

Investor Alert

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NEW ESG RELATED SEC RULE: WHAT'S IN A NAME?

On September 20, 2023, the Securities and Exchange Commission (the “SEC”) continued its campaign of protecting investors from ESG (Environmental, Social, and Governance) “greenwashing” tactics—*i.e.*, exaggerating or misleadingly touting an investment fund’s or product’s ESG practices, ESG strategies, or the extent to which the investment fund or product(s) actually takes into account ESG factors¹—by adopting regulations that would modernize the existing “Names Rules” under the Investment Company Act of 1940.

The Importance of a Name

The SEC has recognized that the name of an investment fund is unique and important within the context of protecting investor rights, as a fund’s name “is typically the first piece of information that investors receive about a fund.”² “Fund names offer important signaling for investors in assessing their investment options.”³ Accordingly, the Names Rules, adopted in 2001, were designed to address materially deceptive or misleading fund names, “recognizing the concern that investors may focus on a fund’s name to determine its investments and risks. The names rule, in

turn, responds to this concern by helping to ensure that investors’ assets in funds are invested in accordance with investors’ reasonable expectations based on the fund’s name.”⁴

Under the Names Rules, if an investment fund’s name suggests a focus in a particular type of investment, or in investments in a particular industry or geographic focus, the fund must adopt a policy to invest at least 80% of the value of its assets in the type of investment, or in investments in the industry, country, or geographic region suggested by its name.⁵ For example, if a fund has the word “energy” in its name, it is required to invest at least 80% of its assets in energy-related investments.⁶

The 2023 Amendment

The final rules adopted by the SEC on September 20, 2023 modernize and expand the scope of the Names Rules to now cover investment fund names that include (i) terms with ESG- or sustainability-related characteristics, (ii) the terms “growth” and “value,” or (iii) terms that reference a “thematic” investment focus.⁷ The SEC recognized that the recent rise of

¹ Investment Company Names, Investment Company Act Release No. 33-11238; 34-98438 (Sept. 20, 2023), <https://www.sec.gov/files/rules/final/2023/33-11238.pdf>.

² *Id.* at 7.

³ *Id.* at 7.

⁴ *Id.* at 6.

⁵ *Id.* at 8.

⁶ Cathy Pareto, *Digging Deeper Into Mutual Fund Names*, Investopedia (June 29, 2022), <https://www.investopedia.com/articles/mutualfund/08/mutual-fund-names.asp>.

⁷ Investment Company Act Release No. 33-11238; 34-98438 at 30.

ESG-related investments, or investments in other “themes,” require greater investor protections for such investments.

Indeed, as of December 2022, Morningstar data categorized 334 domestic funds, including mutual funds, ETFs, and registered closed-end funds, as “thematic” funds – comprising 4 “broad themes” (including “social,” and “technology”); 27 “themes” (including “artificial intelligence and big data,” “food,” etc.); and 150 “subthemes” (including “health innovation,” “Generation Z,” etc.).⁸

Most notably, the SEC emphasized that the current great attention to ESG investment strategies entails “unique considerations” to this particular thematic area. Specifically:

Funds 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 use of ESG or similar terminology (such as “sustainable,” “green,” or “socially responsible”) in fund names may present particular investor protection concerns for several reasons. ***Investor interest in—and funds that offer—ESG strategies have rapidly increased in recent years.*** Asset managers have created and marketed

funds that consider ESG factors in their selection process, and these funds can attract significant interest and stand out to investors by using ESG and related terms in their names. Approaches to ESG investing vary, however, and funds that consider ESG factors have strategies that vary in the extent to which ESG factors are considered versus other factors. The 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.⁹

Implications

The SEC’s adoption and implementation of this final rule amending and expanding the Names Rules is yet another recent example demonstrating the SEC’s impetus to protect investors from the potential harms resulting from greenwashing or misleading claims related to a fund’s ESG goals or capabilities. The expansion of the Names Rules further highlights SEC Chairman Gary Gensler’s and the administration’s focus on ESG-related initiatives – and this expansion is indicative that additional ESG-related proposals are likely on the horizon and may be implemented and finalized soon.

⁸ *Id.* at 13.

⁹ *Id.* at 13-14 (internal citations omitted).

Indeed, last year, the SEC proposed new ESG disclosure related rules, requiring listed companies to not only disclose risks that are “reasonably likely to have a material impact on their business, results of operations, or financial condition” in their registration statements and periodic reports (e.g., Form 10-Ks), but also “to disclose information about its direct greenhouse gas (GHG) emissions (Scope 1) and indirect emissions from purchased electricity or other forms of energy (Scope 2),” as well as certain types of GHG emissions “from upstream and downstream activities in its value chain (Scope 3).”¹⁰ As Labaton previously wrote in a March 29, 2022 [Investor Alert](#), investors would be wise to continue to monitor this particular proposed SEC rule, which has not yet been finalized by the SEC as of this writing.¹¹

Notably, and as to the recent expansion of the Names Rules, the SEC has recognized a degree of “vagueness” in the revised Names Rules, insofar as certain terminology (e.g., “growth” or “sustainability”) do not have universally agreed upon meanings.¹² This could lead to disputes concerning compliance with the rule, as investment funds may argue that they meet the requirements set by the Names Rules based on their

view of the fund name’s meaning. The SEC responded to comments concerning this issue by noting the importance of balancing these concerns with the investor protection goals at issue in the new rules.¹³ Thus, future enforcement activity, or additional SEC guidance, will be instructive in understanding how these revised Names Rules will function in the complex environment of ESG-centric funds.

¹⁰ Zach Warren, *Upcoming SEC climate disclosure rules bring urgency to ESG data strategy planning*, Reuters (Jan. 30, 2023), <https://www.reuters.com/legal/legalindustry/upcoming-sec-climate-disclosure-rules-bring-urgency-esg-data-strategy-planning-2023-01-30/>.

¹¹ Eric J. Belfi and James M. Fee, *Investor Alert: SEC Issues Proposed Rule Changes Addressing Climate-Related Information Disclosure to Investors*, Labaton Sucharow (March 29, 2022), [https://www.labaton.com/blog/sec-](https://www.labaton.com/blog/sec-issues-proposed-rule-changes-addressing-climate-related-information-disclosure-to-investors)

[issues-proposed-rule-changes-addressing-climate-related-information-disclosure-to-investors](https://www.labaton.com/blog/sec-issues-proposed-rule-changes-addressing-climate-related-information-disclosure-to-investors).

¹² See Investment Company Act Release No. 33-11238; 34-98438 at 28-29.

¹³ *Id.* at 30.

Labaton Sucharow's lawyers are available to address any questions you may have regarding these developments. Please contact the Labaton Sucharow lawyer with whom you usually work or the contacts below.

Jake Bissell-Linsk:

jbissell-linsk@labaton.com / 212.907.0731

David Saldamando:

dsaldamando@labaton.com / 212.907.0724

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