

**MEMO# 15476**

December 20, 2002

## **SEC PROPOSAL RELATING TO SHAREHOLDER REPORTS AND QUARTERLY PORTFOLIO DISCLOSURE; CONFERENCE CALL SCHEDULED FOR JANUARY 13**

[15476] December 20, 2002 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 56-02 SEC RULES COMMITTEE No. 107-02 SMALL FUNDS COMMITTEE No. 21-02 ACCOUNTING/TREASURERS COMMITTEE No. 55-02 RE: SEC PROPOSAL RELATING TO SHAREHOLDER REPORTS AND QUARTERLY PORTFOLIO DISCLOSURE; CONFERENCE CALL SCHEDULED FOR JANUARY 13 The Securities and Exchange Commission has issued a release requesting comments on proposed rule and form amendments relating to shareholder reports and quarterly portfolio disclosure of registered management investment companies.<sup>1</sup> The most significant aspects of the proposal are summarized below. Comments on the proposal must be received by the SEC no later than February 14, 2003. We have scheduled a conference call for Monday, January 13, at 3 pm Eastern to discuss the proposal. If you would like to participate on the call, please contact Monica Carter-Johnson by phone at 202-326-5823 or by e-mail at [mcarter@ici.org](mailto:mcarter@ici.org). Detailed information regarding the conference call will be sent shortly. I. Disclosure of Fund Portfolio Holdings A. Summary Portfolio Schedule The Commission is proposing to permit a fund to include a summary portfolio schedule in its reports to shareholders, in lieu of a complete portfolio schedule. The proposed summary portfolio schedule would include, in order of descending value, each of the fund's fifty largest holdings in unaffiliated issuers and each investment that exceeds one percent of the fund's net asset value.<sup>2</sup> 1 Investment Company Act Release No. 25870 (December 18, 2002) ("Proposing Release"). The Proposing Release can be found on the SEC's website at [www.sec.gov](http://www.sec.gov). 2 The Proposing Release states that for purposes of determining whether the value of a security exceeds one percent of net asset value, a fund would be required to aggregate and treat as a single issue all securities of any one issuer. Each issue, however, would be required to be listed separately in the schedule, whether or not issued by a single issuer. All securities not separately listed in the summary schedule would be required to be listed in a category labeled "Other Securities." 2 With respect to each issue required to be listed, the schedule would show the name of the issuer, the balance held at the close of the period (i.e., the number of shares or the principal amount of bonds and notes) and the value of each item at the close of the period. In addition, the summary schedule would show the percentage value of the issue compared to net assets and compared to the total value of all investments in securities of unaffiliated issuers. The Proposing Release states that because

the proposed summary portfolio schedule would require investments to be listed in order of descending value, the requirement in the complete portfolio schedule that investments be listed separately by type would be inapplicable. The proposal, however, would require each type of instrument to be identified by an appropriate symbol or footnote. A fund that uses a summary portfolio schedule would be required to file its complete portfolio schedule with the Commission semi-annually on proposed Form N-CSR, which would be available on the Commission's EDGAR system. In addition, any fund that uses a summary portfolio schedule would be required to provide the complete portfolio schedule to shareholders upon request within three business days of receipt of the request, by first class mail or other means designed to ensure equally prompt delivery, and to disclose in its shareholder reports that the complete schedule is available (1) without charge, upon request, by calling a specified toll-free (or collect) telephone number, (2) on the fund's website, if applicable, and (3) on the Commission's website.<sup>3</sup> The Commission requests comment on certain aspects of the summary portfolio schedule proposal including, for example: (1) whether index funds should be exempt from including their portfolio holdings in their reports to shareholders, as long as the holdings are filed with the Commission and made available to investors upon request and free of charge, and, if so, how the Commission should determine whether a fund tracks a designated index sufficiently closely to qualify for this exemption; and (2) whether Form N-CSR is the appropriate location for funds to disclose their complete portfolio schedules.

**B. Tabular or Graphic Presentation of Portfolio Holdings** The proposed rule would require reports to shareholders to include a tabular or graphic presentation of a fund's portfolio holdings by identifiable category (e.g., industry sector, geographic region, credit quality or maturity). The presentation would show the percentage of net asset value attributable to each category. Under the proposal, a fund would have the flexibility to determine both the categories to be used and the format of the presentation. The Proposing Release states that the categories should be selected, and the format of the presentation designed, to provide the most useful information to investors about the types of investments made by the fund, given its investment objectives. The Commission specifically requests comment on a number of issues including: whether the proposed presentation should be required or optional; whether there are any particular types of funds (e.g., money market funds, index funds, funds with a small number of holdings, or funds that include a full portfolio schedule in their shareholder reports) that should be exempt from this requirement; and whether the Commission should mandate the format of the presentation and identifiable categories of holdings for any or all types of funds.

