The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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CONGRESSIONAL HEARING ON H.R. 1495, THE INVESTMENT COMPANY ACT AMENDMENTS OF 1995

November 8, 1995 TO: BOARD OF GOVERNORS No. 74-95 CLOSED-END FUND COMMITTEE No. 53-95 FEDERAL LEGISLATION MEMBERS No. 24-95 MEMBERS - ONE PER COMPLEX No. 96-95 SEC RULES COMMITTEE No. 117-95 STATE LIAISON COMMITTEE No. 32-95 RE: CONGRESSIONAL HEARING ON H.R. 1495, THE INVESTMENT COMPANY ACT AMENDMENTS OF 1995 _____ On October 31, the House Telecommunications and Finance Subcommittee, chaired by Jack Fields (R-TX), held a hearing on H.R. 1495, the "Investment Company Act Amendments of 1995." Testifying before the Committee were: Panel I: Barry M. Barbash, Director, Division of Investment Management, SEC Panel II: Matthew P. Fink, President, Investment Company Institute Don Powell, President and CEO, Van Kampen American Capital, Inc. James S. Riepe, Managing Director, T. Rowe Price Associates, Inc. Paul G. Haaga, Jr., Senior Vice President and Director, Capital Research and Management Company Marianne K. Smythe, Wilmer, Cutler & Pickering, (former Director of the Division of Investment Management, SEC,) representing Tiger Management Corporation, a hedge fund manager. Both Chairman Jack Fields and Ranking member Edward M. Markey (the bills co- sponsors) indicated support for modernizing the Investment Company Act and emphasized that H.R. 1495 was a "work in progress" and subject to change. Each acknowledged the growth and dynamism of the industry and the need to respond to change without compromising investor protections. Institute Testimony Institute President Matthew P. Fink urged Congress to modernize the Investment Company Act of 1940 to serve the best interests of mutual fund investors and emphasized four areas where modernization of the Act is needed: facilitating communications with investors; promoting cost-effective regulation; enhancing the highly effective system of corporate governance; and permitting innovation in mutual fund products and services. Mr. Fink also described the current dual system of federal-state regulation of the mutual fund industry as harmful to investors. Mr. Fink said the "crazy-quilt" system of state mutual fund regulation hurts investors because it thwarts prospectus simplification, hinders beneficial innovations in products and services permitted by federal law, and diverts state resources away from enforcement and education. Testimony of Don Powell Mr. Powell noted that the Investment Company Act has served investors well, but there are a number of areas where improvements are necessary. Mr. Powell: supported increased flexibility in fund advertising; expressed concern about the proposed additional grant of authority to the SEC regarding fund reports to shareholders, noting that while "mutual fund periodic reporting requirements should also be improved . . . improving the quality of information in these reports, not increasing their volume or frequency, should be the goal -- less can be more"; endorsed the "profile" prospectus, suggesting that its use as

