

**MEMO# 5695**

March 18, 1994

# **INSTITUTE COMMENTS ON REVISED NASAA GUIDELINES FOR FUNDS INVESTING IN BELOW INVESTMENT GRADE BONDS**

March 18, 1994 TO: CLOSED-END FUND COMMITTEE NO. 7-94 SEC RULES COMMITTEE NO. 35-94 STATE LIAISON COMMITTEE NO. 24-94 UNIT INVESTMENT TRUST COMMITTEE NO. 22-94 RE: INSTITUTE COMMENTS ON REVISED NASAA GUIDELINES FOR FUNDS INVESTING IN BELOW INVESTMENT GRADE BONDS

We previously advised you that the NASAA Investment Companies Committee re- issued for public comment "Guidelines for Investment Companies Investing in Junk Bonds or Foreign Debt Securities Rated Below Investment Grade" ("Revised Proposal"). The Revised Proposal would require specific cover page and prospectus disclosure for funds investing in these types of securities. (See Memorandum to Closed-End Fund Committee No. 3-94, SEC Rules Committee No. 16-94, State Liaison Committee No. 15-94 and Unit Investment Trust Committee No. 12-94, dated February 16, 1994.) The Institute recently submitted the attached comment letter to the NASAA Committee on the Revised Proposal. As more fully discussed below, the Institute's letter suggested three possible courses of action -- that NASAA not go forward with the Revised Proposal, that the cover page legend requirement be deleted, or that the general approach taken in the Revised Proposal be modified and further amendments made to certain other of the provisions. In its comment letter, the Institute notes that the Revised Proposal has been substantially modified to take into account comments made by the Institute on an earlier version of the proposal (e.g., percentage thresholds for prospectus disclosure, information required in the asset composition table, definition of "junk bonds"). The letter notes, however, that despite these modifications, the Institute continues to question the necessity of the Revised Proposal and urges NASAA to consider whether adoption of such would provide any additional benefits or protection to investors. The Institute's letter goes on to note the abundance of legends already required to be included on the cover page of a fund's prospectus and recommends that the Revised Proposal be amended to delete the proposed cover page legend since an additional legend would detract from the overall readability of a prospectus and may unnecessarily confuse investors. Should NASAA and the NASAA Committee determine, however, that additional information beyond that currently required to be included in a fund prospectus is necessary, the Institute's letter recommends that the Revised Proposal be amended to: 1. apply the legend requirement to an investment company that invests 35% or more of its assets in bonds (foreign or domestic) that have not been rated investment grade (as defined under the Revised Proposal); 2. base the allocation of disclosure between the

prospectus and Statement of Additional Information upon the fund's overall investment in debt securities other than investment grade bonds; 3. shorten the proposed legend so that it is more concise; and 4. require the asset allocation table to be included in the prospectuses of investment companies that invest at least five percent of their average annual assets in high yield bonds. It is our understanding that members of NASAA may vote on whether to adopt the Revised Proposal at the NASAA Spring Conference (April 16-20, 1994). We will keep you advised of developments. Patricia Louie Associate Counsel  
Attachment

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