COMMENT LETTER

June 9, 1997

Comment Letter on SEC Disclosure Initiatives, June 1997

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Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Proposed Amendments to Form N-1A
(File No. S7-10-97)

Dear Mr. Katz:

The Investment Company Institute[1] is very pleased to comment on the Securities and Exchange Commission's proposal to amend Form N-1A, the registration form mutual funds use to register under the Investment Company Act of 1940 and to register their securities under the Securities Act of 1933.[2]

Under the leadership of its Chairman, Arthur Levitt, Jr., the Commission in recent years has amply demonstrated its determination to make mutual fund disclosure more comprehensible, informative and useful to investors. It has devoted extraordinary attention to achieving this objective: for example, through its March 1995 concept release on improving mutual fund risk disclosure, its two-year pilot project and investor research on the profile prospectus, its January 1997 "plain English" initiative, its longtime encouragement of voluntary industry efforts to improve fund prospectuses, its consideration of simplified money market fund disclosure requirements, its proposal concerning mutual fund names, and its comprehensive review of and proposed amendments to Form N-1A.[3]

This last proposal is of particular importance because it deals with the key disclosure document that every mutual fund investor receives. Because mutual funds are investment vehicles of choice for millions of Americans, it is imperative that every fund communicate with investors as clearly and effectively as possible. With strong encouragement from Chairman Levitt and the Commission, and exceptional cooperation and support from the Commission staff, many mutual funds have sought to craft better disclosure documents. Nonetheless, the proposed changes to Form N-1A will greatly enhance the quality of disclosure all funds provide to investors.

The priority Chairman Levitt has given to improving mutual fund disclosure assures that the Commission's proposals are firmly rooted. They reflect an unprecedented number and variety of public comments and expert opinions, the results of Commission and other research, and broad investor input. Indeed, we believe the Commission has never had a more detailed, comprehensive and compelling basis for its rulemaking than that which it has developed concerning reforms of mutual fund disclosure. We highly commend the Commission and its staff for the exacting consideration that the Commission's proposals reflect. We deeply share the Commission's objectives in this process, and strongly encourage it to complete the effort begun by Chairman Levitt by moving expeditiously to implement the proposed new disclosure standards that will benefit all fund investors.[4]

Our specific comments on the proposal are set forth below. Our comments address, in turn: (1) the continuing appropriateness of the two-part prospectus approach; (2) the proposed amendments to Part A of Form N-1A; (3) changes we propose to Parts B and C; (4) the proposed General Instructions to the form; (5) the proposed transition period for the amendments; and (6) the disclosure review process.

I. The Two-Part Prospectus

When the Commission first adopted Form N-1A in 1983, the two-part prospectus — consisting of Part A (which is provided to all investors) and Part B (the statement of additional information or SAI, which is made available upon request) — was a major innovation. By allowing funds to place certain information in a separate document that could be incorporated by reference into the prospectus, the Commission created the necessary legal framework to allow for shorter, simpler fund prospectuses. In the current proposal, the Commission retains this very sensible approach and carries it even further, by seeking to move more non-essential information from the prospectus to the SAI.

The Proposing Release states that "[t]he two-part disclosure format has been widely used by funds, and the Commission has found that the current approach to incorporation by reference supports the intended purpose of Form N-1A and should be retained."[5] The Institute strongly supports this conclusion. Indeed, we believe that the success of the Commission's efforts to streamline fund prospectuses and focus prospectus disclosure on essential information about a particular fund will turn largely on funds' ability to fully utilize the two-part prospectus approach. It would be incongruous, for example, for a fund to be held liable for failing to include certain disclosure in its prospectus when the Commission has made a judgment that such disclosure need not (or perhaps even should not) appear there. By expressly revalidating the principles of the two-part prospectus in the amended form and the adopting release, the Commission can greatly increase the likelihood of achieving the proposal's goals.

II. Proposed Amendments to Part A

The bulk of the Commission's proposal consists of proposed changes to Part A of Form N-1A, which specifies the information required in mutual fund prospectuses. For convenience, the Institute's comments on the proposed amendments follow the order of the item numbers in the form.

A. Item 1 — Front and Back Cover Pages

The Commission proposes a number of changes to the disclosure requirements for the front and back cover pages of fund prospectuses. Some of the proposed revisions, such as the elimination of disclosure that would repeat information required in the proposed risk/return summary, would go a long way towards "uncluttering" the front cover page. We welcome these changes, and have several additional suggestions concerning proposed cover page disclosures, as described below.

1. Rule 481(b)(1) Legend

Consistent with a recommendation in our Plain English Comment Letter, the Institute recommends that the Commission eliminate the cover page legend required by Rule 481(b)(1) under the Securities Act of 1933, rather than simplifying it, as is proposed.6 Amended Rule 481(b)(1) would require disclosure to the effect that "[t]he Securities and Exchange Commission has not approved or disapproved these securities or passed upon the adequacy of this prospectus and any representation to the contrary is a criminal offense." We continue to believe that even when stated more clearly, this disclaimer is not meaningful to investors.

As we indicated previously, the premise for the legend seems to be a concern that investors otherwise will assume the SEC has given a prospectus its stamp of approval. Even if there was some historical basis for the concern, we do not believe there is a contemporary basis for it as to investment companies. Also, the statement that "any representation to the contrary is a criminal offense" is merely a restatement of the law and does not help investors make an informed investment decision.

In our view, inclusion of the legend is inconsistent with the stated goal of the proposed amendments to Form N-1A: to focus the prospectus on essential information about a particular fund that would assist an investor in making an investment decision. We further note that the Commission has not proposed to require this legend on the cover page of (or, for that matter, anywhere else in) fund profiles.7 For these reasons, we recommend that the legend requirement be deleted.

2. Back Cover Page Disclosure

We also recommend several revisions to the proposed back cover page disclosure requirements. First, the Commission should centralize disclosure regarding the availability of additional information about a fund on the back cover. Specifically, funds should disclose on the back cover page the availability (without charge) of the SAI and annual and semi-annual reports,8 and provide a toll-free (or collect) telephone number (or numbers) for requesting those documents, making shareholder inquiries and (at the fund’s option, unless it is a money market fund) obtaining fund performance information. Funds that are sold through various intermediaries such as broker-dealers or banks should be permitted to indicate that investors may contact the appropriate intermediary to obtain such information.9 Providing disclosure concerning how to obtain additional information about a fund in one standardized, prominent location is preferable to scattering it throughout the prospectus. It will be easier for investors to find.

Second, we recommend changes to minimize potential investor confusion and to avoid unnecessary clutter. For example, the Commission proposes to require that the back cover of the prospectus for a series fund include the names of both the series and the registrant. The Institute is concerned that this disclosure could confuse investors, particularly where the registrant’s name bears no relation to the name of the series offered in the prospectus. For this reason, and because we do not believe the disclosure would serve any essential purpose,10 the Commission should delete this proposed requirement.11 Similarly, the

Commission should drop the proposed requirement to include the registrant's Investment Company Act file number, which has no relevance for investors in making an investment decision.12 In addition, the date of the SAI plays no role in helping investors make informed investment decisions, and it too should not be required on the back cover page.

The Commission proposes to require disclosure on the back cover page concerning the availability of further information about a fund at the Commission's Public Reference Room and on the Commission's Internet site. Funds already would be providing disclosure on the back cover page about how to obtain additional information about the fund. Accordingly, the proposed disclosure is unnecessary. Moreover, investors accessing the Commission's Internet site may become confused if they are not familiar with the format of EDGAR filings, or with the purpose(s) of various types or components of required regulatory filings (e.g., under Rule 497 or Rule 485).13 For all of these reasons, the Commission should delete proposed Item 1(b)(4).

3. SAI Delivery Requirement

The back cover page would disclose the availability of a fund's SAI and a toll-free telephone number to call to request it. Proposed Instruction 2 to Item 1(b)(2) would require that a fund send the SAI within three business days of receipt of a request. To achieve the objective of quick turnaround without unduly rigid requirements, the Commission instead should adopt a standard requiring that the SAI be sent "reasonably promptly," which normally would be deemed to be within three business days.14 This standard would provide necessary flexibility for unforeseen circumstances that are beyond a fund's control (such as disruptions caused by severely inclement weather, prolonged power outages, or for an occasional, minor operational delay). We further recommend that the Commission make clear that funds are not required to keep detailed records of the date of each and every request for an SAI (or shareholder report), but rather should adopt procedures designed to test periodically compliance with the "reasonably prompt" standard.

