

MEMO# 5589

February 16, 1994

NASAA COMMITTEE ISSUES REVISED JUNK BOND GUIDELINES FOR PUBLIC COMMENT

February 16, 1994 TO: CLOSED-END FUND COMMITTEE NO. 3-94 SEC RULES COMMITTEE NO. 16-94 STATE LIAISON COMMITTEE NO. 15-94 UNIT INVESTMENT TRUST COMMITTEE NO. 12-94 RE: NASAA COMMITTEE ISSUES REVISED JUNK BOND GUIDELINES FOR PUBLIC COMMENT _____ Last July, the NASAA Investment Companies Committee issued for public comment proposed "Guidelines for Investment Companies Investing in Junk Bonds or Defaulted Bonds" ("Proposed Guidelines") that would have required specific cover page and prospectus disclosure for funds investing in these securities. In many respects, the proposed disclosure would have been inconsistent with that required by the Securities and Exchange Commission. Moreover, the definition of "junk bonds" contained in the Proposed Guidelines was inconsistent with SEC requirements and industry practice. The Institute submitted a comment letter to the NASAA Committee opposing adoption of the Proposed Guidelines because the proposed disclosures were either unnecessary or inappropriate for investment companies that invest in high yield bonds. (See Memoranda to Closed-End Fund Committee Nos. 18-93 and 20-93, SEC Rules Committee Nos. 62-93 and 76-93, State Liaison Committee Nos. 27-93 and 34-93 and Unit Investment Trust Committee Nos. 30-93 and 36-93, dated July 12, 1993 and August 20, 1993.) Based upon the comments received, the NASAA Committee has revised the Proposed Guidelines ("Revised Guidelines") and re-issued such for public comment. Of particular note, is that the definition for "junk bonds" has been amended in the Revised Guidelines to conform with the SEC's definition and industry practice. Also, the Revised Guidelines remove all references to "defaulted bonds" and include provisions relating to investing in "foreign debt securities". The disclosures that would be required under the Revised Guidelines are summarized below. A copy of the Revised Guidelines is attached. It is our understanding that members of NASAA will vote on whether to adopt the revised Guidelines at the NASAA Spring Conference in April. If adopted by NASAA membership, the Revised Guidelines would apply to the initial and continued registration and qualification of investment companies that invest primarily in debt securities and have portfolios that contain or may contain junk bonds or foreign debt securities rated below investment grade.

A. Legend Requirement The Revised Guidelines would require a cover page legend for an investment company that invests primarily in debt securities and that invests, or has the intention of investing within the foreseeable future, 35% or more of its net assets in either "junk bonds" or "foreign debt securities", as defined in the Revised Guidelines. The Revised Guidelines set forth specific criteria for the legend. Sample legends complying with the criteria are included in the Revised Guidelines.

B. Sticker Requirements The Revised Guidelines would require a fund not currently subject to the legend requirement (i.e., one

that invests less than 35% of its net assets in junk bonds or foreign debt securities) to "sticker" its prospectus with the appropriate legend if it subsequently takes "affirmative action" that results in the fund's investing 35% or more in junk bonds or foreign debt securities rated below investment grade. Increases due to market conditions would not be considered "affirmative action". C. Additional Disclosure Requirements The Revised Guidelines would also require investment companies to include "appropriate" disclosures of the risks involved in investing in junk bonds or below investment grade foreign debt securities in their prospectuses. The revised Guidelines specify when this risk disclosure may be included in the prospectus and when it may be set forth in the Statement of Additional Information. Finally, the Revised Guidelines would require inclusion of an asset composition table in the prospectus consistent with that currently required by the SEC. * * *

Comments on the Revised Guidelines should be submitted to each member of the NASAA Investment Companies Committee no later than Monday, March 28, 1994. A list of the NASAA Investment Companies Committee is attached. Also, it is our understanding that the NASAA Committee may hold an open meeting to discuss the Revised Guidelines and other issues relating to state regulation of investment companies on Monday, March 21, 1994 (tentative date) in Phoenix, Arizona. Please contact me if you would like additional details on this meeting or if you are interested in attending this meeting. Please provide me, either by telephone or facsimile, with any comments you would like incorporated in the Institute's comment letter no later than Tuesday, March 8th. My direct telephone number is 202/326-5821 and the fax number is 202/326-5828. Patricia Louie Associate Counsel

Attachments

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