focus) or income test (funds with 80% of the income it distributes are exempt), depending on the nature of the fund's tax-exempt focus. The SEC staff issued the following responses regarding tax-exempt funds:

> **Q:** *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?*
>
> **A:** Single-state tax-exempt funds must adopt an 80% investment policy that focuses on securities exempt from both federal and state income tax. However, such funds can invest in securities outside the state, provided they disclose this practice in their prospectus.
>
> **Q:** *Are funds using the term "municipal" in their names treated like tax-exempt funds?*
>
> **A:** Yes. The funds using the term "municipal" in their names are subject to the same requirements as tax-exempt funds, including adherence to the 80% investment policy. However, such funds using the term "municipal" may include securities subject to the alternative minimum tax as part of their 80% investment calculation.

Specific Terms Commonly Used in Fund Names

In the 2023 amendments, the SEC staff provided more detailed guidance on terms used in fund names that suggest the fund focuses on investments having particular characteristics and may require adopting an 80% investment policy. The SEC staff provided the following answers regarding these fund types:

> **Q:** *How does the rule apply to a fund using the term "high-yield" in its name?*
>
> **A:** Funds using "high-yield" in their names must generally adopt an 80% investment policy. However, for funds that use the term "high-yield" in combination with "municipal" or "tax-exempt," the SEC staff recognizes the historical practice of investing in higher-grade bonds and would not object to such a fund investing less than 80% of its assets in high-yield bonds.
>
> **Q:** *Does Rule 35d-1 apply to a fund using the term "tax-sensitive" in its name?*
>
> **A:** No. The term "tax-sensitive" (or similar terms like "tax-efficient" or "tax-managed") describes the overall characteristics of a fund's portfolio rather than specific investment types and does not trigger the 80% investment requirement.
>
> **Q:** *How does the rule apply to a fund using the term "money market" in its name?*
>
> **A:** A fund using the term "money market" in its name must invest at least 80% of its assets in money market instruments consistent with the name. However, a generic "money market" fund is governed by Rule 2a-7, which requires investment solely in eligible securities, exempting it from the 80% rule.

Withdrawn 2001 Names Rule FAQs

Given the 2023 amendments to Rule 35d-1, the SEC staff has determined that several FAQs from the original 2001 release are no longer applicable or superseded by the recent changes. These FAQs, which addressed specific circumstances under the 2001 rule or were inconsistent with the 2023 amendments, have been withdrawn.

The withdrawn FAQs include:

- **FAQ #2:** Regarding whether a fund can disclose a change in its investment policy from 65% to 80% in a post-effective amendment under Rule 485(b).
- **FAQ #5:** Application of the rule to tax-exempt funds, including requirement to display after-tax returns in advertisements with performance quotations or imply the fund is managed to control the effect of taxes on the fund's performance.
- **FAQ #6:** Applicability of Rule 35d-1 to funds using terms like "small-cap," "mid-cap," or "large-cap" in their fund names.
- **FAQ #10:** Applicability of Rule 35d-1 to funds with names combining terms like "global" or "international" with "fixed income."

- **FAQ #11:** Implications of Rule 35d-1 for funds, including terms like “intermediate-term bonds” in their fund names.
- **FAQ #12:** Existing guidance on a bond fund’s use of a name suggesting its portfolio has a specific duration.
- **FAQ #14:** What a fund with at least a 60-day notice policy must include in its notice when changing its 80% investment policy.
- **FAQ #15:** Timing requirements for new registrants to comply with Rule 35d-1 requirements.

Conclusion

The SEC's 2025 Names Rule FAQs provide valuable updates and clarifications for investment companies regarding naming funds and applying the 80% investment policy requirement. These FAQs help to ensure that fund names are not misleading and that investors can make informed decisions based on the actual investment focus of the funds. Funds must carefully consider these guidelines when naming their products and ensuring compliance with the SEC’s rules. As always, the SEC staff may update these FAQs in the future to address additional questions or provide further clarification.

FOR MORE INFORMATION

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