UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 3, 1995

Dear Registrant:

The Division of Investment Management (the "Division") has prepared this letter to assist investment company registrants in preparing disclosure filings in 1995. These comments represent the views of the staff of the Division and are not necessarily those of the Securities and Exchange Commission (the "Commission") and should not be considered of precedential value in any court or other official forum. The comments in this letter apply to filings made on Forms N-1A, N-2, N-14 and S-6, unless otherwise indicated.

This letter covers disclosure and procedural developments since February 25, 1994 when the staff issued its last "generic comment letter." Accounting-related matters of interest to registrants and their independent public accountants can be found in the accompanying letter from Lawrence A. Friend, Chief Accountant of the Division, that supplements his letter dated November 1, 1994 addressed to chief financial officers . General guidance for variable annuity, variable life, and other insurance company investment contract registrants can be found in a letter dated October 21, 1994 from Brenda D. Sneed, Assistant Director, Office of Insurance Products.

I. FILING PROCEDURES

A. Post-Effective Amendments Under Rules 485 and 486

The Commission adopted amendments to Rule 485 under the Securities Act of 1933 (the "1933 Act") to revise the procedures by which open-end investment companies ("mutual funds") file post-effective amendments to registration statements. These amendments became effective on October 11, 1994. *See* Investment Company Act Release No. 20486 (August 17, 1994).

The amendments to Rule 485:

(1) permit mutual funds to file post-effective amendments under paragraph (b) of Rule 485 ("B-Amendments") for certain purposes not previously covered by the Rule. These purposes include, among others, delaying the effective date of a previously filed post-effective amendment, updating a fund's discussion of its performance, revising disclosure regarding a mutual fund's portfolio manager and adding interim financial statements;

(2) give the Division delegated authority to suspend the ability of a mutual fund to file B-Amendments for a specified time if the fund has filed a B-Amendment under circumstances in which paragraph (b) is not available;

(3) permit B-Amendments to become effective up to 30 days after filing;

(4) enable the Division to permit certain types of post-effective amendments not otherwise eligible to be filed under Rule 485(b) to become effective immediately upon filing.

See new subparagraph (b)(1)(ix) of Rule 485. Acting under this authority, the staff of the Division has permitted the automatic effectiveness of a post-effective amendment to a registration statement filed by one fund in a fund complex when the amendment reflects substantially identical revisions to those contained in a post-effective amendment of another fund in the complex previously reviewed. Requests pursuant to this new provision should be addressed in writing to the Assistant Director, Office of Disclosure and Review. Insurance company investment contract registrants should send their requests to the Assistant Director, Office of Insurance Products; and

(5) provide that amendments filed under paragraph (a) ("A-Amendments") adding new series will not become effective until 75 days after filing. A mutual fund may designate a longer period - up to 95 days - before the A-Amendment becomes effective.

The Commission has also adopted new Rule 486. This new rule permits closed-end management investment companies and business development companies that periodically repurchase their shares in accordance with Rule 23c-3 under the Investment Company Act of 1940 (the "1940 Act") to file certain post-effective amendments and registration statements that become effective automatically.

B. Amendments to Proxy Rules

The Commission has revised the proxy rules applicable to investment companies ("funds") under the 1940 Act and the Securities Exchange Act of 1934 (the "1934 Act"). *See* Investment Company Act Release No. 20614 (October 13, 1994). The revised rules were effective on November 23, 1994 and apply to all proxy statements filed on or after January 23, 1995. Significant changes reflected in the new rules include:

- **Reorganization of Rules**: The revised proxy rules consolidate the fund-specific disclosure requirements of the Commission's proxy rules into a new Item 22 in Schedule 14A under the 1934 Act, which sets forth general proxy statement requirements. The other items in Schedule 14A, unless they specifically state otherwise, continue to apply to funds.

- **Summary Table**: When a proxy statement solicits votes on different proposals from shareholders of more than one fund, a portfolio of a series fund, or a class of a multiple class fund, the new rules require a table at the beginning of the proxy statement that summarizes each proposal and indicates which shareholders are being requested to approve each proposal.

