MEMO# 4968

July 12, 1993

NASAA COMMITTEE ISSUES PROPOSED "GUIDELINES FOR INVESTMENT COMPANIES INVESTING IN JUNK BONDS FOR DEFAULTED BONDS"

July 12, 1993 TO: CLOSED-END FUND COMMITTEE NO. 18-93 SEC RULES COMMITTEE NO. 62-93 STATE LIAISON COMMITTEE NO. 27-93 UNIT INVESTMENT TRUST COMMITTEE NO. 30-93 RE: NASAA COMMITTEE ISSUES PROPOSED "GUIDELINES FOR INVESTMENT COMPANIES INVESTING IN JUNK BONDS FOR DEFAULTED BONDS" ____ The NASAA Investment Companies Committee recently issued for public comment the attached "Guidelines for Investment Companies Investing in Junk Bonds or Defaulted Bonds" ("proposed Guidelines"). If adopted by NASAA membership, the proposed Guidelines would apply to the registration and qualification of investment companies investing in junk or defaulted bonds. The proposed Guidelines define "defaulted bonds" as "debt securities, including convertible debt securities and municipal obligations, in which the payment of principal or interest is in default." "Junk bonds" are defined as "debt securities, including convertible debt securities and municipal obligations, that are rated lower than BBB by Standard & Poor's Corporation or lower than Baa by Moody's Investors Service, Inc. or unrated debt securities of comparable quality. A. Legend Requirement The proposed Guidelines require a cover page legend for investment companies investing 35% or more of its portfolio in junk bonds or 10% or more of its portfolio in defaulted bonds. The legend must comply with the following criteria: (1) the legend must be set off in a separate paragraph and printed in a typographically distinct manner; (2) issuers must state the maximum percentage of assets that will be or may be invested in junk bonds or defaulted bonds; (3) the legend for companies investing in junk bonds must indicate that junk bonds are subject to greater risk of loss of principal and interest than higher rated bonds or are speculative with regard to payment of interest and return of principal; (4) the legend for companies investing in defaulted bonds must indicate that defaulted bonds may never resume interest payments or repay principal and that the market value of defaulted bonds may be difficult to determine, which may have a negative impact on the ability of the investment company to calculate net asset value; (5) investors must be advised to carefully consider the risks associated with an investment in a fund with a large junk bond and/or defaulted bond position; (6) terms such as "high yield," or "without undue risk," or other statements that detract from the cautionary intent of the legend are not permissible in the legend; (7) the legend must include cross-references to the more detailed disclosure in the prospectus. Sample legends complying with the above criteria are included in the proposed Guidelines. B. Alternative Undertaking The proposed Guidelines would permit certain funds to file an undertaking with the states in lieu of including the foregoing legend on the prospectus cover page. Funds with an investment policy permitting investment in junk bonds equal to or exceeding 35% of fund assets but which currently invest less than the maximum permitted, may file an undertaking which states that (1) the fund invests less than 35% in junk bonds, (2) the prospectus will be amended to include the disclosure required by the proposed Guidelines if the investment reaches or exceeds 35%, and (3) investors will be given 30 days notice before the fund invests 35% or more in junk bonds. A similar undertaking may be filed for funds investing less than 10% in defaulted bonds. C. Prospectus Disclosure The proposed Guidelines would also require investment companies investing a "significant" amount in junk or defaulted bonds to include "appropriate disclosure of the risks involvd in such investments" in the prospectus. "Significant" investment has been defined as a 20% or more investment in junk bonds and a 5% or more investment in defaulted bonds. An asset composition table is also required to be included in the prospectus. * * * Comments on the proposed Guidelines should be submitted to each member of the NASAA Investment Companies Committee and the NASAA General Counsel no later than Monday, August 16, 1993. A list of the NASAA Investment Companies Committee is attached. Please provide me, either by telephone or facsimile, with any comments you would like incorporated in the Institute's comment letter no later than Thursday, August 5, 1993. My direct telephone number is (202) 955-3517 and the fax number is (202) 659-1519. Patricia Louie Associate Counsel Attachments