B. Item 2 — Risk/Return Summary: Investments, Risks and Performance

1. Standardized Format

One of the major features of the Commission's proposal is the proposed risk/return summary, which would provide key information about a fund's investment objectives, principal strategies, risks, performance, and fees in a standardized location and format. The Institute supports this concept, which is modeled after (and would be substantially the same as the first four items of) the proposed fund profile. We believe the summary will assist investors both in understanding the key features of a particular fund and in comparing different funds.

The proposal would require the risk/return summary to be presented in a question-and-answer format, but the Commission requested comment on whether funds should instead be permitted to choose the type of heading for the prescribed disclosure topics. The Institute recommends allowing funds to use headings that convey the required information but are not in question format.15 We believe this is a matter of disclosure style (as opposed to content) that should be left to the discretion of individual fund groups.

2. Narrative Risk Disclosure

a. Summary of Principal Risks
Proposed Item 2(c)(1)(i) would require a fund to summarize "the principal risks of investing in the Fund, including the risks to which the Fund's portfolio as a whole is subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, and total return."[16] The proposal thus would shift the focus of narrative risk disclosure from the risks of individual portfolio securities to the overall risks of a fund.

The results of the Institute's Risk Disclosure Survey suggested that narrative risk disclosure significantly assists investor understanding of mutual fund risk, and that further refinement of narrative risk disclosure would benefit many investors. Shifting the focus of mutual fund risk disclosure to a fund's overall risks is one such refinement that indeed will enhance investor understanding of the risks of a fund investment. Accordingly, we strongly support the Commission's proposed approach to narrative risk disclosure.

In connection with the proposed requirement to summarize the fund's principal risks, the Commission should specifically indicate in the adopting release and in an instruction to proposed Item 2(c)(1)(i) that the prescribed disclosure is not intended to be an exhaustive, all-encompassing discussion of a fund's risks and that funds should not provide a "laundry list" of risks. Such an instruction could state, for example: "The summary of the Fund's principal risks provided pursuant to Item 2(c)(1)(i) is not intended to be an exhaustive, all-encompassing discussion of the Fund's risks. Do not provide a "laundry list" of risks in response to this item." It would be helpful also to include examples of disclosure that would be considered adequate and appropriate for different types of funds. For example, the instruction could provide that a bond fund should summarize the types and levels of risks to which it generally would be subject (e.g., credit risk, interest rate risk, currency risk), and that it should not describe separately the risks of different types of fixed-income securities in which the fund may invest. Funds also should be permitted to note at the end of the summary of their principal risks that there may be additional risks.[17]

b. Investor Characteristics
Proposed Item 2(c)(1)(ii) would require a description of "the characteristics of an investor for whom the Fund may be an appropriate or inappropriate investment (e.g., based on the investor's time horizon, willingness to tolerate fluctuations in principal, or on the tax consequences of investing in the Fund)." The Institute agrees that disclosure along these lines could help an investor decide whether a particular fund potentially may be consistent with his or her investment goals. While we support this basic premise, we urge the Commission to confirm our view that this provision is not intended to require a fund to make a blanket suitability determination, nor does it impose any suitability obligation on funds. The Commission should clarify in the adopting release (and/or in an instruction to Item 2(c)(1)(ii)) that the item seeks to elicit broad brush disclosure about how a fund might fit into an investment program. It also should revise the proposed provision to eliminate the requirement to describe an investor for whom a fund would be inappropriate. Such a requirement could result in disclosure that is not helpful to investors (e.g., "the fund is inappropriate for investors who are not seeking capital appreciation").

c. Funds Advised By or Sold Through Banks; Money Market Funds
Funds that are advised by or sold through banks currently must include disclosure on the cover of their prospectuses that the fund's shares are not deposits or obligations of, nor insured or endorsed by, the bank, and that the shares are not insured by the Federal Deposit Insurance Corporation or any other government agency. The Commission proposes

to simplify this disclosure and move it from the cover to the risk/return summary.

The Institute supports the proposed changes to the language and location of the required legend. We believe the revised legend will convey the necessary message to investors in a straightforward manner and in the appropriate context. We are hopeful that the Commission can persuade the federal banking agencies that the proposed requirement appropriately addresses their regulatory concerns as well. It is essential that all regulators with jurisdiction over fund prospectus disclosure apply a single, uniform legend requirement.

The revised legend also would be required in the risk/return summary for all money market funds, along with simplified disclosure that a money market fund may not be able to maintain a stable net asset value. The Institute supports these proposed changes.

The Proposing Release requests comments on the disclosure required for single state tax-exempt money market funds.18 The Institute agrees with the statement in the Proposing Release that the current disclosure requirement "may exaggerate the risks of a single state money market fund since these funds, like all money market funds, may purchase only those portfolio instruments that meet the credit quality and maturity requirements of Rule 2a-7."19 Accordingly, as the Institute recommended in its 1994 comment letter to the Commission on proposed amendments to Rule 2a-7 and related disclosure requirements, the disclosure should provide that because a single state money market fund may invest a significant portion of its assets in a single issuer, as compared to other types of money market funds, there may be a greater risk that the fund will not be able to maintain a stable net asset value.20

3. Risk/Return Bar Chart and Table

a. Bar Chart
The Institute strongly supports the proposal to require a bar chart showing a fund’s annual total returns for the past ten calendar years.21 The Institute’s Risk Disclosure Survey provided compelling evidence that, by graphically depicting the variability of a fund’s performance, such a bar chart would significantly assist investors in their consideration of mutual fund risk. In addition, it would provide information that investors could readily understand and properly employ to aid them in evaluating a single fund’s volatility and comparing the volatility of several funds.22

As proposed, the total return information in the bar chart would not reflect sales loads. We agree with the proposed exclusion of sales loads from the bar chart return information, as there is no way to reflect them accurately and fairly and omitting them will not detract significantly from the central purpose of the bar chart. Disclosure that sales loads are not reflected in the chart should suffice.

The proposal does not restrict the number of funds for which total return information could be included in a single bar chart. We support this approach because it provides funds with flexibility to structure the presentation of the required information in the manner they deem most appropriate. There may well be instances in which including multiple funds in a single bar chart is helpful to investors because it facilitates comparisons among those funds. As noted in the Proposing Release, the general requirement that information in the prospectus be set forth in a clear and understandable manner would apply to the bar chart presentation.23 This general requirement provides adequate protection against confusing or excessively "noisy" bar charts.

The proposal would require a multiple class fund to provide total return information for only one class. More specifically, a multiple class fund would have to present the required information for the class offered in the prospectus that has been in existence for the longest time or, if two or more classes offered in the prospectus have been in existence for at least ten years or for the same length of time (but less than ten years), the class with the greatest net assets as of the end of the most recent calendar year.

The Institute recommends that the Commission modify the proposed methodology for selecting which class will be reflected in the bar chart to avoid certain undesirable and/or potentially confusing results.24 For example, if a prospectus offers only one class, which is new, but the fund has other, older classes, it may not be appropriate to omit the bar chart (as would be the result under the Commission's proposal). In addition, if all classes have existed for the same amount of time, the largest class (and, accordingly, the class reflected in the bar chart) may change from year to year. This could be confusing to investors and would impose undue administrative burdens on funds.

Accordingly, we believe that the bar chart generally should reflect the oldest class,25 regardless of whether that class is offered in the prospectus.26 As the Proposing Release points out, "the bar chart primarily is designed to show graphically the risks of investing in a fund and not the costs of investing in the fund."27 For this purpose, differences in expense structures among different fund classes are immaterial, and the fact that a prospectus does not offer the oldest class is irrelevant. In our view, it is important to present available information about the historical variability of the fund's total return accompanied, where appropriate, by disclosure that the class in the bar chart is different from the class(es) offered in the prospectus.28

Where more than one class has existed for over ten years, or where two or more classes have existed for the same amount of time (and there are no older classes), multiple class funds should have the discretion to determine which of these is an appropriate class for inclusion in the bar chart. This flexibility is appropriate because, as the Proposing Release states, "the returns of each class differ only to the extent the classes do not have the same expenses."29 These differences generally would not have a significant impact on total return. Thus, the selection of one class versus another in these circumstances should not materially affect the graphic illustration of a fund's total return volatility.

b. Table
The Commission proposes that the total return bar chart be accompanied by a table showing the fund's average annual total returns for the one, five and ten year periods ending on the date of the most recently completed fiscal year (or life of the fund, if shorter) and the returns of an "appropriate broad-based securities market index" for the same periods.30 A money market fund would have to provide its seven-day yield ending on the date of the most recently completed fiscal year and a toll-free or collect telephone number that investors can use to obtain the fund's current seven-day yield.

