

**MEMO# 15432**

December 6, 2002

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

[15432] December 6, 2002 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 51-02 PENSION COMMITTEE No. 48-02 PENSION OPERATIONS ADVISORY COMMITTEE No. 81-02 SEC RULES COMMITTEE No. 101-02 RE: INSTITUTE DRAFT 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.<sup>1</sup> The Institute has prepared a draft comment letter on the proposal. A copy of the draft letter is attached and is briefly summarized below. Comments on the proposal must be submitted to the SEC by December 16th. Please provide any comments that you have on Sections I-III of the attached draft comment letter to Dorothy Donohue by phone (202/218-3563), fax (202/326-5839), or e-mail (ddonohue@ici.org) and any comments on Sections IV and V of the attached draft letter to Thomas Kim by phone (202/326-5837), fax (202/326-5841), or e-mail (tkim@ici.org). Please provide us with any comments no later than Wednesday, December 11th. Deferred Compensation Plans for Investment Company Directors The Commission proposed new Regulation Blackout Trading Restriction ("BTR") under the Exchange Act 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 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 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 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 draft 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 draft 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. Form 8-K Filing Requirement The Commission proposed amending Rules 13a-11(b) and 15d-11(b) under the Securities 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 draft 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 draft 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 draft 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, despite this prohibition, the Commission has permitted certain investment companies to establish pension plans for their employees after finding that such relief was appropriate in the public interest and consistent with the protection of investors. The draft letter then asserts, among other things, that because of the existing limitations with respect to investment companies issuing shares to directors, officers, and employees in exchange for services, it is not necessary or appropriate for the Commission to presume that any equity securities sold during a blackout period were acquired in connection with employment as a director (without regard to the actual source of the securities sold). Notice Requirement Under Blackout Trading Restriction In addition to the recommendations discussed above, the draft 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 employer-sponsored 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 draft letter seeks clarification consistent with the Institute's recommendations<sup>2</sup> 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.<sup>3</sup> 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 draft 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 draft letter recommends that the issuer be required to provide a subsequent notice to affected individuals identifying the ending date once it has been determined. With regard to this point in the draft letter, please provide any comments on the appropriateness of this approach in the context of notices delivered to insiders pursuant to proposed Regulation BTR. 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 Treatment of Plan Loans under Section 402 of the Sarbanes-Oxley Act The draft 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 pension plans made to executive officers and directors. The draft letter, therefore, asks the Commission to clarify that loans from defined contribution plans are not affected by Section 402. With regard to this point, please provide comments on the types of plans (e.g., ERISA-covered defined contribution plans, plans subject to Section 72(p) of the Internal Revenue Code) that the Commission should clarify are beyond the scope of Section 402. Dorothy M. Donohue Associate Counsel Thomas T. Kim Associate Counsel Attachment (in .pdf format)