**C. Quarterly Filing of Complete Portfolio Schedule** The proposal would require a fund to file its complete portfolio schedule as of the end of its first and third fiscal quarters with the Commission on new proposed Form N-Q within 60 days of the end of the quarter.<sup>4</sup> Form N-Q would require funds to file the same schedules of investments that are currently required in annual and semi-annual reports to shareholders. In addition, these schedules could be unaudited. Form N-Q would be required to be signed by the fund, and on behalf of the fund by its principal financial officer or officers. The Proposing Release notes that the proposal would only require the filing of a fund's portfolio schedule on Form N-Q with the Commission on EDGAR and not actual delivery of that information to shareholders. A fund, however, would be required to disclose in its annual and semi-annual reports to shareholders that: (1) the fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year on Form N-Q; (2) the fund's Forms N-Q are available on the Commission's website and may be

reviewed and copied at the Commission's Public Reference Room; and (3) if the fund makes the information on Form N-Q available to shareholders on its website or upon request, a description of how the information may be obtained from the fund. The Proposing Release states that the Commission is cognizant of concerns by some members of the fund industry that more frequent portfolio disclosure would allow for "frontrunning." It further states, however, that at this time the Commission is not persuaded that these concerns are significant enough to prevent the proposal from being put forth for public comment. In addition, the Release states that the Commission attempted to address these concerns by proposing the 60-day filing delay of the required additional quarterly disclosure.<sup>5</sup> The Commission requests comment on several issues relating to the quarterly filing requirement, including, for example: (1) feasible alternatives that would minimize the reporting burdens on funds; (2) whether a 60-day filing delay would sufficiently address the "frontrunning" issue; (3) whether there is evidence that the disclosure required by Form 13F either facilitates or does not facilitate "frontrunning"; and (4) whether the filing periods for shareholder reports, Form 13F and Form N-Q should be made identical and, if so, what period of time is appropriate.<sup>6</sup>

4 As discussed above, funds would be required to file their complete portfolio schedules for the second and fourth fiscal quarters on proposed Form N-CSR. 5 The Proposing Release also noted that a significant majority of funds already make their full portfolio schedule available at least quarterly and that certain fund managers and other institutional investment managers must disclose information about portfolios they manage on Form 13F. 6 The Proposing Release also requests comment on whether, if the time period for filing Form 13F was extended to 60 days from the end of each quarter, there would continue to be a need for requests for confidential treatment of these filings and whether there are other changes that should be made to Form 13F, such as modifying the current \$100 million filing threshold.

4 II. Disclosure of Fund Expenses The proposal would require mutual funds to disclose in their reports to shareholders fund expenses borne by shareholders during the reporting period. In particular, fund shareholder reports would be required to include (1) the cost in dollars associated with an investment of \$10,000, based on the fund's actual expenses and return for the period; and (2) the cost in dollars associated with an investment of \$10,000, based on the fund's actual expenses for the period and an assumed return of five percent a year. The proposed numerical expense disclosure would be accompanied by a prescribed narrative explanation. The Proposing Release states that as an alternative to the proposed approach, the Commission considered requiring mutual funds to provide each investor with an exact dollar figure for expenses paid in each quarterly account statement that the investor receives. The Release states, however, that the Commission has concerns about the cost and logistical complexity that this requirement might entail. The Commission therefore determined that it would be more appropriate to propose including additional expense information in shareholder reports. The Commission requests comments on several aspects of the disclosure of fund expenses, including: (1) whether this disclosure is useful to investors; and (2) whether there are better vehicles than the annual and semi-annual reports to shareholders in which to include this additional disclosure, specifically, would requiring disclosure of the actual costs paid by an individual investor in his or her account statement be preferable and what benefits would individualized cost disclosure provide investors that the proposal would not.

III. Management's Discussion of Fund Performance ("MDFP") The proposal would require that the MDFP be included in annual reports to shareholders. Currently, the MDFP is required to be included in a fund's prospectus unless the information is included in the fund's latest annual report to shareholders. The Proposing Release states that mutual funds typically include the MDFP in their annual reports and that the Commission believes that requiring the MDFP to be included in the annual report would aid investors in assessing the fund's performance over the prior year.

IV. Compliance Date The Proposing Release states that if

the Commission adopts the proposed amendments, they would expect to require all fund shareholder reports filed for periods ending on or after the effective date of the amendments to comply with the proposed amendments. In addition, funds would be required to file reports on Form N-Q with respect to any fiscal quarter ending on or after the effective date. Ari Burstein Associate Counsel

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