

**SUPPORTING STATEMENT**  
**Rule 35d-1**

**A. JUSTIFICATION**

**1. Necessity for Information Collection**

Section 35(d) of the Investment Company Act of 1940 (15 U.S.C. 80a-34(d)) (“Investment Company Act”), as amended by the National Securities Markets Improvement Act of 1996, prohibits a registered investment company from using a name that the Securities and Exchange Commission (“Commission”) finds by rule to be materially deceptive or misleading. Before section 35(d) was amended, the Commission was required to declare by order that a particular name was misleading and, if necessary, obtain a federal court order prohibiting further use of the name. In amending section 35(d), Congress reaffirmed its concern that investors may focus on an investment company's name to determine the company's investments and risks, and recognized that investor protection would be improved by giving the Commission rulemaking authority to address potentially misleading investment company names.<sup>1</sup>

The Commission adopted rule 35d-1 to address certain investment company names that are likely to mislead an investor about a company's investment emphasis.<sup>2</sup> The Commission believes that investors should not rely on an investment company's name as the sole source of information about a company's investments and risks.<sup>3</sup> An

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<sup>1</sup> See S. REP. No. 293, 104<sup>th</sup> Cong., 2d Sess. 8-9 (1996).

<sup>2</sup> Investment Company Act Rel. No. 24828 (Jan. 17, 2001) [66 FR 8509 (Feb. 1, 2001)] (Adopting Release). Investment Company Rel. No. 24828A (Mar. 8, 2001) [66 FR 14828 (Mar. 14, 2001)] (Technical Correction).

<sup>3</sup> See generally “Investor Protection: Tips from an SEC Insider,” Remarks by Arthur Levitt, Chairman, SEC, before the Investors’ Town Meeting at the Houstonian Hotel,

investment company's name, like any other single piece of information about an investment, cannot describe the investment company completely.<sup>4</sup> As Congress has recognized, however, the name of an investment company may communicate a great deal to an investor.

The objective of the rule is to address certain broad categories of investment company names that, in the Commission's view, are likely to mislead an investor about a company's investments and risks. The rule requires registered investment companies to invest at least 80% in the type of investments suggested by their names, if their names suggest investments in:

- a particular type of investment (*e.g.*, the ABC Stock Fund, XYZ Bond Fund, or QRS U.S. Government Fund);
  - a particular industry (*e.g.*, the ABC Utilities Fund or XYZ Health Care Fund);
- and
- a particular country or geographic region (*e.g.*, the ABC Japan Fund or XYZ Latin America Fund).

Rule 35d-1 also requires an investment company that uses a name suggesting that its distributions are exempt from federal income tax or from both federal and state income taxes to invest:

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of Washington, D.C. (Apr. 12, 1995) (“An informed investor looks beyond the packaging a fund, and also sees what’s inside.”); “The SEC and the Mutual Fund Industry: An Enlightened Partnership,” Remarks by Arthur Levitt, Chairman, SEC, before the General Membership Meeting of the Investment Company Institute at the Washington Hilton Hotel, Washington, D.C. (May 19, 1995) (“some fund names can leave investors with the wrong impression about [the fund’s] safety.”).

<sup>4</sup> See Herman, “The Confusion is Mutual: Buyers Beware When Funds Drift From Original Intent,” *NEW YORK DAILY NEWS*, Oct. 24, 1999, at 5; Millman, “First Pop The Hood: A Fund’s Name May Tell You Nothing About How It Acts,” *U.S. NEWS & WORLD REP.*, Feb. 3, 1997, at 70.

- at least 80% of its assets in securities the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; or
- its assets so that at least 80% of the income that it distributes will be exempt, as applicable, from federal income tax or both federal and state income tax.

The rule also prohibits investment company names that represent or imply that the investment company or the securities issued by it are guaranteed, sponsored, recommended, or approved by the U.S. government or any U.S. government agency or instrumentality.

The rule generally requires, among other things, that the 80% investment requirement either must be a fundamental policy of an investment company affected by the rule, or the investment company must have adopted a policy to provide notice to shareholders at least 60 days prior to any change in its 80% investment policy in order for its name not to be deemed misleading under the rule. This preparation and delivery of the notice to existing shareholders is a collection of information within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*).

## **2. Purpose of the Information Collection**

The rule's notice policy provision will help to ensure that when shareholders purchase shares in an investment company based, at least in part, on its name, and with the expectation that it will follow the investment policy suggested by that name, they will have a reasonable time to decide whether to redeem their shares in the event that the investment company decides to pursue a different investment policy.

## **3. Role of Improved Information Technology**

The Commission's electronic filing system (Electronic Data Gathering, Analysis and Retrieval or "EDGAR") is designed to automate the filing, processing and

dissemination of full disclosure filings. The system permits public companies to transmit filings to the Commission electronically. This automation has increased the speed, accuracy and availability of information, generating benefits to investors and financial markets. The rule, however, does not require that an investment company file the notice to shareholders described above with the Commission.