The Institute supports the proposed table subject to some minor modifications. First, the Commission should clarify that where funds choose to include one or more additional indexes in the table, they need not be the same as any additional index or indexes included in the line graph comparison required pursuant to Item 5(b)(1) of Form N-1A (the Management's Discussion of Fund Performance).31 Second, funds that have been in existence for more than ten years should have the option of adding a "life of fund" column to the table. Third, the Commission should revise proposed Item 2(c)(2)(iii) to require that funds provide the total return information specified in the table for calendar year, rather than fiscal year, periods. This change would make the information in the table consistent with that in the bar chart immediately preceding it and would minimize potential investor confusion. In addition, it would facilitate comparisons among different funds. The Commission also should clarify that, as in the case of the bar chart, a fund that does not have total returns for a full calendar year would not include the table.[32]

The Commission's proposal does not specifically address presentation of the table for multiple class funds. The Institute recommends that the table include total return information for all classes offered in the prospectus and, if different, the class reflected in the bar chart. For example, a fund that has two classes of shares, one that has been offered for at least ten years (Class A) and the other for one year (Class B), would include in the table in a prospectus offering Class B shares the 1-, 5- and 10-year performance of Class A and the 1-year performance of Class B. This approach will provide investors with the maximum amount of potentially relevant information and therefore is preferable to limiting the table to the class shown in the bar chart. Funds could disclose in the narrative explanation of the table which classes are included, and why.

The Institute opposes the proposed requirement to provide a money market fund's seven-day yield as of the most recent fiscal year end, as it will require funds to give stale information to investors. Disclosure of a toll-free or collect telephone number for obtaining the fund's current seven-day yield will provide investors with a convenient means of getting up-to-date information. We recommend that such disclosure appear on the back cover page of the prospectus and, more generally, that the Commission permit all funds to include a reference to fund performance information on the back cover page (rather than limiting the disclosure to money market funds).

C. Item 3 — Risk/Return Summary: Fee Table

The Commission proposes several changes to the fee table designed to improve the disclosure it contains. The Institute supports most of the proposed changes, including the proposed revisions to the required fee table "Example." In particular, the proposed narrative explanation of the Example should help investors understand the purpose of the information. It also is appropriate to increase the amount of the hypothetical initial investment used in the Example. Although the $10,000 amount the Commission proposes is higher than the typical initial investment for many fund groups, we understand the Commission's view that the current $1,000 figure is too low (and using a number between the two would unnecessarily complicate the Example).

Under the proposal, the fee table would contain a new line item under shareholder fees for shareholder account fees.[33] The Commission should clarify that this item is intended to reflect fees charged to shareholders for having a fund account. It should not include fees charged by third parties.[34]

The Commission also proposes to revise certain headings and captions in the fee table. For example, the shareholder transaction section of the fee table would be captioned "Shareholder Fees (fees paid directly from your account)." All of the captions under that heading also would refer to fees (e.g., "Maximum Sales Fee (Load) Imposed on Purchases," "Marketing (12b-1) Fees"). The Institute appreciates that the Commission is trying to make the table easier for investors to understand. We share this goal but suggest the use of slightly different terms that we believe would be more familiar to most investors.

Specifically, the shareholder transaction items required to be listed in the table should be referred to as "charges," rather than "fees." We note, for example, that "sales charge" is a term commonly used and understood by investors, whereas "sales fees" is not. Accordingly, the captions in the shareholder transaction portion of the fee table should refer to sales "charges" (e.g., "Maximum Sales Charge Imposed on Purchases,"35 "Redemption Charge,"36 "Exchange Charge," etc.).

Similarly, in the portion of the table that lists fund expenses, we recommend maintaining the current heading for 12b-1 fees (i.e., "12b-1 Fees"), rather than changing the heading to "Marketing (12b-1) Fees." In this regard, we note that not all 12b-1 fees are "marketing" fees. For example, some funds' 12b-1 fees (or a portion of those fees) are used to pay for services provided to maintain shareholder accounts. Thus, the proposed terminology would be inaccurate in many cases. Accordingly, we oppose the proposed change. In the event that the Commission feels compelled to make some change to the caption, however, we suggest that it read as follows: "Distribution [and/or Service] (12b-1) Fees."

D. Item 4 — Investment Objectives, Principal Strategies, and Related Risks

1. Principal Strategies

The Commission's proposal calls for a change in the way funds currently provide disclosure about their investments and risks. As stated in the Proposing Release, "[t]he Commission believes that prospectus disclosure would be more useful to investors if it emphasized the principal investment strategies of a fund and the principal risks of investing in the fund, rather than the characteristics of each type of instrument in which the fund may invest."37 We fully agree with this conclusion and strongly support the general approach to disclosure of fund investments and risks that the Commission proposes.

The Commission's proposal would, among other things, eliminate the current 5% percent standard for determining when a fund should include prospectus disclosure concerning a particular strategy (i.e., prospectus disclosure is not required where a practice would place no more than 5% of a fund's assets at risk). We support elimination of the 5% standard38 in favor of a requirement to disclose the principal strategies the fund will use in seeking to achieve its objectives, including the types of securities in which it principally will invest.39 This approach is consistent with the principle of shifting the focus of fund prospectus disclosure from individual investments (and their risks) to the portfolio as a whole.

Funds also would have to disclose in general terms how the investment adviser decides which securities to buy and which to sell. The Proposing Release states that "[t]his disclosure is intended to provide investors with general information about how the fund's portfolio will be managed."40 It is more likely to place undue emphasis on individual buy and sell decisions. Disclosure concerning how an adviser decides which securities to sell, in particular, likely would be meaningless boilerplate.

The Commission's intent appears to be to elicit disclosure about the adviser's investment philosophy. Because Instruction 1 to proposed Item 4(b)(1) defines "strategy" so broadly (i.e., "any policy, practice or technique used by the Fund to achieve the Fund's investment objectives"), the description of a fund's "principal strategies" should encompass such disclosure. Therefore, the Commission should delete proposed Item 4(b)(2).

2. Temporary Defensive Positions

The proposal would require a fund to disclose the percentage of its assets that may be committed to temporary defensive positions, any risks associated with these positions, and the likely effect of these positions on the fund’s performance. The Commission requested comments on these proposed requirements, "given the temporary nature of defensive positions and the proposed approach of focusing prospectus disclosure on a fund’s principal strategies."[41] A fund no longer would have to disclose the types of securities in which it may invest when taking a temporary defensive position.

The Institute supports elimination of the requirement to disclose the specific types of securities in which a fund may invest while taking a temporary defensive position.[42] This is consistent with the temporary nature of the positions and the proposed approach of focusing prospectus disclosure on a fund’s principal strategies.[43] The Institute opposes the proposed requirement to disclose the percentage of assets that a fund may devote to temporary defensive positions, however. To maintain maximum flexibility, most, if not all, funds would indicate that up to 100% of their assets may be committed to such positions. As a result, the disclosure would not be very meaningful.

We also oppose requiring disclosure of the likely effect of temporary defensive positions on a fund’s performance. Given the very nature of a fund’s use of a temporary defensive strategy, it would be impossible to predict the effect or to put this information in the proper perspective. The circumstances under which a fund might take a temporary defensive position could vary dramatically,[44] and those circumstances themselves might have a significant impact on the fund’s performance. Moreover, it would be important to consider, but impossible to determine in advance, how the fund would have performed under the particular circumstances if it had not taken a temporary defensive position. The proposed disclosure also could tend to overemphasize the significance of temporary defensive positions.

3. Portfolio Turnover

Under the proposal, a fund (other than a money market fund) that expects its portfolio turnover rate to equal or exceed 100% in the coming year would have to disclose its anticipated portfolio turnover rate and what that rate means. It also would have to explain the tax consequences of the fund’s portfolio turnover[45] and how trading costs associated with portfolio turnover may affect the fund’s performance. The Commission’s proposal appears intended to limit the required disclosure to funds that have "high" portfolio turnover. As a practical matter, however, because it can be very difficult to anticipate what a fund’s portfolio turnover rate will be in the future, [46] most funds may feel compelled to include the disclosure.

