

**MEMO# 6452**

December 12, 1994

## **DRAFT COMMENT LETTER ON SEC PROPOSED LEGAL PROCEEDINGS DISCLOSURE REQUIREMENTS**

December 12, 1994 TO: CLOSED-END FUND COMMITTEE No. 34-94 SEC RULES COMMITTEE No. 131-94 UNIT INVESTMENT TRUST COMMITTEE No. 82-94 RE: DRAFT COMMENT LETTER ON SEC PROPOSED LEGAL PROCEEDINGS DISCLOSURE REQUIREMENTS

As we previously advised you, the SEC has proposed amendments that would require new disclosures concerning legal proceedings in investment company prospectuses and proxy materials. (See Memorandum to Closed-End Fund Committee No. 25-94, SEC Rules Committee No. 119-94 and UIT Committee No. 72-94, dated November 8, 1994.) Attached for your review is a draft comment letter responding to the proposal. We would appreciate especially your input on the issues highlighted below concerning the scope of the proposal. The comment letter expresses disappointment that, despite ongoing efforts to simplify fund prospectuses, the Commission is proposing to add new disclosures to fund prospectuses that could be lengthy, legalistic and of questionable relevance to investors. The letter recommends that if the Commission nevertheless goes forward with the proposal, its scope should be narrowed in several respects. For example, under the proposal, disclosure would be required as to an expansive list of actions without any opportunity to evaluate the materiality of the particular facts and circumstances (except in the case of bankruptcy or insolvency proceedings). The list of actions that would be required to be disclosed is set forth in Item 401(f) of Regulation S-K, as proposed to be revised. The draft letter recommends, among other things, that a materiality standard be maintained. Specifically, it suggests that the approach of the proposed disclosure requirements be modeled after Rule 206(4)-4 under the Investment Advisers Act, which concerns an investment adviser's obligation to disclose material financial and disciplinary information to clients. That rule creates a rebuttable presumption that certain actions are material and provides four factors to be considered in determining whether the presumption of materiality is rebutted. In reviewing the draft comment letter, please consider in particular whether the Institute should suggest that the specific actions presumed to be material under our proposed approach should be those set forth in Rule 206(4)-4 or the more extensive list in proposed revised Item 401(f). (A copy of each is attached.) In this regard, please note that if we recommend looking to the actions described in Rule 206(4)-4, it will be necessary to provide some justification for treating directors and executive officers of investment companies differently from those of other types of issuers. Also, consideration should be given to whether it makes sense to look to Rule 206(4)-4, which generally is limited to "investment-related" events, to determine what types of legal proceedings involving an investment company director would be presumed material. Another possibility would be to

start with the list of actions in proposed revised Item 401(f) but recommend changes to narrow the scope of that list if the proposed items are inappropriately broad (e.g., exclude cases that were settled with prejudice, which appear to require disclosure under the proposal). The proposing release sent to you previously discusses in detail and seeks comments on numerous issues concerning the types of actions that would have to be disclosed. In addition to the question of which actions should require disclosure is the issue of which persons or entities should be covered. In this regard, the letter proposes eliminating the reference to any "managerial person" of the investment adviser and replacing it with the fund's portfolio manager or any member of an investment management committee. Please consider whether this would result in reasonable and workable requirements. Also, please consider what, if any, changes the Institute should recommend to the proposed disclosure requirements for unit investment trusts regarding "managerial persons" of the depositor. Comments on the proposal must be filed by January 6th. If you have any comments on the attached draft letter generally and/or the matters highlighted above, please contact me at (202)326-5822 by Friday, December 30th. Frances M. Stadler  
Associate Counsel Attachments

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