- **Fee Table**: The new rules require a fee table in proxy statements that contain proposals that would result, directly or indirectly, in increased fees or expenses. The fee table must compare the proposed fees and expenses to those currently in effect.

- **Election of Directors**: The revised rules continue to require basic information concerning directors and nominees, such as business background and relationships with certain affiliates of the fund. This information is now required for the past five years. Proxy requirements for the election of directors no longer include detailed information about the fund's investment advisor (including the investment advisor's balance sheet), the advisory agreement, or the fund's brokerage arrangements.

- **Management Compensation**: The amended rules require a table setting forth the amount of compensation a director received, pension or retirement benefits accrued by the fund for each director, and estimated annual retirement benefits for each director. The compensation table also must disclose the aggregate remuneration received by a director from all funds in the

same fund complex. "Fund complex" is defined broadly for these purposes as two or more funds that hold themselves out to investors as related companies or that have a common investment advisor.

For disclosure in a proxy statement of compensation of directors serving on more than one board of directors of funds in a fund complex with different fiscal years, the staff has stated that it would not object if:

(1) disclosure of compensation from each fund (columns (1)-(4) of the compensation table) is for the most recently completed fiscal year of that fund or, where compensation can be reasonably estimated or is a presently quantifiable amount, for a fiscal year that will be completed within two months of the date of filing of the proxy statement; and

(2) disclosure of aggregate compensation from the fund complex (column (5) of the compensation table) is for the most recently completed calendar year or, where compensation can be reasonably estimated or is a presently quantifiable amount, for a calendar year that will be completed within two months of the date of filing of the proxy statement.

To make the disclosure of compensation uniform, the new rules also amended fund registration statement forms to require the same compensation table as in Item 22. This information should be reflected in the first post-effective amendment filed on or after January 23, 1995 and may be filed under Rule 485(b) if it is otherwise eligible for such a filing. New registration statements should include the table with amounts estimated for the first fiscal year, but using actual fund complex information if it is available.

- **Investment Advisory Contract and Distribution Plans**: The amended rules retain most of the disclosure requirements concerning shareholder approval of investment advisory contracts and impose similar requirements for distribution plans. The rules, however, no longer require the inclusion of an investment advisor's balance sheet or extensive discussion of brokerage arrangements. There is a new requirement for a discussion of the material factors considered by the board of directors in recommending the advisory contract for shareholder approval, including a discussion of soft dollar arrangements that benefit the investment advisor.

- **Annual Reports**: In connection with the proxy rules revisions, the Commission eliminated for funds the requirement in Rule 14a-3(b) under the 1934 Act that an annual report accompany or precede a proxy statement. Item 22 requires that the proxy statement state that the fund's most recent annual and semi-annual report are available upon request.

C. Registration of Additional Shares Pursuant to Rule 24e-2

Section 24(e)(1) of the 1940 Act provides that registration statements under the 1933 Act relating to certain investment companies may be amended after their effective dates to increase the amount of securities proposed to be offered. Section 24(e)(1) further provides that a filing fee, calculated in the manner specified in Section 6(b) of the 1933 Act, be paid at the time of filing of the amendment. Pursuant to Rule 24e-2 under the 1940 Act, mutual funds and unit investment trusts registering additional securities pursuant to Section 24(e)(1) may, in calculating the filing fee, make an adjustment for the amount of securities of the same class redeemed or repurchased by the issuer in its previous fiscal year.

Registrants are reminded that Rule 24e-2 permits the preservation of net redemption credits *only* if a post-effective amendment containing the information required by Rule 24e-

2(b) is filed in the year immediately following the fiscal year in which the net redemptions occur.

