# SEC UPDATES NAMES RULE FAQS

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**US Asset Management and Investment Funds Alert**

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On 8 January 2025, the staff of the Division of Investment Management of the US Securities and Exchange Commission (the SEC) released an updated set of Frequently Asked Questions (the FAQs) related to the amendments to Rule 35d-1 (Names Rule) under the Investment Company Act of 1940, as amended (the 1940 Act) and related form amendments (collectively, the Amendments) adopted in 2023. The FAQs modify, supersede, or withdraw portions of FAQs released in 2001 (the 2001 FAQs) related to the original adoption of the Names Rule. In addition to the FAQs, the SEC staff also released Staff Guidance providing an overview of the questions and answers withdrawn from the 2001 FAQs (Staff Guidance). Together, the FAQs and the Staff Guidance on the withdrawn FAQs are intended to provide guidance to the various implementation issues and interpretative questions left unclear by the adopting release of the Amendments to the Names Rule (2023 Adopting Release). While the FAQs and the Staff Guidance do not address all key issues and questions related to the Names Rule, they do provide new guidance on certain areas and suggest interpretive frameworks that can be more universally applied.

## REVISIONS TO FUNDAMENTAL POLICIES

In the revised FAQs the SEC staff updates certain FAQs, broadening the reach of those FAQs' applicability. For instance, the SEC staff modifies the 2001 FAQ relating to the shareholder approval requirement for a fund seeking to adopt a fundamental 80% Policy to also provide guidance in instances where an 80% investment policy (an 80% Policy) that is fundamental is being revised. The SEC staff provides clarification concerning the process required to revise fundamental investment policies. The FAQ states that a fundamental 80% Policy may be amended to bring such policy into compliance with the requirements of the amended Names Rule without shareholder approval, provided the amended policy does not deviate from the existing policy or other existing fundamental policies. The FAQs restate that individual funds must determine, based on their own individual circumstances, whether shareholder approval is necessary within this framework. Accordingly, funds may take the position that clarifications or other nonmaterial revisions to a fundamental 80% Policy in response to the amended Names Rule would not require shareholder approval. If it is determined that nonmaterial revisions have been made to a fundamental 80% Policy, notice to the fund's shareholders is required.[1] Funds should also continue to provide 60 days' notice (as required by amended Rule 35d-1) for any changes to nonfundamental 80% policies. A similar analysis can be applied in determining whether a post-effective amendment filed pursuant to rule 485(a) under the Securities Act of 1933 is required in connection to the Names Rule implementation process.

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## GUIDANCE ON TAX-EXEMPT FUNDS

The FAQs provide insight into the SEC staff's view of the applicability of the Names Rule to funds whose names suggest their distributions are exempt from both federal and state income tax. According to the FAQs, such funds fall within the scope of the Names Rule and, per Rule 35d-1(a)(3), must adopt a fundamental policy to invest, under normal circumstances, either:

- 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.
- 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.

With respect to the 80% Policy basket of single-state tax-exempt funds (e.g., a Maryland Tax-Exempt Fund), the FAQs reiterate that those funds may include securities of issuers located outside of the named state. For such a security to be included in the fund's 80% Policy basket, the security must pay interest that is exempt from both federal income tax and the tax of the named state, and the fund must disclose in its prospectus the ability to invest in tax-exempt securities of issuers outside the named state.

Additionally, with respect to the terms “municipal” and “municipal bond” in a fund's name, the FAQs reiterate that such terms suggest that the fund's distributions are exempt from income tax and would be required to comply with the requirements of Rule 35d-1(a)(3) described above. It further reconfirms that securities that generate income subject to the alternative minimum tax may be included in the 80% Policy basket of a fund that includes the term “municipal” within its name but not a fund that includes “tax-exempt” within its name.

## SPECIFIC TERMS COMMONLY USED IN FUND NAMES

In addition, the FAQs provide some insight as to the SEC staff's view of the application of the Names Rule with respect to a number of other terms such as:

### High-Yield

The FAQs affirm the SEC staff's view that funds with the term “high-yield” in the name must include an 80% Policy tied to that term. The FAQs note that the term “high-yield” is generally understood to describe corporate bonds with particular characteristics, specifically, that a bond is below certain creditworthiness standards. However, the SEC staff made an exception for funds that use the term “high-yield” in conjunction with the term “municipal,” “tax-exempt,” or similar. Based on historical practice and as the market for below investment grade municipal bonds is smaller and less liquid, the SEC staff asserts that it would not object if such funds invested less than 80% of their assets in bonds with a high yield rating criteria.[2]

### Tax-Sensitive

The SEC staff confirms in the amended FAQs that “tax-sensitive” is a term that references the overall characteristics of the investments composing the fund's portfolio and would not require the adoption of an 80% Policy.

