The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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INSTITUTE COMMENT LETTER ON SEC PROPOSAL REGARDING INSIDER TRADES DURING PENSION BLACKOUT PERIODS

[15450] December 13, 2002 TO: PENSION MEMBERS No. 60-02 PENSION OPERATIONS ADVISORY COMMITTEE No. 83-02 CLOSED-END INVESTMENT COMPANY MEMBERS No. 66-02 SEC RULES MEMBERS No. 112-02 RE: INSTITUTE COMMENT LETTER ON SEC PROPOSAL REGARDING INSIDER TRADES DURING PENSION BLACKOUT PERIODS As we previously informed you, the Securities and Exchange Commission recently proposed rules and rule amendments that clarify the scope and application of Section 306(a) of the Sarbanes-Oxley Act of 2002 (the "Act"), which prohibits directors and executive officers of issuers from trading equity securities of the issuer during a blackout period.1 The Institute has prepared a comment letter on the proposal. A copy of the letter is attached and is briefly summarized below. Deferred Compensation Plans for Investment Company Directors The Commission proposed new Regulation Blackout Trading Restriction ("BTR") under the Securities Exchange Act of 1934 to clarify the application of Section 306(a) of the Act. Section 306(a) prohibits any director or executive officer of an issuer of any equity security from purchasing or selling any equity security of the issuer during any blackout period with respect to such equity security, if the director or executive officer acquired the security in connection with his or her employment as a director or executive officer. The Proposing Release explains that there have been allegations that at the time that rank-and-file employees were precluded from selling their employer's equity securities in their individual pension plan accounts, corporate executives were exercising their employee stock options. The Proposing Release requests comment on whether the Commission should exclude investment companies from proposed Regulation BTR and, if so, what the rationale would be for the exclusion. In response to the Commission's request for comment, the Institute's letter recommends that the Commission exclude investment companies from Regulation BTR, as adopted, with respect to deferred compensation plans that limit participation to investment company directors. The letter argues that this is appropriate because there are no employees to protect in the case of deferred compensation plans that limit participation to directors. 1 Memorandum to Pension Members No. 54-02, SEC Rules Members No. 100-02, Closed-End Investment Company Members No. 58-02, dated November 14, 2002. 2 Form 8-K Filing Requirement The Commission has proposed amending Rules 13a-11(b) and 15d-11(b) under the Exchange Act to subject registered management investment companies to Form 8-K filing requirements to notify the Commission of a pension plan blackout period. The Proposing Release explains that the purpose of providing this notice to the Commission is to ensure that an issuer's shareholders have notice of the blackout period so that they can monitor compliance with the statutory trading prohibition. The Proposing Release requests comment on feasible alternatives that minimize the reporting

burdens on registered investment companies. The Institute's letter strongly urges the Commission not to adopt the Form 8-K filing requirement for investment companies. The letter argues that investment companies currently are not required to file Form 8-K, and that it is not necessary or appropriate to make them subject to the Form 8-K reporting regime for the purpose of notifying investment company shareholders of a blackout period. Rather, the letter recommends that the Commission require investment companies with employee pension plans to disseminate information regarding a blackout period through another method of disclosure that is reasonably designed to provide notice of the blackout period to shareholders. Such methods could include a press release or a posting on the company's website. Service or Employment Presumption The scope of Section 306(a)'s proposed trading prohibition, as interpreted by the Commission, is limited to: an acquisition of equity securities during a blackout period if the acquisition is in connection with service or employment as a director or executive officer; and a disposition of equity securities during a blackout period if the disposition involves equity securities acquired in connection with service or employment as a director or executive officer. Proposed Rule 100(a) under the Exchange Act would define the term, "acquired in connection with service or employment" to include, among other things, equity securities acquired by a director at a time when he was a director of any company, including an investment company, under a compensatory plan or arrangement, including, but not limited to deferred compensation plans. Proposed Rule 101(b) under the Exchange Act establishes an "irrebuttable presumption" that any equity securities sold during a blackout period were acquired in connection with employment as a director to the extent that the director holds the securities, without regard to the actual source of the securities sold. The Proposing Release requests comment on whether it is appropriate to presume that any equity securities acquired or disposed of during a blackout period were acquired in connection with employment as a director. In response to the Commission's request for comment, the letter urges the Commission not to adopt the proposed irrebuttable presumption with respect to the disposition of investment company shares by directors or executive officers of an investment company during a blackout period. The letter notes that the Investment Company Act prohibits management investment companies from issuing any of their securities for services. It also notes that the Commission and its staff have granted relief from these restrictions to permit investment companies to establish pension plans subject to certain conditions designed to protect shareholders from dilution of the value of their interests. The letter then asserts that the 3 proposed presumption is unnecessary because of the narrow circumstances under which investment companies may compensate their directors with fund shares and inappropriate because it potentially would discourage investment company directors from purchasing, on their own initiative, the shares of the funds they oversee. It also points out, among other things, that because the redemption price (i.e., disposition price) for any investment company shares would be based on net asset value (in the case of open-end investment companies) and the public offering price (in the case of closed-end investment companies), the value of investment company shares would not be diluted as a result of these redemptions. Therefore, fund shareholders would not be adversely affected by such redemptions. Notice Requirement Under Blackout Trading Restriction In addition to the recommendations discussed above, the letter seeks two points of clarification from the perspective of Institute members as plan recordkeepers and service providers to 401(k) and other types of retirement plans. Our first comment responds to the requirement in proposed Regulation BTR that a notice be provided to executive officers and directors regarding the imposition of a blackout period. Here, the letter seeks clarification consistent with the Institute's recommendations2 regarding the blackout notice requirement under Section 306(b) of the Act, under which all affected pension plan participants and beneficiaries must be notified of a blackout period.3

Specifically, because it is often difficult to identify the precise ending date of a blackout period in the notice — as required by the Proposing Release — the letter urges the Commission to clarify that issuers may satisfy the requirement to include an expected ending date in the notice by providing (1) a single expected ending date, where that date is determinable, (2) a range of dates in which the ending date is expected, where the specific ending date cannot be determined with reasonable accuracy, or (3) a description of the circumstances under which the blackout period is expected to end, in those rare situations where even a range of expected ending dates would be essentially meaningless. In any situation where a single expected ending date is not included in the blackout period notice, the letter recommends that the issuer be required to provide a subsequent notice to affected individuals identifying the ending date once it has been determined. Treatment of Plan Loans under Section 402 of the Sarbanes-Oxley Act The letter also seeks clarification under another provision of the Act — Section 402, which prohibits issuers from directly or indirectly extending, maintaining, arranging or renewing a personal loan for directors and executive officers of the issuer. This provision has given rise to concerns over the permissibility of loans from 401(k) and other retirement plans 2 Memorandum to Pension Members No. 56-02 and Pension Operations Advisory Committee No. 77-02, dated November 22, 2002. 3 Memorandum to Pension Members No. 50-02, dated October 23, 2002. 4 made to executive officers and directors. The letter, therefore, asks the Commission to clarify that loans from retirement plans are not affected by Section 402. Dorothy M. Donohue Associate Counsel Thomas T. Kim Associate Counsel Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 15450, or call the ICI Library at (202) 326-8304 and request the attachment for memo 15450. Attachment (in .pdf format)
