The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 11416

November 19, 1999

DRAFT INSTITUTE COMMENT LETTER ON SEC PROPOSALS REGARDING AUDIT COMMITTEE DISCLOSURE

1 The proposed rules also exclude unit investment trusts ("UITs") from the disclosure requirements because they do not have boards of directors and, therefore, do not have audit committees. 1 [11416] November 19, 1999 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 45-99 SEC RULES COMMITTEE No. 98-99 RE: DRAFT INSTITUTE COMMENT LETTER ON SEC PROPOSALS REGARDING AUDIT COMMITTEE DISCLOSURE

_____ As we previously informed you, the Securities and Exchange Commission (“SEC”) has published for comment proposed new rules, and amendments to its current rules, (the “Proposals”) to improve disclosure related to the functioning of corporate audit committees. The Proposals are intended to work in conjunction with the listing standards of the NYSE, AMEX, and NASD that impose requirements on audit committee of listed companies. The proposed disclosures would apply to closed-end funds. The SEC decided to exclude open-end funds from the Proposals since they are not listed on an exchange.1 The proposing release, however, requests comment on whether any or all of the Proposals should apply to open-end funds. In general, the Institute’s draft letter states that while the Institute supports the overall objective of the Proposals -- to promote quality financial reporting and investor confidence in the integrity of the financial reporting process -- we oppose their application to investment companies for several reasons. Investment companies are structured very differently from public operating companies. Accordingly, the potential financial reporting abuses the proposed disclosure requirements are intended to address do not exist in the context of investment companies. In addition, investment companies are subject to extensive regulation under the Investment Company Act of 1940, which protects against many of the abuses the Proposals are designed to address. The draft letter also contains several specific comments on the Proposals. In particular, the Proposals would require that the audit committee provide a report in the company's proxy statement that would disclose, among other things, whether anything came to the attention of the members of the audit committee that caused them to believe that the audited financial statements included in the company's annual report on Form 10-K for the year then ended contain an untrue statement of material fact, or omit to state a material fact necessary to make the statements not misleading. The draft letter points out that investment companies are not required to file Form 10-K. In addition, the draft letter states that the Institute believes that the liability concerns associated with the new disclosures could discourage participation by directors on a fund’s audit committee. The 2 Under the "safe harbors," the additional disclosure would not be considered "soliciting material," "filed" with the Commission, subject to Regulation 14A or 14C or to the liabilities of Section 18 of the Exchange Act,

except to the extent that the company specifically requests that it be treated as soliciting material, or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act. 2 letter notes that the Proposals do include "safe harbors" intended to address these liability concerns.2 We request that members comment on whether, if the SEC subjects closed-end funds to the disclosure requirement, the proposed safe harbors go far enough to address potential liability concerns or whether these safe harbors should be expanded to protect against liability under all of the relevant anti-fraud provisions in the federal securities laws and private actions by shareholders. The Proposals also would require that a company's interim financial statements be reviewed by an independent public accountant prior to the company filing its Form 10-Q with the SEC. The proposing release states that because closed-end funds generally are not required to file a Form 10-Q, these investment companies would not be subject to the proposal requiring the review of quarterly financial statements filed on these forms. The proposing release requests comment, however, on whether a closed-end fund's semi-annual financial statements should be reviewed by independent auditors before being sent to shareholders. The Institute’s draft letter states that it believes that it would be unnecessary, burdensome and costly to require closed-end funds’ semi-annual financial statements to be reviewed by independent auditors before being sent to shareholders. In addition, because closed-end funds typically calculate daily the mark-to-market value of their holdings and distribute a net asset value to the media and others, closed-end fund semi-annual financial reports have much less significance than quarterly earnings releases by operating companies. In addition, the draft letter states that the Institute is not aware of nor have there been any reported cases where the lack of auditor review of a fund’s semi-annual financial statements has compromised investor protection. Comments on this proposal are due to the SEC no later than November 29, 1999. If you have any comments on the draft Institute letter, please provide them to the undersigned by phone at (202) 371-5408, by fax at (202) 326-5841, or by e-mail at aburstein@ici.org no later than November 23. Ari Burstein Assistant Counsel Attachment

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