The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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SEC PROPOSES AMENDMENTS TO RULES 16B-3 AND 16B-7 UNDER THE SECURITIES EXCHANGE ACT OF 1934; COMMENTS REQUESTED BY AUGUST 9TH

[17750] July 2, 2004 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 25-04 RE: SEC PROPOSES AMENDMENTS TO RULES 16b-3 AND 16b-7 UNDER THE SECURITIES EXCHANGE ACT OF 1934; COMMENTS REQUESTED BY AUGUST 9TH The Securities and Exchange Commission has proposed amendments to Rule 16b-3 and Rule 16b-7 under the Securities Exchange Act of 1934.1 These rules exempt certain transactions from the private right of action to recover short-swing profits that is provided by Section 16(b) of the 1934 Act. According to the Release, the amendments are intended to clarify the scope of these exemptive rules, consistent with statements in previous Commission releases. The proposal is summarized below. Comments on the proposal must be filed with the Commission by August 9, 2004. The Institute is considering whether to file a comment letter on the proposal. Please provide any comments on the proposal that you would like us to include in such a letter by July 14, 2004 to me by phone (202.218-3563), fax (202.326-5827), or email (ddonohue@ici.org). I. Rule 16b-3 Rule 16b-3 exempts from Section 16(b) of the 1934 Act certain transactions between issuers of securities and their officers and directors. The recent opinion of the U.S. Court of Appeals for the Third Circuit in Levy v. Sterling Holding Company, LLC.2 raised doubt as to the nature and scope of transactions exempted by this rule (and Rule 16b-7, as discussed below). In its opinion, the court construed Rule 16b-3(d), which applies to “grants, awards, or other acquisitions” as limited to transactions that have a compensation-related aspect. According to the Release, this construction of Rule 16b-3(d) is not consistent with the Commission’s intent in adopting the rule. To eliminate the uncertainty generated by the Levy v. Sterling opinion, the proposal would, among other things, add a note to Rule 16b-3 stating that the exemptions provided by the rule apply to any securities transaction (i.e., both acquisitions and dispositions) between the 1 See SEC Release Nos. 34-49895, 35-27861, IC-26471 (June 21, 2004) [69 FR 35982 (June 25, 2004)] (the “Release”). A copy of the Release is available on the SEC’s website at http://www.sec.gov/rules/proposed/34-49895.htm. 2 314 F.3d 106 (3d Cir. 2002), cert. denied, Sterling Holding Co. v. Levy, 124 S. Ct. 389 (Oct. 14, 2003). 2 issuer and its officers and directors that satisfies the conditions of the rule and are not conditioned on the transaction being intended for a compensatory or other particular purpose. The Release requests comment on, among other things, whether a compensatory or other specified purpose ordinarily should be necessary to exempt an officer’s or director’s disposition of issuer equity securities to the issuer, so that the proposed note should apply only to

acquisitions, not dispositions, under Rule 16b-3. II. Rule 16b-7 Rule 16b-7 provides that the acquisition of a security pursuant to a merger or consolidation is not subject to Section 16(b) if the security relinquished in exchange is of a company that, before the merger or consolidation owned, either (1) 85% or more of the equity securities of all other companies party to the merger or consolidation or (2) 85% or more of the combined assets of all companies undergoing merger or consolidation. According to the Release, the rule is typically relied on in situations where a company reincorporates in a different state or reorganizes its corporate structure. While the Levy v. Sterling opinion acknowledged that Rule 16b-7 could exempt a reclassification, it construed Rule 16b-7 as not exempting certain reclassifications (i.e., those where the original security and the security for which it is exchanged do not have the same characteristics). The Release states that limiting Rule 16b-7 in such a manner "is inconsistent with the text of Rule 16b-7, the rule's interpretive history and the Commission's intent." To eliminate the uncertainty regarding Rule 16b-7 generated by the Levy v. Sterling opinion, the proposal would amend Rule 16b-7 so that, consistent with the rule's title, the text would state "merger, reclassification or consolidation" each place where it currently states "merger or consolidation." In addition, the proposal would amend Rule 16b-7 by adding a paragraph stating that the exemption specified by Rule 16b-7 applies to any securities transaction that satisfies the conditions of the rule and is not conditioned on the transaction satisfying any other conditions. The Release requests comment on whether any further amendment or regulatory action is necessary to clarify that other transactions that do not involve a merger, but could be effected by a merger, also should be exempted by Rule 16b-7 (e.g., statutory exchange). III. Item 405 of Regulation S-K Item 405 of Regulation S-K requires issuers to disclose their insiders' Section 16 reporting delinquencies and provides that "a form received by the registrant within three calendar days of the required filing date may be presumed to have been filed with the Commission by the required filing date" ("Presumption"). When Item 405 was adopted, Form 4, the form used to report changes in beneficial ownership, had to be filed with the Commission within ten days after the close of the calendar month in which the reported transaction took place and all Section 16 reports were filed on paper. The Sarbanes-Oxley Act of 2002 amended Section 16(a) of the 1934 Act to require an insider to file Form 4 electronically within two business days and to require issuers with corporate websites to post these reports on their websites not later than the end of the business day following filing. The Releases states that, in light of these amendments, the Item 405(b)(1) 3 presumption of timeliness for a Section 16(a) report received by the issuer within three calendar days of the required filing date is no longer appropriate. Accordingly, the proposal would amend Item 405 of Regulation S-K to delete the Presumption, without substituting a different presumption or otherwise modifying the substance of Item 405. The Release requests comment on, among other things, whether issuers will have any difficulty monitoring and reporting if the Presumption is so removed. Dorothy M. Donohue Associate Counsel

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