The Institute recommends an alternative approach to portfolio turnover disclosure that is more consistent with the main thrust of the Commission’s proposal. Specifically, portfolio turnover disclosure should be required — where appropriate — in the context of disclosure of a fund’s principal strategies (and/or the adviser’s investment philosophy). Thus, for example, where the fund’s principal strategies involve trading heavily (or, conversely, buying and holding), the fund would have to include disclosure to that effect pursuant to Item 4(b)(1).

4. Risk Disclosure

As discussed above, the Institute strongly supports the Commission’s proposed approach to risk disclosure, which would shift the focus of such disclosure from the risks associated with particular securities to the overall risks of the fund. In this regard, we note that the Commission has not proposed to require funds to use a specified numerical or quantitative risk measure. As the results of our Risk Disclosure Survey underscore, a quantitative risk measurement would not provide information that is understandable and meaningful to most investors, nor help them to evaluate a fund against their own risk sensitivities. Rather, such a measurement — especially one bearing the Commission's imprimatur — could mislead, confuse and ultimately harm investors. We continue to believe that there is no single, all-encompassing measure of risk — and were the Commission to require the use of some particular risk measure, investors would rely on it to their detriment.

E. Item 5 — Management's Discussion of Fund Performance

The Institute has no comments on this item at this time. As permitted under Item 5, many mutual funds provide the required disclosure in their annual reports. We encourage the Commission to turn its attention to improving other investment company disclosure documents, including shareholder reports, in the near future. The Institute may recommend changes to the MDFP in the context of a broad review of shareholder report disclosure.

F. Item 6 — Management, Organization, and Capital Structure

The Commission proposes to eliminate, or move to the SAI, certain disclosure items currently required in the prospectus concerning a fund's management, organization, and capital structure. These items address topics such as controlling persons, affiliated brokers, a fund's form of organization, shareholder voting rights and senior securities. These proposed changes will be very helpful to the Commission's goals of streamlining fund prospectuses and focusing prospectus disclosure on essential information, and we support them. Our comments on other prospectus disclosure related to fund management — specifically, the board of directors, the investment adviser, and pending legal proceedings — are set forth below.

1. Board of Directors

We support the Commission's proposal to move disclosure concerning the responsibilities of a fund's board of directors to the SAI. The general disclosure that fund prospectuses currently contain concerning directors' responsibilities is not likely to help an investor decide whether to invest in a particular fund. In response to the Commission's requests for specific comments, we do not believe that any information about a fund's directors is essential to assist investors in making investment decisions.

As discussed earlier in this letter, the Commission's proposal would require funds to provide on the back cover page a toll-free or collect telephone number for shareholder inquiries. This is an efficient and altogether appropriate way to field investors' questions and address their concerns. The Institute opposes any requirement to disclose in the prospectus an address, telephone number or other additional means specifically for contacting a fund's directors. Fund directors (and in particular, the independent directors) are charged with protecting the interests of shareholders as a whole — not responding to individual shareholder contacts. To be sure, independent directors should — and, in our experience, do — take steps to inform themselves about service problems and other views or concerns communicated by shareholders to the fund. In our judgment, however, separate disclosure inviting direct contact with the fund's directors is neither appropriate to their governance role, nor desirable insofar as it would have the effect of putting them "in the trenches" in responding to individual investors' inquiries or complaints.

We also oppose requiring disclosure of directors' compensation in the prospectus. Among other things, as the Proposing Release points out, such compensation constitutes an exceedingly small portion of total fund expenses.[47] As such, it would not be relevant to an investment decision.

2. Investment Adviser

Proposed Item 6(a)(1) would essentially retain existing prospectus disclosure requirements concerning a fund’s investment adviser.48 Among other things, it would require a description of the investment adviser’s compensation. The Proposing Release indicates that the revised form, like the current form, also would require prospectus disclosure of fees paid to any sub-adviser.49 It requests comments on whether a fund should be permitted to disclose only its aggregate investment advisory fee.

The Institute recommends that the Commission revise Item 6(a)(1) to eliminate the requirement to describe the adviser’s compensation. This information duplicates the information already provided in the fee table and, therefore, it is unnecessary. In addition, the Institute does not believe that disclosure of fees paid to individual sub-advisers should be required. Information about these fees does not assist investors in comparing different funds or making an investment decision with respect to a particular fund. The aggregate advisory fee, which is prominently disclosed in the fee table, is much more relevant.

3. Legal Proceedings

The Commission proposes to retain prospectus disclosure of material pending legal proceedings involving the fund, investment adviser or principal underwriter. Legal proceedings are considered "material" for this purpose "only to the extent that they are likely to have a material adverse effect on the Fund or the ability of the investment adviser or principal underwriter to perform its contract with the Fund."50 In addition to disclosure concerning court proceedings, proposed Item 6(a)(3) would require disclosure concerning "any proceedings instituted, or known to be contemplated, by a governmental authority." (Emphasis added.)

The Institute strongly opposes any requirement to disclose proceedings "known to be contemplated" by a governmental authority. Even if a registrant is aware that proceedings are "contemplated," it would be very difficult, if not impossible, to assess whether such proceedings would be "material," especially since they might not ever materialize.51 In any event, to the extent such proceedings do materialize and are "material," a fund would have to amend or sticker its prospectus to disclose them. Therefore, as is the case under Item 9 of the current form, the required disclosure should be limited to material legal proceedings that have been formally instituted and are currently pending.

G. Item 7 — Shareholder Information

Under the Commission’s proposal, prospectus disclosure about a fund’s purchase and redemption procedures and dividends and distributions would remain substantially the same. The Commission proposes revisions to the disclosure of the tax consequences of investing in a fund designed to focus the disclosure on essential information. The Institute generally supports the proposed changes. Among other things, they would eliminate from the prospectus legalistic disclosure (e.g., concerning Subchapter M of the Internal Revenue Code) that does not help investors select a particular fund.

The Institute opposes, however, the proposed requirement that funds disclose the date by which they will provide shareholders with specific information about the amount of ordinary income and capital gains distributed during the prior calendar year. IRS regulations require funds to send this information to shareholders by a particular date. This aspect of the proposal is inconsistent with the Commission's efforts to eliminate disclosure of legal requirements (see proposed General Instruction C(1)(a)(ii)), and to focus prospectus disclosure on information that will assist investors in making an investment decision.

The Institute recommends a new, optional approach to how the purchase, redemption and other information required by proposed Item 7 could be provided. Specifically, we suggest that the Commission permit funds to provide the required information in a separate document.52 This document, which would be delivered no later than with the confirmation to any investor that has not already received it, would serve as a kind of "owner's manual."53 Shareholders could refer to it for information that is more relevant after they have selected a particular fund. The Institute believes that the option to create a separate document for this purpose potentially would offer a more efficient means for funds to provide disclosure to investors that is common to several, if not all, funds within a fund group.

H. Item 8 — Distribution Arrangements

1. General Requirements

The proposed amendments seek to consolidate information about fund distribution arrangements in one place in the prospectus. Certain information currently required in fund prospectuses with respect to distribution arrangements would be deleted or moved to the SAI. The Institute supports the Commission's general approach, which would make it easier for investors to locate and understand prospectus disclosure concerning distribution arrangements. Consistent with our comments above concerning advisory fee disclosure, however, we suggest that the Commission modify proposed Item 8 to eliminate the requirement to disclose the amount of the fee payable under a fund's 12b-1 plan. As is the case with advisory fees, this information already is clearly presented in the fee table, and it is not necessary or particularly helpful to disclose the same information a second time later in the document.

Similarly, the Commission should delete proposed Item 8(b)(2), which calls for disclosure about service fees paid other than pursuant to a Rule 12b-1 plan. These fees will be reflected in the fee table (either as a separate line item or included under "Other Expenses").54 Separate disclosure describing these fees will not help investors make an investment decision.

In addition, the Commission should revise proposed Item 8 to take into account our recommendations concerning the appropriate nomenclature for sales charges and 12b-1 fees. It also should delete the requirement to disclose front-end sales loads as a percentage of the net amount invested.55 We do not believe this provides any additional useful information to investors.

