INVESTMENT COMPANY INSTITUTE

MEMO# 5090

August 20, 1993

INSTITUTE COMMENTS ON PROPOSED NASAA GUIDELINES FOR INVESTMENT COMPANIES INVESTING IN JUNK OR DEFAULTED BONDS

August 20, 1993 TO: CLOSED-END FUND COMMITTEE NO. 20-93 SEC RULES COMMITTEE NO. 76-93 STATE LIAISON COMMITTEE NO. 34-93 UNIT INVESTMENT TRUST COMMITTEE NO. 36-93 RE: INSTITUTE COMMENTS ON PROPOSED NASAA GUIDELINES FOR INVESTMENT COMPANIES INVESTING IN JUNK OR DEFAULTED BONDS ____ As we previously advised you, the NASAA Investment Companies Committee ("NASAA Committee") issued for public comment proposed "Guidelines for Investment Companies Investing in Junk or Defaulted Bonds" ("Proposed Guidelines") which would require cover page and prospectus disclosure for investment companies investing in junk or defaulted bonds. (See Memorandum to Closed-End Fund Committee No. 18-93, SEC Rules Committee No. 62-93, State Liaison Committee No. 27-93 and Unit Investment Trust Committee No. 30-93, dated July 12, 1993.) The Institute recently submitted the attached comment letter to the NASAA Committee opposing adoption of the Proposed Guidelines by members of NASAA. The letter states that we do not believe the disclosures set forth in the Proposed Guidelines are necessary or appropriate for investment companies that invest in high yield bonds. These investment companies are already subject to extensive and detailed disclosures required by the Securities and Exchange Commission and the Proposed Guidelines would be either duplicative of or, in some cases, inconsistent with these requirements. Moreover, the letter notes, by overstating the risks associated with investments in high yield bonds, the disclosures that would be required under the Proposed Guidelines would actually be misleading. The letter recommends that the Proposed Guidelines be withdrawn, or at the very least, that the disclosure requirements be revised to make them consistent with the current federal disclosure standards. Specifically, the letter recommends that the definitions for high yield or "junk bonds" contained in the Proposed Guidelines be revised to make them consistent with SEC requirements and industry practice. The letter also recommends that the percentage thresholds and asset composition table be revised so that such are consistent with SEC requirements. With respect to funds investing in defaulted bonds, the letter recommends that it would be inappropriate to require cover page disclosure regarding the market value of these bonds and that this may have a negative impact on the fund's ability to calculate net asset value. The letter notes that a general discussion of portfolio pricing in the body of the prospectus is more appropriate than the proposed cover page legend. The letter also questioned the need for additional prospectus disclosure for defaulted bonds since these securities would be subject to the federal restrictions limiting investments in illiquid securities. The letter also sets forth the reasons why the alternative undertaking (which would require investors to be given thirty days prior notice before an investment company invests over 35% of its portfolio in high yield bonds) is completely unworkable. It is our understanding that in light of the comments received by the NASAA Committee, the Proposed Guidelines may be revised. Accordingly, a vote by NASAA members on adoption of the Proposed Guidelines may be delayed until the NASAA Spring Conference. We will keep you advised of developments. Patricia Louie Associate Counsel Attachment