

MEMO# 4397

January 7, 1993

SEC PROPOSES TO DELETE ANNUAL REVIEWS BY BOARDS OF DIRECTORS AND REPROPOSES AMENDMENTS TO RULE 12D3-1

January 7, 1993 TO: SEC RULES COMMITTEE NO. 4-93 CLOSED-END FUND COMMITTEE NO. 1-93 UNIT INVESTMENT TRUST COMMITTEE NO. 1-93 INTERNATIONAL COMMITTEE NO. 2-93
RE: SEC PROPOSES TO DELETE ANNUAL REVIEWS BY BOARDS OF DIRECTORS AND
REPROPOSES AMENDMENTS TO RULE 12d3-1

The Securities and Exchange Commission has proposed amendments to rules 10f-3, 17a-7, 17e-1, 17f-4 and 22c-1 under the Investment Company Act of 1940 to eliminate requirements that directors annually review certain arrangements. In a related release, the SEC proposes amendments to Rule 12d3-1 under the Act to eliminate requirements that any equity security acquired pursuant to the rule be a "margin security" as defined by Federal Reserve Board Regulation T, and that any debt security acquired be investment grade as determined by the board of directors. The rule proposals relating to responsibilities of fund boards of directors implement staff recommendations set forth in Protecting Investors: A Half Century of Investment Company Regulation . Attached are copies of the Commission releases proposing these amendments. The proposals are summarized below. I. Deletion of Annual Review Requirements a. Rules 10f-3, 17a-7 and 17e-1 Rules 10f-3, 17a-7 and 17e-1 allow affiliated transactions that would otherwise be prohibited under the Act to proceed if certain specified conditions are met. Under each rule, the full board and a majority of independent directors must a) initially adopt procedures designed to ensure that all conditions of the rule have been met, b) determine at least quarterly that all transactions pursuant to the rule have complied with the procedures, and c) review the procedures at least annually for "continuing appropriateness." The Commission proposes to replace annual review with a requirement that the board make and approve any changes to the procedures that the board deems necessary. - 1 - b. Rule 17f-4 Rule 17f-4 permits the deposit of fund assets in a securities depository that complies with Commission requirements. Rule 17f-4 requires that the arrangement must be initially approved and annually reviewed by the board of directors. The Commission proposes to amend Rule 17f-4 to eliminate the annual review requirement. Directors would be required to approve depository arrangements initially, and any subsequent changes proposed by the adviser. c. Rule 22c-1 Rule 22c-1 generally requires that current net asset value be computed at least once daily. The rule requires that, at least annually, the board of directors must determine the time(s) each day that the fund will calculate current net asset value. The proposed amendments would delete this requirement, and require instead that the board initially set the pricing time(s) and

thereafter make and approve any changes that it deems necessary. In connection with this proposal, the Commission proposes to make conforming amendments to the Guidelines for Forms N-1A and N-3. II. Rule 12d3-1 Rule 12d3-1 exempts certain acquisitions of securities issued by entities in a securities-related business, subject to a number of quantitative and qualitative conditions set forth in paragraph (b). The qualitative conditions in paragraph (b)(4) and (b)(5) require that any equity security acquired be a "margin security" as defined in Federal Reserve Board Regulation T, and that any debt security acquired be "investment grade" as determined by the board of directors. In 1989, the Commission proposed amendments to rule 12d3-1 to facilitate the acquisition of equity securities of foreign securities-related businesses by registered funds. The proposed amendments would have set forth alternative conditions for the equity securities issued by foreign securities-related businesses that could not meet the "margin security" requirements of paragraph (b)(4). In its comment letter on the 1989 proposal, the Institute urged the Commission to eliminate the quality standards entirely because the standards are not necessary to achieve the policies underlying the rule. In its recent proposal, the Commission agrees that the quality standards set forth in paragraphs (b)(4) and (b)(5) are unnecessary and should be eliminated. The Commission states that the concerns that underlie the restrictions on the acquisitions of securities issued by securities-related businesses under Section 12(d)(3) are adequately addressed by a) the quantitative conditions set forth in paragraph (b)(1)-(b)(3), and b) the - 2 - prohibition on acquiring a general partnership interest in a - 3 - securities-related business, or any security issued by an investment adviser, promoter or principal underwriter of the acquiring company or any affiliated person thereof. The Commission specifically requests comment on whether the quantitative conditions are necessary or whether the concerns about reciprocal practices could be addressed by other conditions. Comment Period Comments are due to the SEC on each release 60 days from the date of publication in the Federal Register. Please contact the undersigned by February 1 with any comments that you may have on these proposals. I can be reached at (202) 955-8419 or by fax at (202) 659-1519. Angela C. Goelzer Associate Counsel Attachments