D. EDGAR Implementation

Mandated electronic filing on the Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") System began for some investment company registrants on April 26, 1993. *See Rulemaking for EDGAR System -- Investment Companies and Institutional Investment Managers*, Investment Company Act Release No. 19284 [58 FR 14848 (Mar. 18, 1993)]. On December 19, 1994, the Commission made final the EDGAR interim rules and adopted minor and technical amendments to those rules. *See Rulemaking for EDGAR System*, Investment Company Act Release No. IC-20783 ("Release No. 20783") [59 FR 67752 (Dec. 30, 1994)]. Release No. 20783 also contains the phase-in schedule and phase-in list establishing the timetables by which investment company registrants who are not already electronic filers will become subject to mandated electronic filing. Phase-in will recommence on January 30, 1995. Investment company registrants assigned to the remaining phase-in groups will be phased in as set forth below:

IM-03 January 30, 1995
IM-04 March 6, 1995
IM-05 May 1, 1995
IM-06 November 6, 1995

To ascertain the phase-in group to which an investment company registrant is assigned, the registrant should consult the Investment Management Phase-In List published as Appendix C to Release No. 20783 and the phase-in and electronic filing rules found in Regulation S-T (17 CFR Part 232).

A registrant making filings on EDGAR must furnish the Commission a paper copy of its first electronic filing made after its phase-in date. The paper copy may be either a traditional paper copy or a computer print-out of the EDGAR filing (with the confidential information in the header blanked out or omitted). The paper copy must include the legend required by Rule 902(g) of Regulation S-T and should be mailed to OFIS Filer Support, SEC Operations Center, 6432 General Green Way, Alexandria, Virginia 22312-2413, and be received no later than six business days after the electronic filing.

Registrants are also reminded that all correspondence (including cover letters and requests for acceleration) related to electronic filings must also be submitted electronically. *See* Rule 101(a) of Regulation S-T. Electronically submitted cover letters should include the information requested in Comment I.A of the February 22, 1993, and Comment I.D of the February 25, 1994, generic comment letters.

Investment company registrants are required to furnish a Financial Data Schedule as an exhibit to certain filings that are submitted electronically, namely registration statements on Forms S-6, N-1, N-1A, N-2, N-3, N-4, and N-5; Form N-SAR; and certain proxy materials (as specified in Item 22(a)(4) of Schedule 14A). However, there are circumstances under which this requirement would not be applicable. For example, an initial filing of Form S-6 typically does not include financial statements; they are furnished in pre-effective amendments. Therefore, the instructions to Form S-6 provide that a Financial Data Schedule is required when any amendment to that form is filed electronically. In addition, the staff has taken the position that a Financial Data Schedule need not be submitted with the filing of a registration statement or amendment on Forms S-6, N-1, N-1A, N-2, N-3, N-4, or N-5 containing no financial

information or containing only information concerning initial capitalization. Of course, a registration statement containing financial information incorporated by reference from another source, such as the annual report to shareholders, would require as an exhibit a Financial Data Schedule. For the specific requirements for Financial Data Schedules, see Rule 483(e) of Regulation C.

Questions regarding the EDGAR phase-in may be directed to Anthony A. Vertuno, Division of Investment Management, at 202-942-0591. Questions regarding the EDGAR rules may be directed to Ruth Armfield Sanders, Division of Investment Management, at 202-942-0633, or to Mr. Vertuno.

E. Filings Under Rule 497

Registrants are reminded that they may not materially alter the nature of the fund contemplated in the last pre-effective amendment by merely filing a Rule 497(b) or (c) prospectus that makes those material changes. For example, if a new fund designed to invest primarily in domestic equity securities, after the effective date of its registration statement but before the commencement of its public offering, changes its investment objective and policies so that it becomes an emerging markets fund, a post-effective amendment filed under Rule 485(a), rather than a Rule 497 prospectus, should be the vehicle for reflecting the change.

II. DISCLOSURE COMMENTS

A. Disclosure Regarding Management's Discussion of Fund Performance

Registrants including their Management's Discussion of Fund Performance in the annual report are reminded that Item 32(c) of Form N-1A requires an undertaking to furnish to each person to whom a prospectus is delivered, upon request and without charge, a copy of the registrant's latest annual report to shareholders. In addition, Item 3 (Condensed Financial Information) of Form N-1A requires the prospectus to disclose that further information about the registrant's performance is contained in the annual report, which may be obtained without charge.

B. Fund Names and Guide 1

Guide 1 to Form N-1A provides, in pertinent part, that if a registrant's name suggests that it will invest primarily in a particular type of security, industry or industries, the registrant should have an investment policy that requires, under normal circumstances, at least 65 percent of the value of its total assets will be invested in the indicated type of security or industry.

