The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

June 24, 2002

ICI Urges SEC to Improve Disclosure of Trading by Corporate Insiders, June 2002

June 24, 2002

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 5th Street,
Washington, D.C. 20549

Re: Form 8-K Disclosure of Certain Management Transactions (File No. S7-09-02)

Dear Mr. Katz:

The Investment Company Institute 1 appreciates the opportunity to comment on the Securities and Exchange Commission's proposal to amend Form 8-K under the Securities Exchange Act of 1934 to require information about certain insider trading activities. The proposal would add a new Item 10 to Form 8-K to require information about: (1) directors' and executive officers' transactions in company equity securities (including derivative securities transactions and transactions with the company); (2) directors' and executive officers' arrangements for the purchase or sale of company equity securities intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) under the Exchange Act; and (3) loans of money to directors and executive officers made or guaranteed by the company or an affiliate of the company. 2

The Institute strongly supports the Commission's proposal. Our members invest almost $4 trillion in U.S. equity securities on behalf of millions of individual shareholders. As significant participants in the securities markets, our members are keenly interested in having timely access to information about transactions in an issuer's securities by corporate insiders. Such information can be important for several reasons. First, it can provide useful insight on management's views of the company's performance and prospects. It also can provide an indication of the extent to which managements' interests are aligned with those of the company. Finally, information about loans of money made or guaranteed by the company to directors and executive officers provides important information to investors about the receipt of additional compensation to such persons that generally is not otherwise publicly available. For all of these reasons, information about insider transactions can be important in helping the marketplace to establish the appropriate value of publicly traded securities.

The Institute is not in a position to provide input on many of the items on which the Commission solicited comment. We do, however, have several specific comments on the proposal, which are discussed below.

A. Relationship of Reporting Requirements under Proposed Item 10 and Section 16(a)

The Commission's proposal would require a company to report on Form 8-K certain transactions by a director or executive officer. The Proposing Release adds that such transactions would be substantially similar, but not identical, to those transactions reportable under Section 16(a) of the Exchange Act. For those transactions that would be reportable under both Form 8-K and Section 16(a), however, the Proposing Release notes that satisfying the Form 8-K reporting requirement would not relieve an officer or director from having to report the same transaction under Section 16(a). 3 The Institute does not believe that it is necessary to require such duplicative filings and, more importantly, they could lead to confusion in the marketplace. Many investors, such as fund portfolio managers and analysts, follow a large number of companies. It would be inefficient and potentially confusing if they have to review information about insider transactions on Item 10 of Form 8-K and then review the same information on a Form 4, particularly since they would have no way of knowing that it was in fact the same information without undertaking a side-by-side comparison.

In the Proposing Release, the Commission requested comment regarding the feasibility of, among other things, permitting officers and directors to satisfy their Section 16(a) reporting obligations by attaching a Form 4 to the company's Form 8-K reporting the same transaction. The Institute supports such an approach as it would obviate the need for duplicative filings. Moreover, permitting an issuer to file one report instead of two would minimize the incidence of mistakes that could occur in recording duplicate transactions on different forms, and would enhance the reliability and integrity of the information reported. Finally, we note that this approach would be consistent with the Commission's current approach under Section 16(a) and Form 8-K. 4

On a related matter, we note that the Commission's proposal would require each director and executive officer to report on the adoption, modification, or termination of any contract, instruction, or written plan for the purchase or sale of company equity securities intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c). We note that when such purchases or sales are made pursuant to a Rule 10b5-1 plan, details of the transaction would be reportable under Section 16(a). To minimize any investor confusion between the reports submitted for Section 16(a) and Item 10 purposes, we recommend that reports filed under Section 16(a) relating to transactions made pursuant to a Rule 10b5-1 plan be appropriately identified to enable investors to understand the nature of the transaction.

B. Electronic Filing

We are pleased that the new disclosure required under the Commission's proposal would be reported on Form 8-K, and therefore, filed electronically with the Commission. Requiring electronic filing of information related to insiders' transactions in corporate equity securities would benefit investors by accelerating the flow of transaction information into the marketplace. 5 For the same reason, we would support Commission initiatives that would

encourage companies to post Item 10 information on their web sites.

C. Derivative Securities Transactions

The Commission's proposal would require directors and executive officers to report transactions in company derivative securities. The Institute supports such a requirement. Mandating disclosure of derivative securities transactions, particularly those that are used for hedging purposes, would provide important information to the marketplace. Just like direct purchases and sales, disclosure of these types of transactions can help shed light on management's view on the company's prospects. There is one aspect of the Commission's proposal, however, that we believe needs minor modification.

The Proposing Release makes clear that "reportable derivative securities also would include security-based swap agreements." 6 The proposed text of the rule, however, is not clear on this point. In particular, Instruction 1 to Item 10 proposes to define "derivative security" as that term is defined in Exchange Act Rule 16a-1(c). Rule 16a-1(c), however, makes no specific mention of security-based swap agreements. In order to minimize any confusion, we recommend that the Commission amend its rules under Section 16 to reflect security-based swap agreements. Moreover, to facilitate uniform compliance with the proposed Item 10 reporting requirements, we recommend that the Commission define reportable transactions for Item 10 purposes by reference both to Section 16 (which includes security-based swap agreements) and the rules thereunder (which define derivative securities in Rule 16a-1(c)).

