

**MEMO# 17258**

March 19, 2004

## **SEC PROPOSES DISCLOSURE RULES RELATING TO PORTFOLIO MANAGERS OF REGISTERED MANAGEMENT INVESTMENT COMPANIES; CONFERENCE CALL SCHEDULED FOR APRIL 7TH**

[17258] March 19, 2004 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 13-04 SEC RULES COMMITTEE No. 27-04 SMALL FUNDS COMMITTEE No. 20-04 RE: SEC PROPOSES DISCLOSURE RULES RELATING TO PORTFOLIO MANAGERS OF REGISTERED MANAGEMENT INVESTMENT COMPANIES; CONFERENCE CALL SCHEDULED FOR APRIL 7TH The Securities and Exchange Commission has proposed amendments to its forms under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 to require registered management investment companies to provide enhanced disclosure regarding their portfolio managers.<sup>1</sup> As summarized below, the Commission's proposal would: Require a fund to identify in its prospectus each member of a committee, team, or other group of persons who is jointly and primarily responsible for the day-to-day management of the fund's portfolio; 1 See Proposed Rule: Disclosure Regarding Portfolio Managers of Registered Management Investment Companies, SEC Release Nos. 33-8396; 34-49398; IC-26383 (March 11, 2004); 69 Fed. Reg. 12752 (March 17, 2004) (the "Proposing Release"). The Proposing Release is available from the Commission's website at <http://www.sec.gov/rules/proposed/33-8396.htm>. The Commission's proposal would amend Form N-1A, Form N-2, and Form N-3 (the registration forms used by open-end funds, closed-end funds, and insurance company managed separate accounts that issue variable annuity contracts, respectively, to register their securities), and Form N-CSR, the form used by registered management investment companies to file certified shareholder reports with the Commission. Comments on the proposal must be filed with the Commission by May 21st.. The Institute will hold a conference call on Wednesday, April 7th at 2:00 p.m. Eastern Time to discuss the proposal. The dial-in number for the call is (800) 779-9469 and the passcode is 54984. If you plan to participate on the call, please send an e-mail to Stephanie Holly at [sholly@ici.org](mailto:sholly@ici.org). If you are unable to participate on the call, but would like to provide comments, please do so by contacting Barry Simmons before the call by phone at (202) 326-5923, fax at (202) 326-5827, or e-mail at [bsimmons@ici.org](mailto:bsimmons@ici.org). 2 Require a fund to provide information in its statement of additional information ("SAI") regarding other accounts managed by any of its portfolio managers, including a description of conflicts of interest that may arise in connection with simultaneously managing the fund and the other accounts, as well as policies and procedures to address conflicts; Require a fund to disclose in its SAI the structure of, and the method used to determine, the compensation of each

portfolio manager; Require a fund to disclose in its SAI each portfolio manager's ownership of securities in the fund and other accounts, including investment companies, managed by the portfolio manager, the fund's investment adviser, or any person controlling, controlled by, or under common control with the fund's investment adviser or principal underwriter; and Require a closed-end fund to provide disclosure regarding its portfolio managers in its reports on Form N-CSR.<sup>2</sup>

**A. IDENTIFICATION OF PORTFOLIO MANAGEMENT TEAM MEMBERS**  
The Commission's proposal would amend Forms N-1A and N-2 to require open-end funds and closed-end funds, respectively, to identify in their prospectuses each member of a committee, team, or other group of persons associated with the fund's investment adviser who is jointly and primarily responsible for the day-to-day management of the fund's portfolio.<sup>3</sup> The required disclosure would include the team member's name, title, length of service, and business experience, as well as a brief description of the member's role on the management team (e.g., lead member). The Proposing Release solicits comments on whether the proposed amendments should: Require identification and disclosure with respect to all of the members of the portfolio management team (under a "jointly and primarily responsible" standard), or only certain team members (e.g., the lead member); Require disclosure of additional information, such as the team's structure and decision-making process; and/or Require the proposed disclosure in a document other than the prospectus, such as the SAI, shareholder reports, or Form N-CSR.<sup>2</sup>

**2 The Proposing Release explains that this is in recognition of the fact that closed-end funds are generally not required to maintain an updated SAI to meet their Securities Act obligations since they do not offer their shares continuously. 3 The Proposing Release adds that the Commission's proposal would also amend Form N-3 in a manner that is "similar to the disclosure that would be required by Forms N-1A and N-2." Proposing Release at 12754.**