2. Multiple Class and Master-Feeder Funds

The Commission's proposal would require additional information about multiple class and master-feeder funds (as applicable) to appear in the context of disclosure about a fund's distribution arrangements. This is a logical and appropriate location for such disclosure, and the Institute supports this approach. The Commission also proposes to eliminate the requirement that a feeder fund discuss the possibility and consequences of no longer investing in the master fund. We agree that this is a remote possibility that does not warrant prospectus disclosure.

The Commission could streamline the prospectus disclosure by multiple class and master-feeder funds still further by eliminating the requirements for disclosure about additional classes or feeders that are not offered in the same prospectus.56 We continue to believe that it is inappropriate for the Commission to require disclosure concerning securities that are not being offered.57

Similarly, the Commission should narrow the proposed cross-disclosure requirement for multiple class funds where the prospectus offers shares that provide for conversions or exchanges from one class to another.58 Full cross-disclosure should be required only where the conversion or exchange to another class is mandatory and/or automatic, rather than elective. The existence of an exchange privilege among different funds does not trigger a requirement for specific disclosure about funds that are not offered in the prospectus but into which investors may exchange. The same should be true where investors are permitted (but not required) to exchange among different fund classes.

I. Item 9 — Financial Highlights Information

The proposed amendments would make certain technical and conforming changes to the financial highlights information currently required in fund prospectuses, and would no longer require the information to appear in the front of the prospectus. The Commission requested comments, however, on how the financial highlights information could be improved, or whether it should be eliminated for some or all funds. The Institute recommends that the financial highlights requirement be deleted from the prospectus. The information would continue to be required in a fund's annual report. Accordingly, this change would not reduce the information provided to investors (except that the annual report contains the financial highlights information for five years, rather than ten years).

As the Proposing Release indicates, the proposed amendments would require a bar chart showing a fund's total returns over a ten-year period. This presentation will make the total return information much more accessible to most investors, and it is not necessary to repeat the information in a different format later in the prospectus. Much of the other information in the financial highlights table does not appear to be very useful to investors and, in any event, it would continue to be included in the fund's annual report.59

III. Proposed Amendments to Part B

The Proposing Release indicates that, after completing work on amendments to the prospectus, the Commission intends to review the SAI requirements and propose amendments to simplify and update SAI disclosure. We strongly support the Commission's continued attention to disclosure issues and will provide comprehensive comments on the SAI requirements at a later time.60 We do have one comment concerning the yield calculation for tax-exempt money market funds, as discussed below.

Although not discussed in the Proposing Release, the Commission's proposal would revise the tax-exempt money market fund yield calculation to require funds that advertise a "tax free" yield to reduce any taxable income by a percentage equal to the maximum rate for individual income taxation.61 This change would address the Commission's concern that prospective investors may be unaware that the yields of some tax-exempt money funds may include some taxable income.62

The Institute supports revising the formula to require that a tax-free yield be "tax-adjusted." We recommend, however, that instead of reducing taxable income by the maximum individual income tax rate, it be reduced by the income tax rate selected by the fund for calculating its tax equivalent and tax equivalent effective yields.63 Permitting funds to use the same tax rate for these different calculations (i.e., tax equivalent yield, tax equivalent effective yield and tax-free yield) would facilitate investor understanding. In contrast, providing investors with data calculated based on different rates would be confusing. Moreover, using the maximum income rate could cause funds' yields to be understated because many investors are not in the highest bracket. Finally, the selection of the maximum income rate appears to be arbitrary. The Commission's objective of enhancing the accuracy of the tax-free yield advertised by funds that have some taxable income or invest in taxable securities could be achieved just as well by allowing funds to select the rate.64

IV. Proposed Amendments to Part C

The Commission proposes several changes to Part C of Form N-1A to eliminate various unnecessary filing requirements. The Institute supports the elimination of these requirements, which do not appear to serve any important purpose but nonetheless impose administrative burdens on funds. In this same vein, we recommend that the Commission delete proposed Item 25 (Number of Holders of Securities) and proposed Item 27 (Business and Other Connections of the Investment Adviser)65 from the form. The Commission also should revise Item 23(e) ("Underwriting Contracts") to require that the form(s) of agreements between principal underwriters and dealers be filed as exhibits — consistent with current practice. Finally, we suggest that the Commission eliminate the Financial Data Schedule requirement in Part C, as the same Schedules are required to be filed as an exhibit to Form N-SAR.

The Commission proposes to amend the requirement that a newly organized fund provide an undertaking to file a post-effective amendment to its registration statement containing updated financial statements within four to six months of the effective date of the registration statement. Under the proposal, a fund would be permitted to file a post-effective amendment within four to six months from the date it commences operations. A fund would have up to eight months to file updated financial statements that are included in its semi-annual or annual report, if the post-effective amendment is filed within 30 days of the date of the latest balance sheet included in the semi-annual or annual report. The Commission requested comments, however, on whether the requirement to provide updated financial information should be retained.

The Institute recommends that the Commission eliminate the requirement that newly organized funds provide updated financial information. As indicated in the Proposing Release, such financial information often reflects a fund's operations for a very short period of time. As a result, it is of limited value to investors. At the same time, the requirement is expensive and burdensome for funds. If the Commission chooses to retain the requirement, however, we recommend that the proposed 30-day filing period be extended to 60 days (consistent with the 60-day period provided under Rule 30d-1 for transmitting reports to shareholders). We understand that it typically takes more than 30 days to complete an audit of the updated financial statements.

V. General Instructions

The Commission proposes to reorganize and simplify the General Instructions to Form N-1A. We support the proposed changes, which would make Form N-1A easier to use. We have several minor comments on the proposed revised instructions.

A. Instruction A — Definitions

Proposed General Instruction A would define certain terms used in Form N-1A to provide greater clarity and avoid repeated references throughout the form. This approach should prove helpful in making the form easier to use. We note that the Commission proposes to define the term "Fund" to mean the registrant or a series of the registrant. We suggest that the definition be expanded also to include a class of the registrant, or of a series of the registrant, because some prospectuses may offer one or more, but less than all, fund classes.

B. Instruction C — Preparation of the Registration Statement

Proposed Instruction C would provide guidance on how to prepare a registration statement, including continuing to emphasize the need to provide clear and concise prospectus disclosure. The specific guidance for responding to the items in Part A of Form N-1A includes an instruction to "[a]void detailed descriptions of practices that are required or otherwise affected by legal requirements." We suggest that the Commission further clarify the intent of this statement. For example, we note that almost all fund practices are "affected by legal requirements."66 It might be helpful to provide a specific example of the type of disclosure that should be avoided.

As proposed, Instruction C would provide flexibility to funds with respect to the presentation of information in a registration statement relating to more than one registrant, series or class. The Institute welcomes this approach, which provides opportunities for fund groups to be creative in designing effective disclosure presentations.

The Institute also supports the Commission's proposal to allow funds that are offered as investment alternatives in participant-directed defined contribution plans qualified under the Internal Revenue Code to modify their prospectuses in certain respects for use by plan participants. Consistent with our comments on the proposed fund profile rule, we recommend that the Commission extend this proposal to non-qualified participant-directed defined contribution plans.67

VI. Proposed Transition Period

The Proposing Release indicates that the Commission expects to provide for a transition period after the effective date of revised Form N-1A to give funds sufficient time to comply with the amendments. Specifically, a fund filing a new registration statement would have to comply with the revised requirements six months after the effective date of the amendments. A fund with an effective registration statement would have to comply at the time of its next annual update, but no later than sixteen months after the effective date of the amendments. The Commission requested comments on the proposed transition period.

The Commission recognizes that it is essential to provide a transition period for complying with the amendments. The transition period it has proposed, however, would be inadequate in some circumstances. For example, in the case of a fund with an effective registration statement, the fund might be filing its next annual update the day after (or within a few days, weeks or months after) the effective date of the amendments. This would make it impossible in some cases, and extremely difficult in many others, for funds to comply.

Compliance with the amendments will involve extensive changes to most fund prospectuses. The proposed changes cannot and should not be implemented mechanically. Rather, if the Commission's broad disclosure improvement objectives are to be achieved, the changes demand careful attention and creative energy, as well as painstaking drafting and several levels of review.68 For example, as discussed above, fund prospectuses currently tend to discuss the risks of individual portfolio securities in which a fund invests. Under the proposed amendments, risk disclosure would have to focus on the overall risks of the fund. Although the Institute supports this new approach to mutual fund narrative risk disclosure, it will pose challenges to those charged with its implementation.

