The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 2480

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SEC STAFF ISSUES SECOND GENERIC COMMENT LETTER

January 22, 1991 TO: ACCOUNTING/TREASURERS MEMBERS NO. 1-91 CLOSED-END FUND MEMBERS NO. 2-91 OPERATIONS MEMBERS NO. 1-91 SEC RULES MEMBERS NO. 2-91 UNIT INVESTMENT TRUST MEMBERS NO. 2-91 RE: SEC STAFF ISSUES SECOND GENERIC COMMENT LETTER _____ The Division of Investment Management recently issued a second "generic comment letter" to investment company registrants intended to provide guidance on disclosure filings. A copy of the letter is attached. The letter covers only developments in the staff's views on disclosure since January 1990, when the staff issued its first generic comment letter. Accordingly, registrants also should refer to that letter for guidance on the staff's views. (The Institute distributed copies of the first letter last year. See Memorandum to SEC Rules Members No. 4-90, Accounting/Treasurers Members No. 2-90, Closed-End Fund Members No. 1-90 and Operations Members No. 3-90, dated January 19, 1990 and Memorandum to Unit Investment Trust Members No. 3-90, dated January 17, 1990.) Set forth below is a brief summary of certain of the items discussed in the letter. Please refer to the letter itself for a more complete discussion of the staff's views. I. PROCEDURAL COMMENTS Prospectus Delivery. The staff stated that the practice of sending copies of any new prospectus to all shareholders each time it is updated satisfies the prospectus delivery requirements of the federal securities laws. In connection with "stickered" prospectuses, funds and their counsel are instructed to consider the nature and materiality of the new disclosure in determining whether to send copies to shareholders. Undertakings. The letter states that a registrant filing an initial Form N-1A (or a post-effective amendment to add a new series) must undertake to file a post-effective amendment containing reasonably current financial statements within four to six months. Any such registrant also must undertake to hold a meeting of public shareholders to consider election of directors, - 1 - ratification of accountants, approval of investment advisory or similar contracts and approval of any 12b-1 plan. As recommended by the Institute, the staff clarified that, in the case of registrants adding a new series, shareholders of that series need only consider the advisory (or similar) contract and any 12b-1 plan. The staff also has revised its policy on how soon this shareholder's meeting is required to be held. As we previously informed you, the time period is now sixteen months from the date of effectiveness or commencement of operations, whichever is later. (See Memorandum to SEC Rules Members No. 84-90, dated December 11, 1990.) Incorporation by Reference. As recommended by the Institute, the staff has clarified that the requirement to include copies of annual reports in filings where financial statements are incorporated by reference from the annual reports is not applicable to EDGAR filings where the annual report has been filed electronically. The letter notes that copies of incorporated materials do not have to accompany prospectuses delivered to investors if they have been previously delivered and the prospectus includes a statement at

the place of incorporation that the incorporated material will be furnished upon request at no charge. Rule 24f-2. The letter states that a registrant ceasing operations must file both a post-effective amendment terminating its Rule 24f-2 declaration and a final Rule 24f-2 notice prior to its cessation of operations. In the case of a reorganization, the date of the transaction's consummation is deemed the fiscal year end of the acquired fund; consequently, the acquired fund must file its 24f-2 notice within two months of that date in order to net redemptions. Other. The letter refers to staff positions taken within the past year with respect to prospectuses contained in periodicals (See Memorandum to SEC Rules Members No. 42-90 and Unit Investment Trust Members No. 36-90, dated June 13, 1990) and granting conditional relief from the requirement to include a certified balance sheet of a fund's investment adviser as of the adviser's most recent fiscal year in proxy materials (See Memorandum to SEC Rules Members No. 84-90, dated December 11, 1990). II. SUBSTANTIVE COMMENTS Fund Names. The staff's position is that a fund that includes the name of a country in its name should have an investment policy requiring at least 65 percent of its assets to be invested in that country under normal market conditions. A "global" fund (or a "world" or "atlas" fund) should have such a policy with respect to at least three different countries; in the - 2 - case of an "international" fund, the requirement is three different countries other than the United States. In the case of series funds, the staff notes that the investment policies of each series must be consistent with the name of the registrant. The letter also refers to the staff's October letter regarding the use of "guaranteed" or "insured" in fund names. (See Memorandum to SEC Rules Members No. 74-90 and Unit Investment Trust Members No. 69-90, dated October 26, 1990.) Foreign Government Securities. It is the staff's position that securities issued by a foreign government do not constitute "government securities" for purposes of diversification or concentration. (Thus, a fund may not reserve freedom to concentrate in securities issued by a foreign government.) Organizational Expenses. If a registrant capitalizes its organization expenses, a straight-line method should generally be used unless the registrant demonstrates that another "systematic and rational method" is more appropriate. Expenses should not be amortized for over sixty months from the commencement of operations. If any original shares are redeemed prior to the end of the amortization period, the redemption proceeds should be reduced by the pro rata share of the unamortized expenses. Rule 144A. A fund that intends to invest in Rule 144A securities and to treat those securities as liquid pursuant to a determination by the fund's board should include additional risk disclosure in its prospectus. The requested disclosure includes a discussion of the nature of Rule 144A securities, the role of the board in determining whether such securities are liquid, the factors the board will take into account and the risk of increasing illiquidity during times when qualified institutional buyers are uninterested in purchasing Rule 144A securities. Redemption Charges. Charges for wiring redemption proceeds should be disclosed in a footnote to the fee table. Account close-out fees should be listed as transaction expenses in the fee table. Other. The letter referred to the staff's earlier letters on disclosure for high yield bond funds (See Memorandum to SEC Rules Members No. 55-89, Closed-End Fund Members No. 49-89 and Unit Investment Trust Members No. 52-89, dated October 5, 1989; Memorandum to SEC Rules Members No. 16-90, Closed-End Fund Members No. 10-90 and Unit Investment Trust Members No. 12-90, dated February 27, 1990; and Memorandum to SEC Rules Members No. 71-90, dated October 18, 1990) and portfolio quality standards for money market funds (See Memorandum to SEC Rules Members No. 36-90, dated May 9, 1990). - 3 - III. CLOSED-END FUNDS The letter sets forth several items that should be - 4 - disclosed by closed-end funds contemplating share repurchases in the secondary market or through tender offers. The items include: (1) that there is no assurance the board will decide to make a tender offer or that it will reduce market discount, (2) the factors influencing market prices of the fund's shares, (3) how

often the board will consider tender offers, (4) that tender offers will decrease total assets and will likely increase the expense ratio, (5) that interest on borrowings to finance tender offers will increase fund expenses and (6) any objective standards the board will consider that would result in not proceeding with the tender offer. The letter also reminds closed-end funds that any tender offers must fully comply with applicable requirements under the 1934 Act. Registrants are instructed to contact both the Office of Trading Practices of the Division of Market Regulation and the Office of Tender Offers of the Division of Corporation Finance before undertaking a tender offer. IV. UNIT INVESTMENT TRUSTS The letter states that, with respect to substitution of portfolio securities, trusts are not permitted to sell securities and reinvest the proceeds solely on the basis of declines in market value due to market or industry conditions. A decline in price can only be grounds for a substitution if it is due to issuer-specific credit factors that, in the sponsor’s opinion, would make retention of the security detrimental to the trust or its unitholders. Craig S. Tyle Associate General Counsel Attachment

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