

**MEMO# 2212**

September 25, 1990

## **INSTITUTE COMMENT LETTER ON SEC CONCEPT RELEASE**

September 25, 1990 TO: BOARD OF GOVERNORS NO. 70-90 RE: INSTITUTE COMMENT  
LETTER ON SEC CONCEPT RELEASE

Comments on the SEC Comment Release regarding reform of the regulation of investment companies must be filed with the SEC by October 10. Therefore, at its meeting on October 4 the Board of Governors will consider the attached draft Institute comment letter, which has been prepared by the Institute's 1990s Ad Hoc Committee and approved by the Executive Committee. (Also attached is a draft of Steve West's 1990s regulatory report which provides background, options and recommendations which conform to those in the draft comment letter.)

Institute Comment Letter With the exception of two changes suggested by the Executive Committee, the attached draft comment letter is based on the recommendations of the Institute's 1990s Ad Hoc Committee, which has met six times over the past two years. Representatives from over 20 different fund groups, representing about 60 percent of industry assets, attended the final meeting at which the draft letter was reviewed and approved. Therefore, the attached draft represents a very broad consensus within the industry. The following is a brief discussion of the major recommendations contained in the letter.

1. All publicly-offered pools of securities (including bank common and collective funds, asset-backed arrangements and mortgage REITs) should be made subject to the Investment Company Act with the SEC authorized to promulgate appropriate rules and exemptions for particular types of pools, as it has done for variable insurance products. The Ad Hoc Committee voted 18 to 2 in favor of this recommendation.
2. Managed investment companies should be permitted to option of organizing either in traditional corporate form or in unitary (contract) form, the predominant structure used in other countries. The vote of the Ad Hoc Committee was 20 to 1 in favor.
3. Unit trusts investing in fixed portfolios of securities should be permitted to be organized either in open-end form (as under present law), or in closed-end form. The use of the closed-end form would permit the public offering of mortgage-backed and asset-backed pools, many of which cannot presently be publicly offered since they cannot comply with the Act. The vote was 17 to 0 in favor.
4. The Act should be amended to remove the current rigid open-end/closed-end dichotomy so as to permit funds to redeem on a periodic basis. This would allow the creation of innovative products and could serve to reduce closed-end fund discounts. The vote was 21 to 0 in favor.
5. Funds which are limited to institutional investors should be exempted from various provisions of the Act, including those relating to governance, capital structure, redeemability and possibly certain of the prohibitions on affiliated party transactions. After experience has been gained in this area, the Commission should report to Congress on the advisability of extending some or all of these changes to other types of funds. The vote was 21 to 0 in favor.
6. Mutual funds should be permitted to make written

offers without prospectus liability, just as broker-dealers are permitted to make oral offers without such liability. The vote was 21 to 0 in favor. 7. Mutual fund written advertisements which are subject to prospectus liability should be permitted to include purchase applications, so that an investor could purchase shares directly from an advertisement. The Ad Hoc Committee voted 12 to 0 to include this proposal, with its initial scope limited to money market funds. The Executive Committee recommended inclusion of all types of funds. 8. The United States should negotiate treaties with other nations providing for cross-border sales of investment company shares, provided there is both adequate investor protection and equal market access. The vote was 21 to 0 in favor. - 3 - 9. The administrative procedures for obtaining exemptive relief under Section 6(c) should be liberalized. Specifically, SEC response to an exemption application should be required within 90 days, and applicants should be entitled to rely on relief granted a prior applicant unless the SEC takes action to the contrary within 30 days. In addition, the Ad Hoc Committee voted 12 to 6 in favor of a proposal to amend section 6(c) to permit the SEC to override any provision of the 1940 Act in granting exemptive relief. However, the Executive Committee recommended that such an amendment not be proposed. 10. Section 36(b) should be amended to: (1) allow a court to award the prevailing party the costs of maintaining or defending the action; (2) require a party to post a bond sufficient to cover those costs; and (3) change the burden of proof to "clear and convincing evidence". The vote in favor of recommendations 1 and 2 was unanimous; however, the Ad Hoc Committee split 9-9 on the third recommendation. The Executive Committee approved all three recommendations. 11. Regulation S-X should follow tax accounting in order to eliminate differences between book and tax accounting in financial statement reporting and share valuation. The vote by a mail ballot sent to the Ad Hoc Committee after its final meeting was 11 to 4 in favor. 12. Riskless principal transactions should be treated as agency transactions for purposes of Section 17. The vote was 16 to 0 in favor. 13. Generally, in the case of series funds, regulatory provisions should apply to each separate series, except where it is appropriate to take advantage of economies of scale or otherwise required by state corporate law. The vote was unanimously in favor. 14. The current requirement of \$100,000 minimum capital for each investment company should not be changed. However, an investment adviser to a registered investment company should be subject to a \$1 million net worth requirement. The vote was 13 to 6 in favor. 15. The SEC and the CFTC should work together to lessen the possibility of dual registration of a fund as both an investment company and a commodity pool. The vote was unanimous in favor. West Report - 4 - When completed, Steve West's report will be the final product of the regulatory portion of the Institute's 1990s - 5 - project. Work on this report was begun approximately two years ago and has continued since that time through a number of meetings of the Institute's 1990s Ad Hoc Committee. The report is organized in three major sections: (1) background and history; (2) options for regulatory reform, and (3) recommendations of Board of Governors. The recommendations section has been conformed to the Institute's draft comment letter. Matthew P. Fink Senior Vice President and General Counsel