The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 3467

January 22, 1992

SEC STAFF ISSUES THIRD GENERIC COMMENT LETTER

January 22, 1992 TO: CLOSED-END FUND MEMBERS NO. 6-92 OPERATIONS MEMBERS NO. 4-92 SEC RULES MEMBERS NO. 3-92 UNIT INVESTMENT TRUST MEMBERS NO. 5-92 ACCOUNTING/TREASURERS MEMBERS NO. 5-92 RE: SEC STAFF ISSUES THIRD GENERIC COMMENT LETTER _____ The Division of Investment Management issued the attached letter to the investment company industry to provide guidance on the filing of registration statements and post-effective amendments in 1992. The letter covers disclosure developments since the last "generic comment letter", dated January 3, 1991. The contents of the letter are summarized below; however, please refer to the letter for more complete discussion of the staff's views. I. Filing Requirements A. Filing Fee Increase The letter reminds registrants that 1933 Act registration fees have been increased to 1/32 of 1% of the maximum aggregate price at which the securities will be offered. B. Rule 24f-2 Requirements The letter reminds registrants that the fee offset from the "netting" of redemptions can only be used if the 24f-2 Notice is received by the Commission within two months (not 60 days) after the close of the registrant's fiscal year. C. Combined Prospectuses The staff states that it is permissible to use combined prospectuses for funds that are registered separately under the 1940 Act. Since the funds are registered separately, each fund must file with the Commission a separate registration statement. The staff requires that registrants using a combined prospectus should include a statement that there is the possibility that one fund may be liable for any misstatements, inaccuracy, or incomplete disclosure in the prospectus concerning the other fund. D. Form N-14 and Rule 488 The staff advises that while registrants filing registration statements on Form N-14 may elect to use Rule 488 under the 1933 Act to designate an automatic effective date (thirty to fifty days after filing), they should make sure that the registration statement is complete and accurate before filing under that Rule. Otherwise, the registrant will be required to file a pre-effective amendment to delay the effective date. Therefore, if the items required by Form N-14 are not available at the time of initial filing or extensive disclosure revisions are anticipated, registrants should file under Rule 473 instead of under Rule 488. E. Omission of Adviser's Balance Sheet Unless the advisory agreement is being voted on for the first time and absent special circumstances, the letter states that an investment adviser's balance sheet may be omitted from proxy statements under Rule 20-2(a)(9) under the 1940 Act if the adviser's gross revenue from all services performed for registered investment companies is less than 20% of the adviser's gross revenues. F. Proxy Comments The staff clarifies that registrants may print and mail proxies without first receiving any comments from the staff if the preliminary proxy statement has been on file with the Commission for ten calendar days. If the staff intends to comment on the preliminary proxy, the registrant will, before the end of tenth day, be provided the

comments or alerted that comments are forthcoming. II. Disclosure Comments A. Index Funds An investment company or series that uses the word "index" in its name should be substantially invested in securities of the underlying index and should have a policy of weighing its portfolio to approximate the relative composition of the securities contained in the underlying index. In addition, disclosure should be made with respect to: (1) the standard used to track the accuracy with the index (e.g., what correlation coefficient is used); (2) how tracking will be monitored; and (3) what steps will be taken if tracking accuracy is not maintained. B. Money Market Fund Disclosure The letter states that the prospectus cover page disclosure required under Item 1(a)(vi) of Form N-1A for funds holding themselves out as money market funds must appear together and in the order designated. The staff clarifies that the statement will be prominent if it appears in some typographically distinctive manner (e.g., boldface, italics, red letters, etc.). C. Third Party Fees Registrants are required to add a footnote to the fee table where customers of banks and other financial institutions must pay fees for services in order to purchase shares of an investment company offered exclusively by that entity, even though such services may not be fund related. Where only one institution is imposing the additional fee (e.g., where the shares are offered through a cash management account), or where the fund is designed to be offered primarily by a fund affiliate which charges an additional fee, the fee should be included as an item in the fee table. D. Exculpatory Language Concerning Telephone Transactions The staff is currently considering the legality of the disclaimer found in some fund prospectuses and application forms that the registrant or transfer agent will not be liable for following instructions for telephone exchanges or redemption transactions that prove to be fraudulent and will not be responsible for verifying the authenticity of instructions. Until this issue is resolved, registrants that provide for such disclaimers must include the following disclosure in their prospectuses: (1) a clear description of the registrant's policy with respect to exculpation from liability in the event of a fraudulent telephone exchange or redemption transaction; (2) a statement that the investor, as a result of this policy, will bear the risk of loss; (3) a statement that the staff of the SEC is currently considering the propriety of such a policy. E. Investment Policies and Rule 144A Funds that have fundamental policies prohibiting them from investing in restricted securities or securities subject to legal or contractual restrictions on resale must change their policies before investing in Rule 144A securities. In addition, the staff reminds funds that in determining the liquidity of Rule 144A securities, the board must consider the trading markets for that specific security. In addition, the staff states that the board is not required to approve and review each Rule 144A security purchased by the fund. Instead, the board is responsible for developing and establishing procedures for determining liquidity and monitoring the adviser's implementation of them. F. Segregated Accounts The staff reiterates its view that when a fund establishes a segregated account, as it is required to do if it is engaging in certain transactions, the account must be maintained with the fund's custodian and contain only liquid assets, such as cash, U.S. Government securities, or other liquid high grade debt obligations. Equity securities cannot be used for these purposes. In addition, the fund is required to disclose in its statement of additional information the kinds of assets that will be placed in the segregated account and the fact that the segregated account will be maintained by a custodian. III. Recent Revisions of Staff Positions A. Section 12(d) and CMOs The letter discusses a recent no-action letter issued by the staff in which it liberalized its position regarding the application of the limitations of Section 12(d)(1) on issuers of collateralized mortgage obligations (CMOs) that have received exemptive orders under Section 6(c) of the 1940. (The Blackstone Income Trust Inc., pub. avail. February 8, 1991). B. Municipal Lease Obligations The generic comment letter discusses a letter sent to the Institute, in which the staff modified its position with respect to the liquidity of municipal lease securities. (See Memorandum to SEC Rules

Members No. 37-91, dated June 27, 1991). C. Liquidity of IOs and POs The staff has liberalized its previous position that interest-only and principal-only fixed mortgage-backed securities ("IOs" and POs") should be deemed illiquid. The staff now takes the position that the determination of whether a particular government-issued IO or PO backed by fixed-rate mortgages is liquid may be made under guidelines and standards established by the board of directors. The staff states that such a security may be deemed liquid if it can be disposed of promptly in the ordinary course of business at a value reasonably close to that used in the calculation of the NAV per share. Amy B.R. Lancellotta Associate General Counsel Attachment

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