

MEMO# 2565

February 27, 1991

SEC ADOPTS AMENDMENTS TO RULES UNDER SECTION 16

February 27, 1991 TO: CLOSED-END FUND MEMBERS NO. 11-91 RE: SEC ADOPTS AMENDMENTS TO RULES UNDER SECTION 16

The SEC has adopted amendments to the rules under Section 16 of the Securities Exchange Act of 1934, governing reporting and short-swing profit recovery with respect to certain insider transactions. The amendments, most of which become effective on May 1, 1991, were proposed originally in December 1988 and were repropounded in August 1989. The Institute submitted comment letters in response to both proposals, and the final amendments incorporate most of the Institute's suggestions. A summary of the amended rules as they pertain to both closed-end funds as issuers and closed-end funds as shareholders is set forth below. A copy of the adopting release is attached.

I. Closed-End Funds As Issuers

A. Application of Section 16 Pursuant to Section 30(f) of the Investment Company Act of 1940, the reporting and short-swing profit recovery requirements of Section 16 apply to every person who is directly or indirectly the beneficial owner of more than ten percent of any class of outstanding securities (other than short-term paper) issued by a registered closed-end investment company, and to any officer, director, member of an advisory board, investment adviser or affiliated person of an investment adviser of such investment company. Under the new rules, the term "officer" is defined to include certain specified individuals as well as any other person who performs significant policy-making functions.

B. Timing of Filing Reports The rules have been amended to permit insiders to report transactions on Form 4 on a date earlier than that which is required by the rules. In addition, as amended, the rules provide that a form is timely filed for purposes of Section 16 if it is delivered to a third party business in sufficient time for the third party business to guarantee delivery of the filing to the SEC by its due date.

C. Form 5 The amended rules will require the filing of reports on newly adopted Form 5, within 45 days after the issuer's fiscal year end, to disclose certain holdings and transactions not previously reported on Forms 3, 4 or 5. These include transactions exempt from Section 16(b), certain small acquisitions, and holdings and transactions that should have been reported during the most recent fiscal year but were not. (The first Form 5 filing must disclose holdings and transactions that should have been reported during each of the issuer's last two fiscal years.) Exempt transactions for this purpose include, among others, acquisitions of securities pursuant to a dividend reinvestment plan.

D. Compliance To encourage increased compliance with Section 16 requirements, the amended rules require a closed-end fund to disclose information regarding delinquent Section 16 filings in Form N-SAR (as an annual supplement to the form filed after the end of the fund's fiscal year) and in the fund's definitive proxy materials. Specifically, the fund must disclose the identity of insiders who filed late or failed to file, and the number of delinquent filings and transactions for each

such insider. Delinquent filings reported prior to the effective date of the new rules need not be disclosed.

II. Closed-End Funds As Shareholders

A. Determination of Insider Status Under the amended rules, ten percent holders under Section 16 are those persons deemed ten percent holders under Section 13(d) of the 1934 Act and related rules. However, the reporting and short-swing profit provisions of Section 16 apply only to those securities in which a ten percent holder has a "pecuniary interest". In determining ten percent holder status, institutions that are eligible to file ownership reports on Schedule 13G (e.g., a registered investment company or a registered investment adviser) are not deemed beneficial owners of securities held for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business, and without the purpose or effect of changing or influencing control of the issuer. Thus, an investment adviser generally would not have to aggregate shares held by investment companies and private accounts managed by the adviser and count those shares towards ten percent holder status.

B. Pecuniary Interest Test As noted above, the amended rules provide that the Section 16 reporting and short-swing profit recovery obligations apply only with respect to securities in which an insider has a direct or indirect pecuniary interest. As was proposed, the pecuniary interest test includes a safe harbor with respect to certain performance-related management fees. Specifically, no pecuniary interest is created by a performance-related fee where the fee is based on performance over a period of a year or more (regardless of when it is payable), and no more than ten percent of the portfolio's market value is attributable to the issuer's equity securities. In addition, as suggested by the Institute, the final rules make it clear that asset-based management fees do not create a pecuniary interest on the part of an investment adviser or trustee in the securities managed.

C. Attribution of Insider Status to Trusts Under the original proposal, a trust would have become subject to Section 16 if a trustee was an insider. However, the rules as adopted attribute insider status to the trust only if an insider trustee has or shares investment control over the trust's portfolio securities and the trustee, or a member of the trustee's immediate family, has a pecuniary interest in the issuer's securities held by the trust. As a result, as requested by the Institute, an investment company organized as a trust generally would not be subjected to Section 16 merely because a member of the board of trustees was an insider. In addition, the final rules provide that a trustee's insider status does not subject the trust to Section 16 if the trustee is an institution eligible to file reports on Schedule 13G (e.g., a registered investment adviser).

III. Effective Dates Most of the rule changes take effect May 1, 1991. The requirements for issuers to disclose delinquent filers take effect with respect to their first fiscal year ending on or after November 1, 1991.

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