

MEMO# 8974

June 9, 1997

INSTITUTE COMMENTS ON SEC'S DISCLOSURE INITIATIVES

* See Memorandum to Primary Contacts - Member Complex No. 14-97 and SEC Rules Members No. 17-97, dated March 3, 1997; Memorandum to Unit Investment Trust Committee No. 16-97, dated March 10, 1997. June 9, 1997 TO: PRIMARY CONTACTS - MEMBER COMPLEX No. 37-97 SEC RULES COMMITTEE No. 59-97 UNIT INVESTMENT TRUST COMMITTEE No. 39-97 DISCLOSURE REFORM WORKING GROUP RE: INSTITUTE COMMENTS ON SEC'S DISCLOSURE INITIATIVES

As we previously reported, the Securities and Exchange Commission has proposed significant changes to the disclosure requirements applicable to mutual funds.* The proposals would (1) substantially revise Form N-1A, (2) allow funds to use a simplified "fund profile," which would provide investors with the option of purchasing fund shares or requesting the long-form prospectus, and (3) increase the "name test" investment requirement from 65% to 80% (which would apply to all investment companies). The Institutes comment letters on these proposals are summarized below and a copy of each is attached. The letters reflect the consensus of members developed at several meetings held to discuss the proposals.

Form N-1A The Institutes letter on the proposed amendments to Form N-1A praises the Commissions efforts to make mutual fund disclosure more comprehensible, informative and useful to investors. It indicates that the proposed amendments will greatly enhance the quality of disclosure all funds provide to investors, and strongly encourages the Commission to move expeditiously to implement the new disclosure standards. In particular, the letter supports the proposal to require a standardized "risk/return summary" at the beginning of each prospectus. The letter also strongly supports the proposed bar chart showing a funds annual total returns for the past ten calendar years. In addition, the letter expresses strong support for the proposals general approach to disclosure of fund investments and risks, which would focus on a funds principal investment strategies and the principal risks of the portfolio as a whole. While very supportive of the proposal overall, the letter proposes numerous technical changes. For example, the letter recommends, among other things: (1) that all references to the availability of additional information about a fund appear on the back cover page; (2) a revised approach to the selection by a multiple class fund of an appropriate class for inclusion in the bar chart; (3) that funds be permitted to provide purchase, redemption and certain other information to investors in a separate "owners manual" document; (4) elimination of a proposed requirement to disclose material legal proceedings "known to be contemplated" by a governmental authority; and (5) deletion of the financial highlights table from the prospectus. The letter suggests that the Commission revise the proposed transition period to provide that existing funds must comply with the amendments within 18 months from their effective date. It notes that

discipline will be required of both the Commission and the industry if the proposals promise of significantly improving mutual fund disclosure is to be realized fully. Fund Profile The Institutes letter strongly supports the Commissions proposal to authorize the use of fund "profiles" and urges the Commission to act expeditiously in adopting a final profile rule. The letter supports the Commissions proposal to permit a profile to contain information about more than one fund and supports the proposed approach regarding disclosure of investment advisers, subadvisers, and portfolio managers. The Institutes letter also is very supportive of the Commissions efforts to permit funds to tailor a fund profile for retirement plan participants and specifically supports permitting funds to omit purchase and redemption information, distribution and taxation information and information regarding fund services from profiles provided only to retirement plan investors. The letter also contains several recommendations designed to further enhance the utility of the profile and encourage its widespread use by funds as a supplement to their prospectuses. For example, the letter recommends that the Commission specifically limit the amount of purchase and redemption information that funds are required to provide in the profile. In addition, the letter recommends that the Commission only require a profile to be filed with the Commission prior to use in two circumstances -- before its first use and when a fund has been added to an existing profile (and not, as proposed, each time a substantive change is made to an existing profile). The letter also suggests that the Commission reiterate the summary nature of the profile as providing a concise presentation of key information about a fund in a standard format. In addition, the letter urges the Commission to clarify the adequacy of the profiles contents by withdrawing the statement in the proposing release that "a fund would not be able to use a profile when material information relating to its particular circumstances is not addressed by the instructions for the 9 items of required disclosure." Finally, the letter urges the Commission to affirmatively state that a fund that complies in good faith with the Commissions instructions in the preparation and distribution of a profile should be able to rely on Section 19(a) of the Securities Act to defend against litigation that alleges that the fund omitted material information from the profile.

Fund Name Rule 3The Institutes letter on the proposed fund name rule, Rule 35d-1 under the Investment Company Act, expresses general support for a requirement that funds with names that suggest they focus on a particular type of investment invest at least 80% of their net assets in the type of investment suggested by their name. The Institutes support, however, is conditioned upon the proposed rule being revised in three significant respects: (1) funds should not be required to adopt the 80% investment requirement as a fundamental policy; (2) the name rule should apply only "under normal conditions;" and (3) the 80% standard should be based only on a funds net assets, unless a fund has adopted a policy to borrow for investment purposes, in which case it should apply to the funds net assets plus any such borrowings. These changes are designed to provide funds subject to the rule appropriate investment management flexibility. In this regard, the letter states that the requirements of the rule should not be so stringent as to discourage funds from using descriptive names. In addition, the letter recommends that single state money market funds be exempt from the proposed rule because of the limited supply of securities eligible for purchase by such funds. The letter also recommends that the Commission require funds with a stated maturity policy to have a commensurate duration policy, once a standardized methodology for calculating duration has been developed.

Craig S. Tyle Vice President & Senior Counsel Attachments (in .pdf format) Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute's Information Resource Center at (202)326-8304, and ask for this memo's attachment number: 8974.

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