D. Other Items

1. Persons Subject to Item 10 Reporting; Holdings Information

The Commission's proposed Item 10 reporting requirements would apply to directors and executive officers. The Commission requests comment on whether to extend the reporting requirements to principal financial officers and principal accounting officers that are not identified as "executive officers" in their respective companies. 7 We believe that it would be appropriate to extend the reporting requirements to these individuals. Because of their position, principal financial officers and principal accounting officers are typically privy to key corporate information that is not always available to the public on a timely basis. To the extent these persons engage in transactions involving their company's equity securities, they should be required to disclose that information, and to do so in a timely manner. To exclude these officers from the proposed Item 10 reporting requirements merely because they lack the "executive" title would seem to exalt form over substance.

To implement this change, we recommend that the Commission amend proposed Item 10 to use the term "officer" as defined in Exchange Act Rule 16a-1(f). Not only would the term "officer" cover an issuer's principal financial officer and principal accounting officer, it would also facilitate greater harmonization with the reporting requirements under Section 16. 8

The Commission also requests comment on whether it should require directors and executive officers to disclose information regarding their holdings in the company in addition to the transactional information proposed under Item 10. We believe it would be appropriate to require disclosure of this information. In our view, having information on a director or executive officer's holdings would enable an investor to place the transaction giving rise to the Form 8-K filing in the proper context. While holdings information is already

available in the proxy statement, requiring updated holdings information in the Form 8-K would obviate the need to reconcile current activity with prior holdings in order to arrive at an updated holding amount.

2. Sample Item 10 Disclosure

The Proposing Release provides a table containing sample Item 10 disclosure that is designed to facilitate compliance with the proposed Form 8-K amendments. The Institute supports the proposed tabular format for this disclosure. Such a straightforward presentation of this information will greatly assist investors, especially those, such as fund managers and analysts, who follow a large number of issuers. It would also be helpful to investors if the Commission in its adopting release could encourage issuers to provide a comprehensive and “plain English” description of the transactions required by Item 10. Providing a comprehensive, “plain English” description of a complex derivative securities transaction, for example, would greatly facilitate investor understanding of the transaction reported.

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The Institute appreciates the opportunity to express its views on the Commission’s proposal. If you have any questions, or would like additional information, please contact the undersigned at (202) 326-5815.

Sincerely,

Craig S. Tyle
General Counsel

cc: Alan L. Beller, Director
Division of Corporation Finance

Paul F. Roye, Director
Division of Investment Management

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes8,984 open-end investment companies ("mutual funds"), 504 closed-end investment companies, and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.925trillion, accounting for approximately 95% of total industry assets, and over 88.6 million individual shareholders.

2 SEC Release No. 33-8090; 34-45742 (April 12, 2002); 67 Fed. Reg. 19913 (April 23, 2002) (the “Proposing Release”).

3 The periodic filing requirements under Section 16(a) include reporting on Form 4 (quarterly) and Form 5 (annually) of statements of changes in beneficial ownership by directors, officers and principal stockholders. See Exchange Act Rule 16a-3. The Commission’s proposal, however, would not require Item 10 reporting by principal stockholders.

4 Exchange Act Rule 16a-3(f)(2) states that no Form 5 is required if all the transactions that are otherwise required to be filed on the form were previously reported. Similarly, Exchange Act Rule 13a-11(a) mandates current reporting on Form 8-K, unless substantially the same

information as that required by the form had been previously reported.

5 On a related matter, we note that the Commission has stated that it intends to engage in a future rulemaking to mandate electronic filings of Section 16(a) reports, which currently are not subject to an electronic filing requirement. Proposing Release at n. 23. The Institute would support such an initiative. Requiring electronic delivery of Section 16(a) reports would benefit investors as it would enable the receipt of important information free of charge and on a more timely basis than is presently the case.

6 Id. at 19920.

7 On a related matter, the Commission has solicited comment on whether to extent the Item 10 reporting requirements to more than ten percent beneficial owners. Proposing Release at 19916. We do not believe that it would be appropriate to extend these reporting requirements to these persons. In many instances, such persons (including investment companies) may be passive investors who hold securities for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business. These investors generally do not have access to the same internally generated information that would be available to the issuer's directors and officers. Therefore, information about a ten percent beneficial owner's transactions in an issuer's securities would not generally provide the marketplace with relevant information for setting the price of the issuer's securities. Moreover, as noted in the Proposing Release, ten percent beneficial owners may not be subject to the same fiduciary duties to the company as directors and executive officers, and do not receive compensation from the company. Proposing Release at 19916.

8 We note that in all other respects, the definitions of "officer" in Rule 16a-1(f) and of "executive officer" in Rule 3b-7 are substantially identical.