For these reasons, we urge that the Commission revise the proposed transition period to provide that existing funds69 must comply with the revised form no later than 18 months after the effective date of the amendments.70 This period would give funds a minimum of five months to comply with the amendments,71 which we believe is the minimum necessary in light of their significance and wide-ranging impact.72

VII. The Disclosure Review Process

The amendments to Form N-1A hold the promise of significantly improving the quality of mutual fund prospectus disclosure. Discipline will be required of both the Commission and the industry, however, if this promise is to be realized fully. The amended form seeks to "focus prospectus disclosure on essential information about a fund that would assist an investor in deciding whether to invest in that fund."73 This in turn must serve as the touchstone for the staff's review and comment process. Staff comments that produce "disclosure creep" have frustrated the Commission's best intentions under existing Form N-1A requirements.74

Likewise, rigorous and sustained efforts will be required of funds themselves to craft documents fully in keeping with the Commission's disclosure objectives. The staff should use the comment process to actively promote the goals of the proposed amendments — for example, to focus narrative disclosure on a fund's principal strategies and on its overall portfolio risks, as the proposal envisions. The staff can and should comment constructively where prospectuses include disclosure that is clearly inconsistent with these goals.

Once the Commission adopts its amendments, extensive analysis should be undertaken prior to the adoption of any new disclosure requirements in Form N-1A. This analysis should focus on the utility of the information to investors in relation to the clear costs to investor understanding likely to be incurred in making disclosure ever more lengthy and complex. The Commission — and it alone — has responsibility for fund disclosure requirements as a system for optimally informing investors. The Commission cannot afford to indulge mere predilections for extra information of uncertain value, or simply respond to issues temporarily in vogue, by multiplying disclosure requirements. Such temptations are always at hand.75 They should be strongly resisted.

In addition, as noted above, the Institute has recommended that the amendments to Form N-1A and the Commission's proposed "plain English" requirements become effective as to mutual funds simultaneously. Upon adoption of the plain English requirements, the Commission and its staff should administer them with particular care and flexibility.76 In the context of a mutual fund prospectus, it may well be necessary, for example, to use technical terms in some instances in order to provide disclosure that is both precise and concise.

The Institute recognizes that the Commission staff has been highly responsive and supportive in connection with the efforts of individual fund groups to simplify their prospectuses to date. We are confident that this same spirit of cooperation — in pursuit of the common goal of more effective communication with investors — will continue as these important initiatives evolve into formal requirements that are implemented by our members.

* * *

The Institute deeply appreciates the opportunity to comment on the proposed amendments to Form N-1A and commends the Commission on these and other proposals to improve mutual fund disclosure. If you have questions about our comments or need additional information, please contact me at (202) 326-5810, Craig Tyle at (202) 326-5815 or Frances Stadler at (202) 326-5822.

Sincerely,

Paul Schott Stevens
Senior Vice President
General Counsel

cc: The Honorable Arthur Levitt, Chairman
The Honorable Steven M.H. Wallman, Commissioner
The Honorable Isaac C. Hunt, Jr., Commissioner
The Honorable Norman S. Johnson, Commissioner
Barry P. Barbash, Director, Division of Investment Management

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,456 open-end investment companies ("mutual funds"), 440 closed-end investment companies and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about $3,677 trillion, accounting for approximately 95% of total industry assets, and have over 59 million individual shareholders.

2 SEC Release No. IC-22528 (February 27, 1997) ("Proposing Release").

3 The Institute has consistently supported and actively participated in Commission initiatives to improve mutual fund disclosure. For example, to supplement its July 28, 1995 comment letter on the Commission's risk disclosure concept release, the Institute conducted empirical research concerning risk disclosure. See Investment Company Institute, Shareholder Assessment of Risk Disclosure Methods (Spring 1996) ("Risk Disclosure Survey"). Similarly, in connection with the profile prospectus pilot program, the Institute and several of its members undertook research to evaluate investor reactions to the profile prospectus and preferences concerning the format and content of mutual fund disclosure. See Investment Company Institute, The Profile Prospectus: An Assessment by Mutual Fund Shareholders (May 1996). See also Letter from Paul Schott Stevens, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (September 27, 1995) (supporting simplified prospectuses for money market funds); Letter from Paul Schott Stevens, Senior Vice President and General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (March 24, 1997) (supporting the objectives of the proposed "plain

English" disclosure requirements) ("Plain English Comment Letter"). Today, we are filing two separate comment letters that support, and make various recommendations concerning, the Commission's proposals related to fund profiles and fund names, respectively.

4 We also encourage the Commission to continue the momentum of its efforts to improve investment company disclosure by turning its attention, as soon as possible, to other investment company disclosure documents (e.g., shareholder reports, unit investment trust prospectuses, the statement of additional information, etc.).

5 Proposing Release at p. 80 (citation omitted).

6 The Plain English Comment Letter made this recommendation with respect to proposed Item 501(b)(5) of Regulation S-K, which contains a parallel legend requirement for corporate issuers.

7 In contrast, other legends (such as those applicable to bank-related funds) — although removed from the cover page — would be required in both the full prospectus and the profile.

8 Proposed Item 2(b)(2) would require disclosure in the risk/return summary concerning the availability of additional information about a fund's investments in its annual and semi-annual reports to shareholders. In connection with our above recommendation, we suggest that the Commission delete the last sentence of this item, as well as related Instructions 1 and 3. See also note 14, infra, and accompanying text. (Our letter on the Commission's fund profile proposal makes a different recommendation with respect to this requirement for profiles. See Letter from Paul Schott Stevens, Senior Vice President and General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (June 9, 1997) (regarding fund profiles)). The Commission should provide an exclusion from the requirement to disclose the availability of annual and semi-annual reports for new funds that do not yet have such reports.

9 In connection with these recommendations, we propose that Item 1(b)(2) be revised as follows: "A statement that the SAI and the Fund's annual and semi-annual reports to shareholders include additional information about the Fund and are available, without charge, upon request. Also explain how shareholder inquiries can be made. Provide a toll-free (or collect) telephone number to call to request the SAI, the Fund's annual and semi-annual reports, and (at the Fund's option, unless the Fund is a money market fund) fund performance information, and to make shareholder inquiries, and/or indicate (as appropriate) that investors can obtain this information by contacting their broker or financial adviser." Funds should have the flexibility to tailor the specific language to refer to other financial intermediaries through which their shares are available (e.g., banks).

10 The Proposing Release states that "[t]he name of the registrant may assist investors in obtaining additional information about a particular series or the registrant." We understand that it is necessary to know the registrant's name to search the Commission's EDGAR database. In our view, however, it would be both inadvisable and inappropriate to suggest that investors attempt to obtain information about a fund through EDGAR. Even assuming that an investor knows how to access EDGAR, the system's formatting problems make the documents it includes nearly incomprehensible. Under the proposal, the back cover page would contain information about the availability of additional information and how to make shareholder inquiries. This should adequately address the needs of investors that are

interested in additional information.

11 We note that this information would be included in the SAI.

12 If the Commission deems this information to be relevant to investors, we would not oppose requiring that it be provided in the SAI.

13 Funds that intend to disseminate their prospectuses electronically and that are electronic filers currently are required to disclose that the Commission’s web site contains additional information about registrants that file electronically. We understand that investors seeking such additional information have become confused and contacted fund groups to ask questions such as "What is a 497 filing?" Although providing investors easy access to additional, potentially relevant information is important, we believe that goal is better met through requiring funds to provide SAIs, shareholder reports or other information promptly upon request.

14 This standard also should apply in the case of requests for shareholder reports, the availability of which also would be disclosed on the back cover page if the Commission follows our recommendation earlier in this letter. In addition, the Commission should make clear that in appropriate cases, financial intermediaries could respond to these requests. (See note 9, supra.) The Commission could implement these recommendations by revising Instruction 2 to proposed Item 1(b)(2) to provide as follows: "When a request for the SAI or annual or semi-annual report is received, the Fund or, if applicable, the appropriate financial intermediary, should send the SAI, annual or semi-annual report reasonably promptly by first class mail or other means designed to ensure equally prompt delivery. For this purpose, "reasonably promptly" normally will be deemed to be within 3 business days of receipt of the request by the Fund or the financial intermediary."