### Income

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The FAQs confirm that the term “income,” is not alluding to investments in “fixed income” securities, but rather when used in a fund's name, it suggests an objective of current income as a portfolio-wide result. The FAQs declare that the term “income” would not, alone, require an 80% investment policy.

While SEC staff's guidance when considering the three terms noted above does not provide an overview of how all terms should be treated because an amount of judgment is required for certain terms, they do confirm the general framework should be used when analyzing the applicability of Rule 35d-1 to other terms. Specifically, and consistent with the 2023 Adopting Release, the examples reiterate that terms describing overall portfolio characteristics are outside the scope of the Names Rule, while the terms describing an instrument with “particular characteristics” are within scope of the Names Rule.

## MONEY MARKET FUNDS

The FAQs also confirm that funds that use the term “money market” in their name along with another term or terms that describe a type of money market instrument must adopt an 80% Policy to invest at least 80% of the value of their assets in the type of money market instrument suggested by its name. The FAQs further explain that a generic money market fund, one where no other describing term is included in its name, would not be required to adopt an 80% Policy. The FAQs also cite relevant information included in frequently asked questions related to the 2014 Money Market Fund Reform.

## WITHDRAWALS FROM 2001 FAQS

In addition to the modification of certain questions within the FAQs, the SEC staff also withdrew a number of key questions from the 2001 FAQs. The SEC staff stated that certain questions were removed for several reasons, including the fact that certain questions were no longer relevant as they addressed circumstances that were specific to the 2001 adoption of the Names Rule, or that they believed the questions were already addressed in the 2023 Adopting Release. Below is a discussion of certain questions that were removed:

- The SEC staff withdrew the outdated 2001 FAQ discussing revising former 65% investment policies to 80% Policies.
- The FAQs also withdrew a question related to notice to shareholders of a change in investment policy as the Amendments and the 2023 Adopting Release both clearly describe the requirements for Rule 35d-1 notices.
- The 2001 FAQs' guidance regarding terms such as “intermediate-term bond” was also withdrawn. This guidance in the 2001 FAQs set forth the SEC staff position that a bond fund with the terms “short-term”, “intermediate-term”, or “long-term” in its name should have a dollar-weighted average maturity of, respectively, no more than three years, more than three years but less than 10 years, or more than 10 years and an 80% investment policy to invest in bonds. The FAQs removal of the definition suggests the potential for expanding the definition of such terms.
- The 2001 FAQs' guidance also removed several FAQs related to specific terms:
    - The question regarding the use of terms such as “international” and “global” was removed as the 2023 Adopting Release states that such terms describe an approach to constructing a portfolio and

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thus not requiring an 80% investment policy. However, the SEC staff would often require funds to adopt certain policies reflecting “international” or “global” investing in practice prior to the 2023 Adopting Release, so whether that reference changes the review staff practice will remain to be seen.

- The question related to the use of “duration” was also removed as the 2023 Adopting Release states that such term references a characteristic of the portfolio as a whole.

Although the FAQs may be helpful, many uncertainties regarding the implementation and application of the Amendments to the Names Rule exist and additional guidance will be necessary to more clearly understand and implement the Amendments. Additionally, this guidance comes on the heels of the Investment Company Institute's letter to the SEC in late December 2024 requesting that the SEC delay implementation of the Names Rule. Given that the development and finalizing of the FAQs requires a significant amount of time and effort, the timing of their release does not suggest that the SEC will or will not act on that request.

Our Asset Management and Investment Funds lawyers will continue to monitor developments regarding the Names Rule and provide updates, as necessary. Please contact us with any questions that you may have.

## FOOTNOTES

[1] The notice requirements to shareholders are described under Rule 35d-1(d), requiring notice to be provided in plain English separately from other documents, with a prominent, bold-face statement such as “Important Notice Regarding Change in Investment Policy [and Name],” and describe the fund's adopted policy, the nature of the change to the policy, the fund's old and new names, and the effective date of any policy or name changes.

[2] For example, under the amended FAQs, a fund with the name “High Yield Municipal Bond Fund” would be required, under the rule, to adopt an 80% investment policy to invest, under normal circumstances, at least 80% of the value of its assets in municipal bonds that provide distributions exempt from federal income tax. However, it would not require an 80% Policy tied to “high-yield” investments because the market for such securities is limited in the municipal markets. Whereas if the fund were named the “High Yield Bond Fund,” it would require an 80% Policy in which the fund invests, under normal circumstances, at least 80% of its assets in securities that are considered “high-yield”.

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