

MEMO# 2548

February 22, 1991

SEC ADOPTS AMENDMENTS TO RULES UNDER SECTION 16

February 22, 1991 TO: SEC RULES MEMBERS NO. 12-91 UNIT INVESTMENT TRUST MEMBERS NO. 8-91 INVESTMENT ADVISER MEMBERS NO. 7-91 INVESTMENT ADVISER ASSOCIATE MEMBERS NO. 7-91 RE: SEC ADOPTS AMENDMENTS TO RULES UNDER SECTION 16

The SEC has adopted amendments to the rules under Section 16 of the Securities Exchange Act of 1934, governing reporting and short-swing profit recovery with respect to certain insider transactions. The amendments, which become effective on May 1, 1991, were proposed originally in December 1988 and were repropoed in August 1989. The Institute submitted comment letters in response to both proposals, and the final amendments incorporate most of the Institute's suggestions. A summary of the amended rules pertaining to beneficial ownership status and special rules for trusts and trustees is set forth below. Related excerpts from the adopting release are attached. Determination of Insider Status Under the amended rules, ten percent holders under Section 16 are those persons deemed ten percent holders under Section 13(d) of the 1934 Act and related rules. However, the reporting and short-swing profit provisions of Section 16 apply only to those securities in which a ten percent holder has a "pecuniary interest". In determining ten percent holder status, institutions that are eligible to file ownership reports on Schedule 13G (e.g., a registered investment company or a registered investment adviser) are not deemed beneficial owners of securities held for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business, and without the purpose or effect of changing or influencing control of the issuer. Thus, an investment adviser generally would not have to aggregate shares held by investment companies and private accounts managed by the adviser and count those shares towards ten percent holder status.

Pecuniary Interest Test As noted above, the amended rules provide that the Section 16 reporting and short-swing profit recovery obligations apply only with respect to securities in which an insider has a direct or indirect pecuniary interest. As was proposed, the pecuniary interest test includes a safe harbor with respect to certain performance-related management fees. Specifically, no pecuniary interest is created by a performance-related fee where the fee is based on performance over a period of a year or more (regardless of when it is payable), and no more than ten percent of the portfolio's market value is attributable to the issuer's equity securities. In addition, as suggested by the Institute, the final rules make it clear that asset-based management fees do not create a pecuniary interest on the part of an investment adviser or trustee in the securities managed.

Attribution of Insider Status to Trusts Under the original proposal, a trust would have become subject to Section 16 if a trustee was an insider. However, the rules as adopted attribute insider status to the trust only if an insider trustee has or shares investment control over the trust's portfolio securities and the trustee, or a member of the trustee's

immediate family, has a pecuniary interest in the issuer's securities held by the trust. As a result, as requested by the Institute, an investment company organized as a trust generally would not be subjected to Section 16 merely because a member of the board of trustees was an insider. In addition, the final rules provide that a trustee's insider status does not subject the trust to Section 16 if the trustee is an institution eligible to file reports on Schedule 13G (e.g., a registered investment adviser). Frances M. Stadler Assistant General Counsel Attachment

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