

MEMO# 4027

August 18, 1992

PROPOSED NEW TYPES OF FUNDS - POLICY ISSUES TO BE CONSIDERED AT SEPTEMBER 1 MEETING

August 18, 1992 TO: BOARD OF GOVERNORS NO. 62-92 SEC RULES COMMITTEE NO. 60-92
CLOSED-END FUND DIVISIONAL COMMITTEE CLOSED-END FUND COMMITTEE NO. 15-92 RE:
PROPOSED NEW TYPES OF FUNDS - POLICY ISSUES TO BE CONSIDERED AT SEPTEMBER 1
MEETING _____

We previously sent you the SEC's proposals which would permit the creation of mutual funds and closed-end funds that could redeem or repurchases shares on a periodic basis. (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.) As set forth in those memoranda, the Institute will be holding a special meeting on September 1 to discuss the proposed rules. The SEC's proposals raise a large number of technical issues which will be discussed at the meeting. In addition, the proposals raise a number of fundamental policy issues which also will be discussed at the meeting. For example: 1. Number of New Types of Funds The SEC has proposed the creation of three new types of funds: a. Closed-end funds which could repurchase no less than 5% or more than 25% of their outstanding shares on a periodic basis (e.g., quarterly, annually). b. Open-end funds which could offer redemptions at periodic intervals ("Interval Funds"). c. Open-end funds which could extend the payment of redemption proceeds for up to 31 days after redemption ("Extended Payment Funds"). The introduction of so many new types of funds at once, after 52 years of a strict open-end/closed-end dichotomy, could cause investor confusion. - 1 - If we believe that investor confusion is likely to result, we need to consider what course of action we should suggest to the SEC. For example, we could recommend one or more of the following suggestions: (1) the SEC only authorize the creation of one new type of fund at this time and consider future action at a later date with respect to the two other types of funds, depending on the success of the first fund; (2) the various periodic alternatives be limited so that, for example, an Interval Fund would be permitted to redeem its shares only quarterly; (3) the Extended Payment Fund not be authorized because it is less needed and is more likely to cause investor confusion since the public has become accustomed to open-end funds promptly paying redemption proceeds; and (4) prominent disclosure be required on the cover page of the prospectus, and in advertisements and sales literature describing the differences between the redemption rights offered by a traditional mutual fund and those of an Interval Fund or an Extended Payment Fund. 2. Closed-End Fund Distribution Concerns Several closed-end fund members who do not have a relationship with a distributor expressed concern that a change to the traditional closed-end fund structure could be harmful to these funds. The concern expressed was that if a closed-end fund that is trading at a discount could make periodic repurchases in an effort to

reduce the discount but does not do so, the fund could become a likely target for a takeover. Thus, all closed- end funds could be pressured to make periodic repurchases, which could be problematic for those funds that do not have distribution channels in place to offer new shares. 3. General Concerns Several people have expressed a general concern about permitting new types of funds. They argue that permitting the creation of new types of funds might make it easier for unscrupulous firms to create funds which give rise to problems, thus giving the entire industry a black eye. For example, could the SEC proposal encourage sponsors to establish funds holding especially risky and/or illiquid securities, which may not be able to meet their repurchase or redemption obligations? * * * * At the September 1 meeting, we will discuss these and other policy issues before focusing on the many technical issues raised by the proposals. We therefore request that attendees come to the meeting prepared to discuss these and other policy issues. Since policy matters may require the input of various individuals in your firms, we suggest that attendees discuss these matters with the appropriate individuals so that each attendee will be able to express his or her firm's positions at the meeting. - 2 - - 3 - We will be preparing an agenda for the meeting and would appreciate receiving your suggestions for both policy and technical issues to be covered. Amy B.R. Lancellotta Associate Counsel

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