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SEC's Scrutiny of Greenwashing Risks Continues with Modifications to the '40 Act Names Rule

October 4, 2023

Reading Time : **2 min**

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On September 20, 2023, the U.S. Securities and Exchange Commission (SEC) issued a final rule amending the so-called "Names Rule" (found **here**) that is "designed to modernize and enhance" protections under Rule 35d-1 of the Investment Company Act of 1940. The final rule is part of the SEC's holistic efforts to regulate environmental, social and governance (ESG) matters, and is the SEC's latest attempt to curb greenwashing in U.S. capital markets. The amendments require registered investment funds that include ESG factors in their names to place 80% of their assets in investments corresponding to those factors, thereby extending to ESG funds the SEC's long-standing approach of regulating the names of registered funds to ensure they are marketed to investors truthfully. Fund complexes with more than $1 billion in assets will have two years from the final rule's effective date (60 days after publication in the *Federal Register*) to comply, while fund complexes with less than $1 billion in assets will be given a compliance period of 30 months.

Chair Gary Gensler said "[t]he Names Rule reflects a basic idea: A fund's investment portfolio should match a fund's advertised investment focus. In essence, if a fund's name suggests an investment focus, the fund in turn needs to invest shareholders' dollars in a manner consistent with that investment focus. Otherwise, a fund's portfolio might be inconsistent with what fund investors desired when selecting a fund based upon its name." The sole dissenting vote against the rule modification, Commissioner Mark Uyeda, said "[w]ith these amendments, the Commission overemphasizes the importance of a fund's name, as if to suggest that investors and their financial professionals need not look at the prospectus

disclosures." Commissioner Uyeda also expressed concern that fund investors will bear the increased compliance costs associated with the rule change.

The final rule release states that the use of ESG-related terms such as "sustainable" or "green" presents "particular investor protection concerns," as "[f]unds that consider ESG factors in their investment strategies comprise a thematic area that entails unique considerations, and that involves the use of terminology that may be especially powerful in fund names to attract investors."

The SEC originally proposed a rule change that would have made it "materially deceptive" to include ESG factors in the name of an "integration fund" that integrates ESG factors into its investment process, but not in a way that is determinative compared to other factors. However, the SEC omitted this prohibition in the final rule and expressly decided not to adopt the proposed approach "at this time." The removal of the integration fund concept from the Names Rule may presage that the corresponding concept in the still-pending ESG fund/adviser disclosure rule may be pared back similarly (the proposing release can be found **here**). We will monitor those developments accordingly. If you have any questions about the names of ESG funds your firm manages or the SEC's broader ESG-related regulation of investment funds and advisers, please contact us.

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