a "stand-alone" offering document should be permitted. Mr. Powell cited the duplicative regulatory review of fund prospectuses by the SEC staff and each of thirty-odd state securities commissions as an obstacle to the success of the profile prospectus, and recommended that Congress "address this issue by lodging exclusive authority over fund prospectuses with the SEC"; and recommended that Congress and the SEC act to ensure that mutual funds are able to offer products and services through electronic and other media, expressing concern "that (in contrast to the SEC) some states might not be as willing to accommodate electronic document delivery." Testimony of James S. Riepe Mr. Riepe focused on several provisions in H.R. 1495 that would "enhance the ability of the mutual fund industry to continue its tradition of offering innovative products to better serve investors." Mr. Riepe: expressed strong support for the concept of a UFIC, a "Unified Fee Investment Company." A UFIC is a new investment company structure under which all fund expenses would be paid out of a single fee, which would be prominently disclosed to investors. Mr. Riepe noted that changes to H.R. 1495 would better enable the provision to achieve its intended results; strongly supported enactment of the "fund of funds" provision in the bill as it would eliminate unnecessarily cumbersome requirements and obviate the need for fund groups to seek individual SEC exemptive orders. Mr. Riepe noted that the provision would essentially codify recent SEC exemptive orders removing certain stringent limitations originally imposed on existing funds of funds; endorsed the "profile prospectus," noting that Price Associates is an active participant in the pilot project that developed a short-form document containing key information about a fund in a standardized format; and also noted the ineffectiveness of the dual federal-state regulatory system for mutual funds. He said "The additional substantive requirements that many individual states have imposed . . . have neither provided nor resulted in any improvement over those mandated by the 1940 Act. . . . It is difficult to believe that if Congress were starting de novo today to regulate the mutual fund industry that it would design the present overlapping, costly and burdensome federal-state structure that provides no additional benefits or protections for investors." Testimony of Paul G. Haaga, Jr. Mr. Haaga focused on those aspects of H.R. 1495 and Investment Company Act modernization generally that relate to: compliance and recordkeeping; corporate governance; federal-state regulation; the UFIC and advertising. He noted that "even with the success of the Investment Company Act of 1940 as a statute, modernizing efforts are not only helpful but necessary as the industry moves into the next decade." Mr. Haaga: cautioned that the provision in H.R. 1495 granting SEC staff "access at any time in routine inspections to any investment company records, including confidential records relating to internal compliance...could inhibit the willingness of supervisory and compliance personnel to communicate candidly and to document their internal perceptions of potential problems." Mr. Haaga continued that "such communication and documentation are critical components of an effective internal compliance system"; with respect to a provision in the bill expanding the SECs authority to require certain reports, urged that "a more precise delineation of the SECs authority to require such reports, perhaps tailored to address the SECs need for special information in periods of market crisis, would serve the SECs needs without potentially adding burdensome reporting and filing requirements that lack corresponding benefits to fund shareholders"; supported those provisions that would "rationalize investment company shareholder voting requirements and facilitate the voting process"; also recommended "that the federal and state regulatory schemes be tailored to make greatest use of the limited resources of the various regulators in a manner that will best promote investor protection"; and supported the elimination of "the present requirement that mutual fund advertisements be limited to information ‘the substance of which is contained in the statutory prospectus. Elimination of this requirement would not reduce investor protection because the advertisements would remain subject to the prospectus liability standards." Testimony of Barry M. Barbash Barry M. Barbash, the

Director of the Division of Investment Management, testified for the SEC. He expressed the Commissions general support for the legislation, and noted the following: the Commission supports amendments that would strengthen the independence of fund boards of directors and update the Acts shareholder voting requirements and related procedures, although the Commission has "concerns about the potential effects of an amendment that would change the vote of fund shareholders required to approve certain actions taken by a fund"; the Commission supports the elimination of the requirement limiting fund advertising to information the "substance of which" is in the funds prospectus because it would further the Commissions efforts to develop shorter, more "investor-friendly" disclosure documents; the Commission supports those provisions in the bill relating to books, records and inspections. The Commission views these provisions as "improving and making the [inspection] program more efficient" by making the recordkeeping requirements of the Investment Company Act similar to those applicable to broker-dealers and depository institutions under the Securities Exchange Act of 1934 and thereby, according to Barbash, would strengthen the Commissions inspections program; the Commission supports the concept of the UFIC; regarding an exemption under the Investment Company Act for investment companies sold only to "qualified purchasers," the Commission continues to believe "that the preferable approach...would be to provide the Commission with rulemaking authority to define the class of investors eligible to participate in the new pools." Nonetheless, the Commission supports the amendment in H.R. 1495 which does not provide such authority; and the Commission supports the "fund of funds" provision. Testimony of Marianne Smythe Mrs. Smythe testified on behalf of Tiger Management and in favor of broadening the amendment in H.R. 1495 that would exempt from registration "private investment companies" that are open exclusively to investors with substantial assets. Mrs. Smythe recommended that H.R. 1495 be modified to: create a safe harbor to ensure fund sponsors that a private investment company formed in reliance on section 3(c)(7) would not be integrated with another company formed by the same sponsor in reliance on the Acts present private investment company exception, section 3(c)(1); add a "grandfather clause" that would allow existing investors to continue their participation in 3(c)(7) funds whenever those funds are created from existing 3(c)(1) funds; and decrease the amount of assets that a person must have invested in order to be considered a qualified purchaser, from $10 million to $5 million. We will keep you informed as this matter develops. For additional information, please contact the Legislative Affairs Department at 202/326-5890. For a copy of the testimony package, please call the Institute’s Information Resource Center at 202/326-5298, and ask for enclosure number: 7396. For those members with access privileges, this memo, without the attached testimony, can be found on ICINET. Please contact Liz Dolan at 202-326-5933. Julie Domenick Senior Vice President Public Affairs

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