#### **4. Efforts to Identify Duplication**

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication and reevaluates these requirements whenever it proposes a rule or a change in a rule. The reporting and recordkeeping requirements provided by rule 35d-1 are not duplicated elsewhere.

#### **5. Effect on Small Entities**

We review all rules periodically, as required by the Regulatory Flexibility Act, to identify methods to minimize recordkeeping or reporting requirements affecting small businesses.

The current reporting requirements for investment companies do not distinguish between small entities and other entities. The burden on smaller investment companies to comply with reporting requirements, however, may be greater than for larger investment companies, which generally have more resources than smaller investment companies. Nevertheless, the Commission believes that imposing different requirements on smaller investment companies would not be consistent with investor protection and the purposes of the reporting requirements provided by rule 35d-1.

Although the Commission considered special requirements for small entities, the Commission concluded that adopting different standards for small entities might create a

risk that investors in small entities would be more likely to be misled by the names of these entities. In addition, we believe that uniform disclosure and reporting standards for all investment companies will allow investors to compare investment companies more easily when making an investment decision. Allowing different standards for small entities may create confusion for investors who wish to make comparisons among larger and smaller investment companies.

**6. Consequences of Less Frequent Collection**

The notice policy provision of rule 35d-1 provides investors with material information about changes in the investment objective of the investment companies in which they invest prior to those changes, thereby allowing the investors to redeem their shares before the investment company changes its investment objective. In the absence of the notice policy, investors may not have access to information useful to making informed decisions, and consumer confidence in the fund industry could be adversely affected.

**7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)**

Not applicable.

**8. Consultation outside the Agency**

Comments on investment company issues are generally received from registrants, trade associations, the legal and accounting professions, and other interested persons. The Commission and the Division of Investment Management staff also participate in an ongoing dialogue with representatives of the fund industry through public conferences, meetings, and informal exchanges. These forums provide us with useful means to identify and address paperwork burdens that may confront the industry. The

Commission requested public comment on the collection of information requirements in Rule 35d-1 before it submitted this request for extension and approval to the Office of Management and Budget. The Commission received no comments in response to its request.

**9. Payment or Gift To Respondents**

Not applicable.

**10. Assurance of Confidentiality**

Not applicable.

**11. Sensitive Questions**

Not applicable.

**12. Estimate of Hour Burden**

The Commission believes that notices provided to shareholders under a notice policy that meets the requirements of rule 35d-1 are typically a short, one-page document that may be enclosed with other written materials sent to shareholders, such as prospectuses, annual and semi-annual reports, and account statements. The number of burden hours spent preparing and arranging delivery of these notices therefore are low. The Commission estimates that the annual burden associated with the notice requirement of the rule to be 20 hours per affected investment company or series. The Commission anticipates that each affected respondent would incur these burden hours only once.

The Commission estimates that there are approximately 7,200 open-end and closed-end management investment companies and series that have descriptive names that are covered by the rule.<sup>5</sup> The Commission estimates that 72, or 1%, of these

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<sup>5</sup> The Commission estimates that there are currently 8,009 open-end management investment companies and series of such investment companies and 659 closed-end investment companies that are registered with the Commission and would fall within the

investment companies and series will at some point provide prior notice to their shareholders of a change in their investment policies pursuant to a policy adopted in accordance with this rule. Of these estimated 72 investment companies and series that are expected to provide prior notice to their shareholders of a change in their investment policies, the Commission estimates that 24, or one-third, did so within the previous year. The Commission estimates that each of these 24 investment companies and series spent an average of 20 hours complying with the notice alternative provided by the rule, for an annual total of 480 hours.

The Commission, using an hourly wage rate of \$310 for in-house legal counsel, estimates that the total annual cost of the hour burden imposed by the notice provision under rule 35d-1 is \$148,800 (480 [annual hour burden] x \$310 [hourly wage rate]).<sup>6</sup>

### **13. Estimate of Total Annual Cost Burden**

We estimate that rule 35d-1 will not impose any burdens other than those discussed in item 12 above.

### **14. Estimate of Cost to the Federal Government**

We expect any burdens to the federal government as a result of the notice policy provision to be minimal and do not expect an increase in staff time or annual operating costs in connection with this collection of information requirements.

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definition of “Fund” contained in rule 35d-1. Of this total, the Commission estimates that 83%, or 7,200, have descriptive names that are covered by the rule.

<sup>6</sup> The wage rate used is based on salary information for securities industry attorneys outside of New York compiled by the Securities Industry Association, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, and employee benefits and overhead. See SECURITIES INDUSTRY ASSOCIATION, REPORT ON MANAGEMENT & PROFESSIONAL EARNINGS IN THE SECURITIES INDUSTRY 2005 (Sept. 2005).

**15. Explanation of Changes In Burden**

Not applicable.

**16. Information Collection Planned for Statistical Purposes**

Not applicable.

**17. Approval to not Display Expiration Date**

Not applicable.

**18. Exceptions to Certification Statement**

Not applicable.

**B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS**

Not applicable.