**3 B. DISCLOSURE OF OTHER ACCOUNTS MANAGED, POTENTIAL CONFLICTS OF INTEREST, AND POLICIES AND PROCEDURES TO ADDRESS CONFLICTS**  
The Commission's proposal would require a fund to provide disclosure in its SAI regarding other accounts for which any of the fund's portfolio managers is primarily responsible for the day-to-day portfolio management.<sup>4</sup> The proposal would also require a fund to disclose the number of other accounts managed by a portfolio manager, and the total assets in the accounts, within each of the following four categories: (1) registered investment companies; (2) other investment companies (e.g., hedge funds); (3) other pooled investment vehicles; and (4) other accounts. For each such category, the fund would also be required to disclose the number of accounts and the total assets in the accounts with respect to which the advisory fee is based on account performance. The Commission's proposal would also require the fund to describe any conflicts of interest that may arise in connection with a portfolio manager's simultaneous management of the fund and the other accounts. This would include, for example, conflicts related to investment strategy or allocation of investment opportunities. Moreover, the fund would be required to describe the policies and procedures used by the fund or the fund's adviser to address any such conflicts.<sup>5</sup> The Proposing Release solicits comments on whether the proposed amendments should: Require additional information about the other accounts managed by a portfolio manager, or about the potential conflicts of interest; Require disclosure about actual conflicts that may have occurred as a result of managing the fund and other accounts; Require funds with a portfolio management team to impose the disclosure requirement on each team member, or only certain members, e.g., the lead member; Require disclosure in a document other than the SAI, such as the prospectus, shareholder reports, or Form N-CSR; and/or Eliminate the conflicts disclosure provision and replace it with a provision that would prohibit portfolio managers from managing certain types of accounts.

**4 If a committee, team, or other group that includes the portfolio manager is jointly and primarily responsible for the day-to-day management of an account, the fund would be required to include that account in responding to the proposed disclosure**

requirement. 5 The Proposing Release notes, however, that in order to mitigate the burden of preparing descriptions of policies and procedures, a fund may satisfy this requirement by including a copy of the policies and procedures used to address conflicts of interest. 4 C. DISCLOSURE OF PORTFOLIO MANAGER COMPENSATION STRUCTURE The Commission's proposal would require a fund to disclose in its SAI the structure of, and the method used to determine, the compensation received by its portfolio managers from the fund, its investment adviser, or any other source with respect to management of the fund and any other account as described above.<sup>6</sup> For purposes of this disclosure, compensation would include, without limitation, salary, bonus, deferred compensation, and pension and retirement plans and arrangements, whether the compensation is cash or non-cash. For each type of compensation, the fund would be required to include a description of the criteria on which that type of compensation is based, for example, whether the compensation is (1) fixed, (2) based on fund pre- or after-tax performance over a certain time period, or (3) based on the value of assets held in the fund's portfolio. The description would also have to clearly disclose any differences between the method used to determine the portfolio manager's compensation with respect to the fund and the method used with respect to the other accounts.<sup>7</sup> The Proposing Release solicits comments on whether the proposed amendments should: Require funds to disclose any additional information on portfolio manager compensation, including the actual amount of compensation paid to the manager; Require funds with a portfolio management team to impose the disclosure requirement on each team member, or only certain members, e.g., the lead member; and/or Require disclosure in a document other than the SAI, such as the prospectus, shareholder reports, or Form N-CSR. D. DISCLOSURE OF SECURITIES OWNERSHIP OF PORTFOLIO MANAGERS The Commission's proposal would require a fund to disclose in its SAI the ownership of securities of each of its portfolio managers in the fund and in other accounts, including investment companies, managed by the fund's investment adviser or the portfolio manager. This provision would apply to securities owned beneficially<sup>8</sup> or of record in: (1) the fund; (2) other accounts identified by the fund that are managed by the portfolio manager; and (3) any 6 The Proposing Release makes clear, however, that the Commission's proposal would not require funds to disclose the value of compensation paid to a portfolio manager. 7 For example, if the portfolio manager receives part of an advisory fee that is based on performance with respect to some accounts but not the fund, this would have to be disclosed. 8 The Commission's proposal would deem a person to be a "beneficial owner" of a security if the person is a "beneficial owner" under either Rule 13d-3 under the Exchange Act, which focuses on a person's voting and investment power, or Rule 16a-1(a)(2) under the Exchange Act, which focuses on a person's economic interests in a security. The Commission requests comment on whether the definition of beneficial ownership should be based on these two rules or limited to just one of them. The Commission also requests comment on whether the disclosure requirement should apply to record ownership of securities. 5 other account, including a fund, managed by the fund's adviser, or by any person directly or indirectly controlling, controlled by, or under common control with the fund's investment adviser or principal underwriter. Notably, this disclosure would apply to securities owned by each portfolio manager and his or her immediate family members.<sup>9</sup> On this point, the Commission's proposal would require each fund to disclose, on an aggregate basis for each manager and his or her immediate family members, the securities ownership information in a tabular format, including: (1) the name of the portfolio manager; (2) the account in which the portfolio manager or immediate family member owns securities; (3) the title of the class of securities owned; and (4) the dollar range of securities owned. Moreover, the Commission's proposal would require disclosure of the dollar range of securities owned by portfolio managers, as is required for fund directors' ownership of equity securities in the funds they oversee. Here, funds would have to disclose