15 In addition, we strongly support the Commission’s proposal to permit funds using a question-and-answer format to substitute substantially similar questions to those set forth in the form.

16 We recommend minor changes to the wording of this proposed requirement to clarify its scope. First, by describing a fund’s "principal risks" as "including" the specified items, the requirement as currently drafted is altogether open-ended. To address this concern, the Commission should delete the words "of investing in the Fund, including the risks." Second, the proposed requirement, read literally, appears to require disclosure of any circumstance that might adversely affect a fund’s net asset value, yield or total return, no matter how minor the impact might be. We suggest that it be modified to require disclosure only of circumstances reasonably likely to have a significant adverse effect on the fund’s net asset value, yield or total return. Otherwise, funds may feel compelled to include disclosure of unlikely circumstances or of circumstances that, if present, would have only a negligible effect on NAV, yield or total return. This result would frustrate the Commission’s goals of streamlining and simplifying fund prospectus disclosure. Similar changes should be made to proposed Item 4(c), which contains language almost identical to that cited above. (Item 4(c) includes the word "particular" before the word "portfolio." The Commission should conform the wording of the two items, or explain any distinction.)

17 Funds should be permitted to include a similar statement in connection with the narrative risk disclosure in the body of the prospectus (since the disclosure is supposed to focus on a fund’s "principal" risks).

18 Such a fund is required to disclose that it may invest a significant percentage of its assets in a single issuer and that investing in the fund may be riskier than investing in other types of money market funds. This disclosure is not required if the fund limits its investments in a single issuer to no more than 5% of the fund's assets.

19 Proposing Release at p. 24 (citation omitted).

20 See Letter from Paul Schott Stevens, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (May 6, 1994).

21 Proposed Instruction 1(a) to Item 2(c)(2)(ii) would require funds to provide annual returns "beginning with the latest calendar year . . . ." (Emphasis added.) We do not believe this is what the Commission intends (for example, it is inconsistent with the sample bar chart on p. 26 of the Proposing Release) and suggest that the instruction be revised to require the bar chart to begin with the earliest calendar year. We also suggest that the requirement in paragraph (2)(ii) of Item 2(c) that each return be presented in numerical form next to each bar be revised slightly to allow a fund to present that information in proximity to the bar. This change would allow funds to present the numerical returns on a level line, rather than on top of each bar, which may vary in height, as in the example in the Release.

22 Under the proposal, the bar chart and the table following it would have to appear under a subheading referring to risk and performance. The chart shows the variability of a fund's total returns, which, while important, is not the only relevant information about a fund's risks that would appear in the prospectus. The same is true in the case of the table that shows how the fund's one, five and ten-year average annual total returns compare with the performance of a broad-based securities market index. We are concerned that a subheading such as "Risk/Return Bar Chart and Table" would suggest, inaccurately, that the chart and table reflect all the relevant information about the risks of the fund. Based on this concern, and because there is no need for a subheading, the Commission should delete this proposed requirement. A narrative explanation of the bar chart and table still would be required.

23 Proposing Release at p. 28, n. 69.

24 Our recommendations also apply to master-feeder funds.

25 As an alternative, funds should be able to include the performance of the oldest class, adjusted, as appropriate, to reflect the sales charges, or fees and expenses, of a newer class offered in the prospectus. Funds that include such performance information in the bar chart also should do so in the table discussed below.

26 We propose an exception to the requirement to use the oldest class in the case of a multiple fund prospectus. In that situation, it would be confusing to have a bar chart that included different classes of different funds. Instead, funds should be able to choose a uniform class, so long as the choice is reasonable and it is the oldest class for at least one fund.

27 Proposing Release at p. 30.

28 In cases in which the class that is reflected in the bar chart is being offered in the prospectus, and other classes are also being offered in the same prospectus, funds should be required to disclose that these other classes have different expense arrangements.

29 Proposing Release at p. 29.

30 In response to the Commission’s specific request for comment, it would be inappropriate to require the annual returns of one or more indexes to appear in the bar chart instead of the table. This would unduly complicate the bar chart and diminish its effectiveness in showing the volatility of the fund’s total return.

31 Similarly, if the Management’s Discussion of Fund Performance includes one or more additional indexes, the table should not be required to include those, or any, additional indexes.

32 In connection with our recommendations concerning multiple class funds, the Commission should make clear that a multiple class fund would omit the bar chart and table only where no class has total returns for a full calendar year.

33 Proposed Instruction 2(d)(ii) to Item 3 indicates that all shareholders are deemed to pay an account fee "[u]nless any shareholder not wishing to use the services covered by the fee may avoid the fee and a significant number of shareholders do, in fact, avoid the fee." It is not clear what this Instruction contemplates. The Commission should clarify its intent — perhaps by providing an example.

34 The Proposing Release indicates in the context of discussing required disclosure related to distribution arrangements that the proposed amendments would no longer require disclosure of third party fees because these fees are not charged by the fund. In a footnote, however, the release states that "[i]n some cases, fees charged by a third party, in effect, represent fees of the fund (e.g., when the fees are charged to all shareholders to invest in the fund) and would be required to be disclosed in the prospectus." Proposing Release at p. 70, n. 218. The Institute believes this statement is inconsistent with the Commission’s decision, which we support, not to require disclosure of fees charged by third parties. The Commission should clarify that funds are not required to disclose third party fees under any circumstances, and that any responsibility to disclose such fees rests with the parties that charge them.

35 The proposed parenthetical reference ("(Load)") in the middle of the various sales charge captions is unnecessary for investor understanding of the information presented. It makes the captions appear unduly complicated and long. We recommend its deletion.

36 The Proposing Release states in n. 95 on p. 37 that funds would not be required to disclose wire redemption fees in the fee table, but rather could disclose them in a footnote to the fee table or with other disclosure about redemption procedures. We support this approach because such fees are not redemption fees. The Commission should specify in the instructions to the fee table that funds may omit wire redemption fees from the table.

37 Proposing Release at p. 39 (citation omitted). The examples set forth in n. 114 on p. 42 are very helpful, and the Commission should consider incorporating them into the Instructions to Item 4. We also recommend adding an example related to corporate bond funds, to make clear that the required disclosure for such funds generally should focus on credit quality and other distinguishing characteristics of bonds.

38 Other SEC staff pronouncements applicable to mutual funds have incorporated percentage standards that govern the type and amount of prospectus disclosure that is required with respect to particular types of investments. The Proposing Release indicates

on p. 83 that the Commission intends to issue an "Investment Company Registration Package" that would include updated and reorganized information gleaned from the Guides to Form N-1A, the staff's "Generic Comment Letters," and other Commission and staff interpretive positions. We respectfully request an opportunity to review and comment on the proposed Registration Package before it is issued in final form. In addition, we recommend that the Commission make clear that positions that are not included in the Registration Package are considered withdrawn.

39 The Proposing Release states in n. 109 on p. 41 that "[a] bond fund, for example, typically would discuss the maturities, durations, ratings, and issuers of the bonds in which the fund principally invests." The Commission should clarify that disclosure about bond issuers for this purpose would address the general types of issuers (e.g., corporate, government, etc.) and not individual companies. With this clarification, the guidance should be incorporated into the Instructions to Item 4.

40 Proposing Release at p. 42.

41 Proposing Release at p. 43 (citation omitted).

42 It may be appropriate for a fund to disclose, for example, that it may hold cash or cash equivalents in certain circumstances. Our comment letter on the Commission's proposal concerning investment company names makes additional recommendations related to temporary defensive positions. See Letter from Paul Schott Stevens, Senior Vice President and General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (June 9, 1997) (regarding proposed investment company name rule).

43 For the same reasons, funds should not be required to disclose the risks of such positions.

44 Such circumstances might include, for example, where a fund experiences unexpectedly high sales of its shares (generating a large influx of cash) or where the adviser anticipates a potential stock market correction.

45 The proposal seems to assume that "high" portfolio turnover necessarily has adverse tax consequences. This is not the case. For example, funds do not always, or only, sell their best-performing securities (i.e., those that will generate capital gains).

