

MEMO# 4235

February 4, 2005

INSTITUTE LETTER ON SEC'S INTERVAL FUND PROPOSALS

November 6, 1992 TO: BOARD OF GOVERNORS NO. 79-92 SEC RULES COMMITTEE NO. 84-92 CLOSED-END FUND COMMITTEE NO. 28-92 CLOSED-END FUND DIVISIONAL COMMITTEE INTERVAL FUNDS AD HOC COMMITTEE RE: INSTITUTE LETTER ON SEC'S INTERVAL FUND PROPOSALS _____

As we previously informed you, the SEC has proposed rules and rule amendments to permit (1) closed-end funds to repurchase their shares at periodic intervals ("Closed-End Interval Funds"), (2) open-end funds to redeem their shares at periodic intervals and take up to 31 days to pay redemption proceeds ("Open-End Interval Funds"), and (3) open-end funds to accept daily redemptions and take up to 31 days to pay redemption proceeds ("Daily Extended Payment Funds"). (See Memorandum to Board of Governors No. 55-92, dated August 9, 1992, and Memorandum to SEC Rules Committee No. 52-92 and Closed-End Fund Committee No. 13-92, dated August 3, 1992.) The Institute submitted the attached comment letter on the SEC's proposals. In its letter, the Institute expressed support for the Closed-End and Open-End Interval Fund proposals, with modifications. However, the Institute urged the SEC not to adopt the Daily Extended Payment Fund proposal at this time because of concerns that these funds could cause investor confusion since they would closely resemble traditional mutual funds -- in that they both would accept daily redemptions -- but would not be required to pay redemption proceeds within 7 days. In contrast, we concluded that since Interval Funds would accept repurchases and redemptions only on a predetermined periodic basis, there was less likelihood of investor confusion with traditional mutual funds. Set forth below is a brief summary of the Institute's comments on the Closed-End and Open-End Interval Funds proposals.

I. Closed-End Interval Funds (Proposed Rule 23c-3) A. Terms of Repurchase Offers 1. Fundamental Policies - The Institute recommended that instead of requiring a Closed-End Interval Fund to adopt a fundamental policy specifying that the fund will make repurchase offers and the terms of such offers, as proposed by the SEC, many of the features of a repurchase program should be left to the discretion of the fund and its directors. 2. Repurchase Amounts - The SEC proposed to limit each Closed-End Interval Fund repurchase offer to no less than 5% and not more than 25% of the fund's outstanding shares. The Institute supported the proposed 5% minimum but recommended that, instead of the proposed 25% maximum, funds be permitted to establish their own maximum (up to and including 100%). 3. Periodic Intervals - The Institute suggested modifying the SEC's proposal, which would permit periodic intervals of 3, 6, 12, 24, and 36 months, to drop the 24 and 36 month alternatives. 4. Notification - The Institute objected to the proposed requirement that funds send shareholders a notice disclosing information about the repurchase offer before each offer. The Institute recommended that the proposal be modified to permit a Closed-End Interval Fund to provide the relevant information in its prospectus, supplemented by a notice either

sent to shareholders or published in a newspaper ad, if the information included in the prospectus is not complete or has been modified. In addition, we recommended that funds be required to send the information about their repurchase offers that is included in their prospectuses separately to shareholders on an annual basis.

5. Payment of Repurchase Proceeds - The Institute recommended that Closed-End Interval Funds be permitted to pay repurchase proceeds to shareholders within 31 days after a repurchase deadline (which is the date by which funds must receive repurchase requests from shareholders). The SEC proposed allowing Open-End Interval Funds to take up to 31 days to pay such proceeds, but would limit Closed-End Interval Funds to 7 days after the repurchase deadline.

B. Issuance of Senior Securities - The SEC proposed limiting the ability of Closed-End Interval Funds to issue senior securities to a standard similar to that for open-end funds under the 1940 Act, except that these funds would be permitted to borrow from other lenders as well as banks. The Institute recommended amending the proposal so that Closed-End Interval Funds would be permitted to issue senior securities pursuant to the standard applicable to traditional closed-end funds, so long as the senior securities are callable by the fund within the time period that the fund chooses to pay repurchase proceeds or will mature within that period.

C. Portfolio Liquidity - The Institute opposed the two-part liquidity requirement proposed by the SEC for Closed-End Interval Funds, which would require that: (1) at all times, a portion of a fund's assets equal to at least 150% of the minimum repurchase amount consist of liquid securities; and (2) at the time a fund sends a notification of a repurchase offer, the fund would have to be invested in liquid securities in an amount equal to 150% of the repurchase offer amount. Instead, we recommended that Closed-End Interval Funds be required to be invested, as of each repurchase deadline, in an amount no less than 85% of the repurchase offer amount in liquid securities, which would be defined as securities that can be sold, in the ordinary course of business, at approximately the value that the fund uses in valuing its investments, within a period of time equal to the period between the repurchase deadline and the repurchase payment date (which, as noted above, we recommended be up to 31 days).

D. Disclosure of Periodic Repurchases - In addition to the proposed disclosure requirements about Closed-End Interval Fund periodic repurchase offers, we recommended that these funds be required to use a descriptive term (such as "periodic repurchase" or "interval") on the cover page of their prospectuses and in their advertisements and sales literature to educate the public that this is a new type of fund, and not a traditional open-end or closed-end fund.

II. Open-End Interval Funds (Proposed Rule 22e-3)

A. Terms of Repurchases

1. Ability to Delay Payment - The Institute generally supported the SEC's proposal to permit open-end funds to delay payment of redemption proceeds beyond the current 7 day requirement. However, as noted above, we believe that the ability of funds to take up to 31 days to pay redemption proceeds should be available only to open-end funds that make redemptions on a periodic basis (i.e., Open-End Interval Funds).

2. Fundamental Policies - The Institute recommended that the provisions of proposed Rule 22e-3 requiring Open-End Interval Funds to adopt fundamental policies specifying their redemption procedures be modified by leaving several features of such procedures to the discretion of the funds and their directors (similar to our recommendation for Closed-End Interval Funds, noted above).

3. Periodic Intervals - The Institute supported the proposed intervals of 1, 2, and 3 months for Open-End Interval Funds.

B. Liquidity - The Institute opposed the proposed liquidity requirement for Open-End Interval Funds, which would require at least 85% of a fund's assets to satisfy at all times either of two standards: the fund must reasonably believe that the asset can be sold in the ordinary course of business, at approximately the price used in computing the fund's net asset value, in a period equal to the fund's period for paying redemption proceeds (which could be up to 31 days); or the asset must mature before the next redemption payment date. The Institute recommended that the proposal be modified so that the liquidity standard applies only as

of each redemption deadline, rather than at all times. C. Disclosure; Use of the Term "Mutual Fund" The Institute recommended that Open-End Interval Funds be required to include a descriptive term on the cover page of their prospectuses and in advertisements and sales literature distinguishing these funds from traditional mutual funds (such as "limited redemption" or "interval"). In addition, we recommended that Open-End Interval Funds be prohibited from holding themselves out as "mutual funds". Amy B.R. Lancellotta Associate Counsel Attachment (in .pdf format)

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