

MEMO# 4572

March 10, 1993

INSTITUTE COMMENT LETTER ON PROPOSALS TO DELETE ANNUAL BOARD REVIEWS AND AMEND RULE 12D3-1

1 */ On January 18, 1993, the Institute submitted proposed revisions to rule 17f-5 to eliminate unnecessary obligations placed on fund boards of directors under the current rule. The Institute's proposal would permit a fund's board of directors to delegate the selection of foreign custodians and management of the arrangements to a U.S. custodian qualified under section 17(f) of the Act or the fund's investment adviser, subject to certain conditions. See Memorandum to Board of Governors No. 5-93, SEC Rules Committee No. 9-93 and International Committee No. 3-93, dated January 22, 1993. March 10, 1993 TO: SEC RULES COMMITTEE NO. 22-93 CLOSED-END FUND COMMITTEE NO. 6-93 UNIT INVESTMENT TRUST COMMITTEE NO. 14-93 INTERNATIONAL COMMITTEE NO. 4-93 RE: INSTITUTE COMMENT LETTER ON PROPOSALS TO DELETE ANNUAL BOARD REVIEWS AND AMEND RULE 12d3-1 _____ As we previously informed you, the SEC has proposed amendments to rules 10f-3, 17a-7, 17f-4 and 22c-1 under the Investment Company Act of 1940 to eliminate requirements that directors annually review certain arrangements. The SEC also proposes to amend rule 12d3-1 under the Act to eliminate requirements that any equity security acquired be a "margin security" as defined by Federal Reserve Board Regulation T and that any debt security acquired be investment grade as determined by the board of directors. (See Memorandum to SEC Rules Committee No. 4-93, Closed-End Fund Committee No. 1-93, Unit Investment Trust Committee No. 1-93, International Committee No. 2-93, dated January 7, 1993) Attached is a copy of the Institute's comment letter on the proposals. As stated in the letter, the Institute agrees that the annual board reviews under the rules at issue are not necessary and should be eliminated. In the case of rule 17f-4, however, the Institute argues that the Commission proposal does not go far enough to eliminate unnecessary obligations because the board would remain obligated to approve each depository arrangement.*/1 The letter states that the responsibility to - 1 - approve a depository arrangement is a matter more appropriately left to a fund's investment adviser or U.S. custodian, and recommends that the Commission eliminate the requirement for board approval. The Institute's letter supports the proposed amendments to eliminate the quality standards set forth in paragraphs (b)(4) and (b)(5) of rule 12d3-1. In 1989, the SEC proposed to amend rule 12d3-1 in a manner that would have facilitated purchases of foreign equity securities, but otherwise would have retained the rule's existing quality standards. In its comment letter on the 1989 proposal, the Institute urged that the quality standards did not further the purposes of the rule and should be eliminated. In addition to supporting the proposed amendments to rule 12d3-1, the Institute's letter urges the Commission to consider

amending the rule to permit an index fund to invest its assets in a manner designed to replicate a nationally recognized index, even if such index includes the common stock of the fund's investment adviser, promoter, principal underwriter or any of their affiliates. Currently, such purchases are prohibited under rule 12d3-1(c). The Institute's letter argues that the potential conflicts of interest that Section 12(d)(3) and rule 12d3-1 were designed to prevent are eliminated by the fact that the fund and its adviser are not exercising any investment discretion as to the percentage of fund assets invested in the securities. * * * * *

We will keep you informed of developments. Angela C. Goelzer Associate Counsel

Attachment

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