

MEMO# 21198

May 31, 2007

Institute's Revised Draft Proposal to Amend Rule 19a-1 Under the Investment Company Act; June 12th Conference Call

URGENT/ACTION REQUESTED

[21198]

May 31, 2007

TO: ACCOUNTING/TREASURERS COMMITTEE No. 10-07
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 18-07
SEC RULES COMMITTEE No. 46-07
SMALL FUNDS COMMITTEE No. 18-07
TAX COMMITTEE No. 25-07 RE: INSTITUTE'S REVISED DRAFT PROPOSAL TO AMEND RULE 19A-1 UNDER THE INVESTMENT COMPANY ACT; JUNE 12TH CONFERENCE CALL

Attached is a revised draft of the Institute's proposal to amend Rule 19a-1, [\[1\]](#) which reflects the discussion that occurred on our May 16th conference call. The revised proposal is briefly summarized below.

We will be having a conference call to discuss your views on the revised proposal on Tuesday, June 12th at 2:00 eastern time. The dial-in number for the call is 1-888-577-8991 and the pass code is 27572.

If you can not participate on the call but have comments on the proposal, please contact Dorothy Donohue by phone at (202) 218-3563 or email at ddonohue@ici.org with respect to the disclosure related recommendations, and Keith Lawson by phone at (202) 326-5832 or email at lawson@ici.org or Greg Smith by phone at (202) 326-5851 or email at smith@ici.org with respect to the accounting recommendations. If you plan to participate on the call, please contact Barbara Watkins by e-mail at bwatkins@ici.org.

The revised proposal would amend Rule 19a-1 to permit funds to satisfy their disclosure obligations under Rule 19a-1 by including the relevant information on their own, or an affiliate's, Internet website and quarterly in account statements or any other type of written communication mailed (including by electronic mail) to beneficial shareholders. Under the proposal, closed-end funds would be required to disclose by means of a press release that Section 19(a) Notices will be posted to a specified website while mutual funds would be required to make this disclosure in their prospectuses. All funds would be required to disclose in their semi-annual and annual shareholder reports the Internet availability and location of Section 19(a) Notices. Funds would be required to keep their Section 19(a) Notices on the website for at least twenty-four months from the date of posting.

The revised proposal would require funds to transmit Section 19(a) Notice information to beneficial shareholders in account statements, check stubs, or any other type of written communication mailed no less frequently than quarterly either together with, or separately from, account statements. This flexible approach will permit funds to communicate distribution information to beneficial shareholders in a manner that takes into account how shares are distributed. For example, direct sold funds may prefer to transmit information to beneficial shareholders on or with account statements or distribution checks. Broker-sold funds may choose to communicate with beneficial owners in another type of quarterly communication given the difficulties currently associated with including information on or together with brokerage statements. The recommended approach is intended to be flexible enough to permit funds to work with broker-dealers to develop efficient and effective ways to transmit distribution information to beneficial shareholders.

Under the revised proposal, funds would retain the flexibility to report net investment income on a tax basis in account statements because this information is important for beneficial owners for tax planning and other purposes. If a distribution for a particular period also consists of capital gain or return of capital, funds additionally would be required to transmit to beneficial owners Section 19(a) Notice information either on account statements or other written communications.

The proposal also would clarify Rule 19a-1 to prescribe the particular accounting treatment for the sources of distribution. Under the proposal, a fund's distribution would be treated as arising first from net investment income (a book concept) and calculated under generally accepted accounting principles ("GAAP"). Amounts distributed in excess of net income would be reported as net realized gains (i.e., capital gains) so long as they are supported by earnings and profits (calculated on a tax basis). The remainder of the distribution, if any, would be reported as a non-taxable return of capital calculated as determined for federal income tax purposes. This treatment is consistent with the AICPA's Statement of Position No. 93-2, Determination, Disclosure, and Financial Statement Presentation of Income, Capital Gain, and Return of Capital Distributions by Investment Companies (i.e., the "ROC-SOP"). In addition, any revisions to amounts previously reported would be required to be reported on a cumulative basis in the fund's next regularly scheduled Section 19(a) notice. Finally, the draft proposal recommends providing a de minimis exception from reporting for

small amounts of capital gain or return of capital.

Dorothy M. Donohue
Senior Associate Counsel

[Attachment](#)

endnotes

[\[1\]](#) Section 19(a) requires the payment of any dividend, or a distribution in the nature of a dividend payment, to be accompanied by a written statement, (a “Section 19(a) Notice”) that adequately discloses the source(s) of a payment if it is made from any source other than accumulated undistributed net income. Rule 19a-1(a) requires the Section 19(a) Notice to be on a separate piece of paper, and to clearly indicate what portion of the payment is from: (1) net income; (2) net profits from the sale of securities or other properties; and/or (3) paid-in surplus or any other capital source.

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