The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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INSTITUTE COMMENTS ON SEC CONCEPT RELEASE REGARDING REFORM OF REGULATION OF INVESTMENT COMPANIES

October 9, 1990 TO: SEC RULES MEMBERS NO. 70-90 MEMBERS - ONE PER COMPLEX NO. 44-90 CLOSED-END FUND MEMBERS - ONE PER COMPLEX UNIT INVESTMENT TRUST MEMBERS - ONE PER COMPLEX RE: INSTITUTE COMMENTS ON SEC CONCEPT RELEASE REGARDING REFORM OF REGULATION OF INVESTMENT COMPANIES _____ Two years ago, as part of its 1990s project, the Institute began a study to consider changes needed to modernize the structure and regulation of investment companies. In connection with this effort, an Ad Hoc Committee on the 1990s met approximately 6 times over the past two years to consider various recommendations for regulatory reform. Last spring, the SEC began its own study of investment company regulation. An SEC concept release soliciting public comment on this subject was issued in June. (See Institute memorandum to SEC Rules Members No. 43-90, Members - One Per Complex No. 23-90, Closed-End Fund Members - One Per Complex, and Unit Investment Trust Members -One Per Complex, dated June 18, 1990). Attached is a copy of the comments submitted by the Institute on the SEC's concept release. The recommendations made in the comment letter represent a broad consensus within the industry, since the letter was approved at a meeting of the Ad Hoc Committee attended by members representing approximately 60 percent of industry assets and by the Board of Governors at its meeting on October 4th. The following is a brief discussion of the major recommendations contained in the comment letter. 1. All publicly-offered pools of securities (including bank common and collective funds, asset-backed arrangements and mortgage REITs) should be made subject to the Investment Company Act with the SEC authorized to promulgate appropriate rules and exemptions for particular types of pools, as it has done for variable insurance products. - 2 - 2. Managed investment companies should be permitted to option of organizing either in traditional corporate form or in unitary (contract) form, the predominant structure used in other countries. 3. Unit trusts investing in fixed portfolios of securities should be permitted to be organized either in open-end form (as under present law), or in closed-end form. The use of the closed-end form would permit the public offering of certain asset-backed and other pools, many of which cannot presently be publicly offered since they cannot comply with the Act. 4. The Act should be amended to remove the current rigid open-end/closed-end dichotomy so as to permit funds to redeem on a periodic basis. This would allow the creation of innovative products and could serve to reduce closed-end fund discounts. 5. Funds which are limited to institutional investors should be exempted from various provisions of the Act, including those relating to

governance, capital structure, redeemability and possibly certain of the prohibitions on affiliated party transactions. After experience has been gained in this area, the Commission should report to Congress on the advisability of extending some or all of these changes to other types of funds. 6. Mutual funds should be permitted to make written offers without prospectus liability, just as broker-dealers are permitted to make oral offers without such liability. 7. Mutual fund written advertisements which are subject to prospectus liability should be permitted to include purchase applications, so that an investor could purchase shares directly from an advertisement. 8. The United States should negotiate treaties with other nations providing for cross-border sales of investment company shares, provided there is both adequate investor protection and equal market access. 9. The administrative procedures for obtaining exemptive relief under Section 6(c) should be liberalized. Specifically, SEC response to an exemption application should be required within 90 days, and applicants should be entitled to rely on relief granted a prior applicant unless the SEC takes action to the contrary within 30 days. - 3 - 10. Section 36(b) should be amended to: (1) allow a court to award the prevailing party the costs of maintaining - 4 - or defending the action; (2) require a party to post a bond sufficient to cover those costs; and (3) change the burden of proof to "clear and convincing evidence". 11. Regulation S-X should follow tax accounting in order to eliminate differences between book and tax accounting in financial statement reporting and share valuation. 12. Riskless principal transactions should be treated as agency transactions for purposes of Section 17. 13. Generally, in the case of series funds, regulatory provisions should apply to each separate series, except where it is appropriate to take advantage of economies of scale or otherwise required by state corporate law. 14. The current requirement of $100,000 minimum capital for each investment company should not be changed. If, however, there are concerns that this standard is not adequate, two alternatives could be considered. Either an investment adviser to a registered investment company could be subject to a $1 million net worth requirement or a $1 million seed money requirement could apply to the first investment company of an adviser with a $100,000 requirement imposed on subsequent investment companies. 15. The SEC and the CFTC should work together to lessen the possibility of dual registration of a fund as both an investment company and a commodity pool. * * * * * We will keep you informed of further developments. Catherine L. Heron Deputy General Counsel Attachment