portfolio managers' ownership of securities using the following dollar ranges: none, \$1.00 - \$10,000, \$10,001-\$50,000, \$50,001-\$100,000, \$100,001-\$500,000, \$500,001-\$1,000,000, or over \$1,000,000. The Proposing Release notes that the required information about a portfolio manager's ownership of securities, as well as the information regarding other accounts managed and compensation structure, would be required to be provided as of the end of the fund's most recently completed fiscal year.<sup>10</sup> The Proposing Release solicits comments on whether the proposed amendments should: Modify the scope of the group of accounts covered by the proposed disclosure requirement; Require disclosure of the actual value of securities owned by the portfolio manager as opposed to disclosing the range of securities owned by the manager; Require a fund to additionally (or alternatively) disclose the percentage of a portfolio manager's net worth that is invested in securities of the fund or other accounts; Exclude certain types of securities from the proposed disclosure requirement (e.g., disclose only ownership of equity securities); Impose the disclosure requirement on securities owned by the portfolio manager's immediate family members, and in the process, broaden the definition to include, for example, parents, siblings, and in-laws; <sup>9</sup> For purposes of this disclosure, "immediate family member" would mean a person's spouse, a child residing in the person's household (including step and adoptive children), and any dependent of the person, as defined in Section 152 of the Internal Revenue Code. <sup>10</sup> The Proposing Release notes, however, that in the case of an initial registration statement or an update to a fund's registration statement that discloses a new portfolio manager, information with respect to any newly identified portfolio manager would be required to be provided as of the most recent practicable date. <sup>6</sup> Require a fund with a portfolio management team to impose the disclosure requirement on each team member, or only certain team members; and/or Require a fund to provide the securities ownership information, as well as information regarding other accounts managed and the manager's compensation structure, as of the end of the fund's most recently completed fiscal year, or as of another more appropriate date. E. AMENDMENT OF FORM N-CSR As noted, because closed-end funds are not generally required to maintain an updated SAI to meet their obligations under the Securities Act, the Commission's proposal would require them to provide disclosure regarding their portfolio managers on Form N-CSR. Specifically, a closed-end fund would be required to include on Form N-CSR the basic information (name, title, length of service, and business experience), as well as the proposed disclosure regarding other accounts managed by the fund's portfolio manager, his or her compensation structure, and his or her ownership of securities. In addition, a closed-end fund would be required to disclose any change in its portfolio managers, and to provide all of the required portfolio manager disclosure for any newly identified portfolio manager, in its semi-annual reports on Form N-CSR. In terms of timing, the Proposing Release notes that the disclosure in Form N-CSR relating to the name, title, length of service, and business experience of a portfolio manager would be required to be current as of the date of filing of the report. The disclosure regarding other accounts managed, compensation structure, and securities ownership generally would be required to be current as of the end of the fund's most recently completed fiscal year.<sup>11</sup> F. REMOVAL OF EXCLUSION FOR INDEX FUNDS The Commission's proposal would impose the proposed disclosure requirements on portfolio managers of index funds. Specifically, the proposal would remove the current provision in Form N-1A that excludes a fund that has as its investment objective replication of the performance of an index from the requirement to identify and provide disclosure regarding its portfolio managers.<sup>12</sup> The Proposing Release solicits comments on whether the Commission should: Remove the exclusion for index funds, and in so doing, subject the funds' portfolio managers to all or just some of the proposed requirements; and/or <sup>11</sup> In the case of a newly identified portfolio manager in an annual or semi-annual report, however, the disclosure would be required to be current as of the most recent practicable date. <sup>12</sup>

The Proposing Release explains that imposing the proposed disclosure requirements on portfolio managers to index funds is appropriate given that conflicts may arise when a manager is managing both an index fund and an actively-managed fund that invest in some of the same securities. 7 Subject money market funds to the proposed requirements (by removing the provision that presently excludes money market funds from having to identify and provide disclosure regarding their portfolio managers). 8 G. COMPLIANCE DATE The Proposing Release notes that once the proposal is adopted, the Commission expects to require all new registration statements and annual reports on Form N-CSR, and all post-effective amendments that are annual updates to effective registration statements, filed on or after the effective date to comply with the new disclosure requirements. In addition, the Commission expects to require post-effective amendments that add a new series, filed on or after the effective date, to comply with the new disclosure requirements with respect to the new series. Barry E. Simmons Associate Counsel

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