46 Historic portfolio turnover information is, and would continue to be, required in shareholder reports.

47 Proposing Release at pp. 52-53.

48 Fund prospectuses no longer would have to disclose the name and general business of a person that controls the investment adviser. We support this change.

49 Proposing Release at p. 51.

50 See proposed instruction to Item 6(a)(3). The Commission should make clear that funds may take indemnification into account when determining whether legal proceedings are "material."

51 For example, we are aware of one situation in which the Commission, over a four-year

period, was investigating certain activities of a fund’s investment adviser. Had the proposed disclosure requirement been in effect during this period, the fund may have been compelled at various points in time to make prospectus disclosure when it appeared that proceedings were "contemplated" as a result of the investigation, but at other times may have included no such disclosure when it seemed that no proceedings would result. Ultimately, the Commission did institute formal proceedings against the investment adviser, but they were not "material" for purposes of the proposed disclosure requirement.

52 We recommend that the Commission revise Item 7 to permit funds to meet the requirements of that item by incorporating by reference into the prospectus a separate document containing the required information that is delivered to all shareholders.

53 We suggest that, for purposes of filing Form N-1A, funds be permitted to incorporate by reference the "owner’s manual," if it already has been filed with the Commission.

54 Proposed Instruction 3(b) to Item 3 requires funds to disclose "the amount of any distribution or similar expenses deducted from the Fund’s assets other than pursuant to a 12b-1 plan under an appropriate caption or a subcaption of ‘Other Expenses’." Distribution expenses can only be deducted from a fund’s assets pursuant to a 12b-1 plan. The Commission should clarify the application of this instruction.

55 See proposed Item 8(a)(1).

56 See Proposed Item 8(c)(4).

57 See Letter from Paul Schott Stevens, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (February 22, 1994) (commenting on proposed Rule 18f-3). In that letter, the Institute recommended, in lieu of extensive cross-disclosures, that the Commission require a legend disclosing the existence of other classes or feeder funds that are offered as investment alternatives to those offered in the prospectus. Upon reconsideration, we no longer believe that any cross-disclosure is needed with respect to securities that are not being offered. Such cross-disclosure inappropriately imposes upon the marketplace the Commission’s views on which securities should be considered investment alternatives. Consistent with the Commission’s stated intention to "focus prospectus disclosure on essential information about a particular fund that would assist an investor in deciding whether to invest in that fund," funds should be permitted to limit prospectus disclosure to classes or feeders that are offered in that prospectus. We recognize that our recommendations concerning presentation of the bar chart and table for multiple class and master-feeder funds would, in certain cases, require information about classes or feeders not offered in the prospectus. In those cases, however, the information serves as a proxy for information about classes or feeders that are being offered. It is not provided for comparative purposes or to alert investors to the existence of possible investment alternatives.

58 See Proposed Item 8(c)(3).

59 If the Commission chooses to retain the financial highlights table in the prospectus, however, we urge it to make the following changes. First, the Commission should shorten the period covered from ten years to five years. This is the period covered in the annual report and there is no reason for a longer period in the prospectus. Second, the Commission should eliminate the requirement to disclose average commission rates. This disclosure is notoriously flawed; for example, it does not capture bid/ask spreads on over-the-counter

securities and bonds; it does not take into account that commissions generally are higher for foreign securities; and it is presented out of context and without explanation. As a result of these and other shortcomings, the experience of the Institute's members suggests that the information is of virtually no value to investors. Third, the total return information should be eliminated from the table. This duplicates information provided more effectively in the bar chart. Fourth, the Commission should delete the expense ratio from the table. Funds already disclose their expense ratio in the fee table. Fifth, the Commission should eliminate the income ratio disclosure requirement, because the information is similar to a fund's SEC yield, which investors can easily obtain in a more current form. Sixth, the Commission should delete the requirement to disclose a fund's net assets at the end of the period, because this duplicates information in the balance sheet in a fund's shareholder reports.

60 We suggest that the Commission consider, among other things, eliminating the requirement to disclose, as to any control person that is a company, the jurisdiction under the laws of which it is organized and all of its parents. (See proposed Item 14(a).) In addition, the Commission should consider deleting the dollar amount fee disclosure requirements (e.g., for advisory and 12b-1 fees) because the information is not meaningful to investors.

61 See Proposed Item 21(a), Instruction 4.

62 See Investment Company Act Release No. 21216 (July 19, 1995) (money market fund prospectus simplification proposal). We recommend that the Commission clarify that U.S. Treasury or U.S. Government funds that advertise their yield as exempt from state tax would not be subject to this requirement. Otherwise, they would have to calculate yield based on the tax rates in all 50 states, which is impracticable.

63 The Institute had recommended this approach previously in its comment letter on the money market fund prospectus simplification proposal. See Letter from Paul Schott Stevens, General Counsel, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (September 27, 1995).

64 Proposed paragraphs (a)(3) and (a)(4) of Item 21 set forth the calculations for a money market fund tax equivalent current yield and tax equivalent effective yield. In calculating those yields, funds have the discretion to select the rate they use, so long as it is disclosed.

65 We note that Item 6 of Schedule D of Form ADV requires similar disclosure. Even if the Commission is not inclined to delete proposed Item 27 in its entirety, it should narrow the scope of the item by limiting the disclosure required concerning officers of the adviser to executive officers (or those officers specified in Item 2(a) of Schedule A of Form ADV).

66 Proposed Instruction C(1)(a)(ii). It appears that the Commission is seeking to simplify and clarify a provision of existing Instruction G to the effect that "[d]escriptions of practices that are necessitated or otherwise affected by legal requirements should generally not include detailed discussions of such requirements." The wording of the proposed revised instruction, while shorter, remains somewhat awkward (e.g., "practices required . . . by legal requirements") and unclear.

67 We also suggest that the Commission clarify that funds could include plan-related purchase, tax or other information different from that required by proposed Items 7 and 8. See Letter from Paul Schott Stevens, Senior Vice President and General Counsel,

Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (June 9, 1997) (regarding fund profiles).

68 Moreover, in our Plain English Comment Letter, we recommended that if the Commission adopts the proposed plain English requirements, it is essential that they become effective as to mutual funds at the same time as amendments to Form N-1A and approval of fund profiles. Thus, at the same time that funds revise their prospectuses for purposes of complying with the N-1A amendments, they would be making any revisions necessitated by the plain English requirements. Such changes similarly could require a significant amount of work.

69 The Commission should clarify that a new series of an existing fund will be treated as "a fund with an effective registration statement" for purposes of the transition period.

70 We recommend that the Commission make the proposed amendments effective on the first day of the month following their adoption.

71 The Commission’s proposal appears to contemplate providing a transition period that would allow funds to file post-effective amendments complying with the revised form based on their regular filing schedule. We strongly support such an approach because it is cost-effective, particularly for funds that mail the prospectus with their annual report. Accordingly, our recommendation and the examples set forth below assume that funds would make post-effective filings to comply with the amendments on their normal cycle.

72 For example, assume that the effective date of the amendments is January 1, 1998. Under our proposal, the final compliance date would be July 1, 1999. To avoid having to file outside of its regular cycle, an existing fund with a March 31 fiscal year end would have to file a post-effective amendment complying with the new requirements by June 2, 1998 (approximately five months after the effective date) to have an effective registration statement on August 1, 1998. Similarly, an existing fund with a May 31 fiscal year end that wishes to mail its annual report with the prospectus would have to file a post-effective amendment by June 1, 1998 to have an effective registration statement on July 30, 1998 (the date by which the annual report must be mailed).

73 Proposing Release at p. 1.

74 We support the proposed disposition of the guides to Form N-1A and staff "generic comment letters," which also have been sources of "disclosure creep" in the past. As indicated above, we respectfully request an opportunity to review the Investment Company Registration Package before it is adopted in final form.

75 See, e.g., Roger Lowenstein, Fund Prospectuses: Let the Sunlight In, Wall St. J., May 29, 1997, at C1 (suggesting that fund portfolio managers be required to disclose the amount of shares they own of the funds they manage).

76 As we stated in the Plain English Comment Letter, the Commission should make clear, when it adopts the plain English requirements, that the staff will not function in the role of "grammatical police" (to use Chairman Levitt’s phrase). In this regard, we respectfully reiterate our concerns with the proposal to amend Rule 461 to permit the SEC to refuse to accelerate the effectiveness of a registration statement on the basis of whether the plain English requirements have been met.