

**MEMO# 1329**

August 8, 1989

## **PROPOSED AMENDMENTS TO FORM N-2; OEA STUDY ON CLOSED-END FUNDS**

August 8, 1989 TO: BOARD OF GOVERNORS NO. 46-89 SEC RULES MEMBERS NO. 38-89  
CLOSED-END FUND MEMBERS NO. 36-89 ACCOUNTING/TREASURERS COMMITTEE NO. 29-89  
RE: PROPOSED AMENDMENTS TO FORM N-2; OEA STUDY ON CLOSED-END FUNDS

Attached is the release issued by the SEC proposing (i) revisions to Form N-2, the registration form for closed-end funds under the Investment Company Act of 1940 (the "1940 Act") and the Securities Act of 1933 (the "1933 Act"), (ii) amendments to various procedural rules under the 1933 Act and (iii) staff guidelines for preparation of Form N-2. Also attached is a study by the Office of Economic Analysis of the SEC on The Post- Offering Price Performance of Closed-End Funds (the "OEA Study") and an update of the OEA Study. The release states that the Commission expects to consider proposing for comment amendments to Form N-1A for mutual funds that are similar to two of the changes it is proposing to Form N- 2. These changes concern the proposed requirement that total return data be included in the per share table and that the identity and background information of the portfolio manager be disclosed. Outlined below are the significant changes proposed to be made to Form N-2 and a summary of the OEA Study.

**Proposed Format of Form N-2** The proposed changes would divide the Form N-2 into three parts: Part A would be a simplified prospectus; Part B would be the "Statement of Additional Information", which would include financial information about the fund to be provided promptly upon request; and, Part C would be other information required to be in the registration statement but not delivered to investors.

**- 2 - Proposed Disclosure Requirements in Form N-2** Under the proposal, closed-end funds would be required to include in the Form N-2:

1. Prominent disclosure on the cover page of the prospectus used during a public offering informing shareholders that closed-end fund shares frequently trade at a discount and that there is a greater risk of loss for shareholders who purchase shares in the initial offering. The Commission is seeking comment on whether the disclosure requirements concerning the discount should be different for bond funds and equity funds. In addition, the Commission is requesting comment on whether funds should be permitted to develop this disclosure or, instead, the Commission should prescribe the legend.
2. A fee table detailing expenses paid directly and indirectly by shareholders and the fund, e.g., sales loads and expenses deducted from fund assets, such as management fees. In addition, funds would be required to show in the table payments to preferred shareholders. Unlike the fee table for mutual funds, the proposed fee table for closed-end funds does not instruct the fund to look at expenses during the last fiscal year to determine the annual expenses; instead, closed-end funds are instructed to state the basis on which expenses are deducted or, if none, to estimate the expenses that will be deducted. The proposed fee table would not be required for funds that offer only debt securities.
3. Disclosure of the name and background of the portfolio manager in the prospectus. As

stated above, the Commission expects to consider proposing a similar change to Form N-1A for mutual funds. 4. Disclosure concerning any change of control provisions in the fund's charter or bylaws. 5. Disclosure with respect to share repurchase programs designed to reduce the discount from net asset value and other issues relating to fund tender offers. Per Share Table The proposal includes extensive revisions to the per share table required in the prospectus. The proposed changes include shortening the table and requiring total return quotations for each period. The release states that the Commission expects to consider proposing similar changes to Form N-1A for mutual funds. The per share table required for closed-end funds would continue to be required only in prospectuses that are used in subsequent offerings or in connection with certain business combinations. - 3 - Annual Updating of Form N-2 The Commission is proposing to exempt closed-end funds from the 1940 Act rule requiring investment companies to annually update their registration statements. Comment Period The comment period for the proposed revisions to Form N-2 ends on October 20, 1989. Please provide me with any comments you may have on the proposed revisions by September 22, 1989. OEA Study The OEA Study examined the post-offering price performance of a sample of 64 closed-end funds that came to market between 1985 and 1987. In summary, the results of the Study reveal that after the first 24 weeks following the initial public offerings: bond funds traded at an average discount of 0.012%, and 58.3% of the bond funds traded at a premium; domestic stock funds traded at an average discount of 10.019%, and 11.1% of the domestic stock funds traded at a premium; and, foreign stock funds traded at an average discount of 11.424%, and 14.3% of the foreign stock funds traded at a premium. Commissioner Grundfest noted in a separate statement included in the release that during the period following the OEA Study period, the number of initial public offerings of closed-end funds declined, especially with respect to domestic stock funds. Referring to data in the update of the OEA Study, he observed that from January 1988 through May 1989 there were 77 closed-end funds offered in the U.S. of which 65 (84.4 percent) were bond funds, 7 (9.1 percent) were foreign stock funds, and only 5 (6.5 percent) were domestic equity funds. Amy B. Rosenblum Assistant General Counsel Attachments