Frequently, fund names have suggested that *all*, or *substantially all*, of a particular fund's assets will be invested in a certain type of security, industry, country, or geographic region. In such cases, the staff believes that the fund's investment policy should conform with the higher threshold implied by its name.

C. Updated Risk Disclosure

A fund's prospectus disclosure must adequately inform investors as to the risk factors peculiar to the fund (*e.g.*, investment strategies, assumptions, practices or techniques) or its portfolio of securities. *See*, for example, Item 4 of Form N-1A and Guide 21 thereto and Item 8 of Form N-2. Over time, with changes in the marketplace or in the fund's portfolio or

investment strategy or practices, the significance of some risk factors may change, or new ones may be introduced. Registrants cannot rely on the Commission to identify these changing areas of risk significance and new areas of risk disclosure. Registrants are reminded that they have a duty, on an ongoing basis, to analyze fund risk and review prospectus risk disclosure, and to update prospectus disclosure when appropriate.

III. Recent Staff Positions

A. Shareholder Approval of New Funds' Assigned Advisory Contracts Following Acquisition of Advisor

In a letter to the Investment Company Institute (pub. avail. Nov. 6, 1992), the staff stated that a fund no longer would be asked to undertake, in its initial registration statement, to hold a shareholders' meeting to approve, among other things, the fund's investment advisory contract. The staff recently considered shareholder approval in the context of a fund whose advisor was acquired by another entity shortly after the commencement of the fund's public offering of its securities. In that case, the staff said that it would not object if the fund's contract with the advisor was not re-approved by the fund's shareholders after the acquisition. The facts that the staff found persuasive were: (1) the advisor was acquired shortly (*e.g.*, less than six weeks) after the fund began offering its shares to the public; (2) the initial shareholder of the fund had approved the pre-acquisition contract and also would approve the post-acquisition advisory contract; (3) the post-acquisition advisory contract would contain the same material terms as the pre-acquisition contract; (4) the persons who significantly contribute to the investment advice relied on to manage the fund's portfolio were expected to remain the same; and (5) the fund would disclose the impending acquisition and assignment to shareholders through prospectus disclosure.

B. Advertising Past Performance Following a Reorganization

In *North American Security Trust* (pub. avail. August 5, 1994) the staff stated that it would not recommend enforcement action under Rule 482 under the 1933 Act or Rule 34b-1 under the 1940 Act if a fund formed as a result of merging three other funds advertised its historical performance using, for periods prior to the reorganization, the performance data of the predecessor fund that it most closely resembled. The staff said that, in determining whether any predecessor fund resembles a new or surviving fund closely enough to justify the use of the predecessor fund's performance, the factors to be considered are the funds': (i) investment advisors; (ii) investment objectives, policies, and restrictions; (iii) expense structures and expense ratios; (iv) asset sizes; and (v) portfolio compositions. The staff believes that the survivor of a business combination for accounting purposes (*i.e.*, the fund whose financial statements are carried forward), typically will be the fund whose historical performance may be used by a new or surviving fund. While this letter involved mutual funds, the same rationale would apply to a merger of closed-end funds.

C. Diversification Issues: Privately Issued Asset-Backed and Mortgage-Backed Securities

In *Hyperion Capital Management, Inc.* (pub. avail. August 1, 1994) the staff granted no-action assurance if, for the purposes of determining compliance with Section 5(b)(1) of the 1940 Act, a fund treats each underlying pool of assets backing certain privately issued mortgage-backed and asset-backed securities, rather than the sponsor or depositor of the pool, as a

separate issuer provided that (1) in the event of the sponsor's bankruptcy, the sponsor's creditors would have no recourse against the pool, and (2) the holder of the asset-backed or mortgage-backed security would look to the pool for payment.

In *J.P. Morgan Structured Obligations Corp.* (pub. avail. July 27, 1994) the staff declined to grant no-action assurance if a fund treated certain notes as instruments issued or guaranteed by the U.S. Government or an agency thereof ("Government Securities") for purposes of paragraph (d)(1) of Rule 2a-7 under the 1940 Act. Although the trust issuing the notes would hold Government Securities, the trust also proposed to enter into an interest rate and/or currency exchange agreement ("Swap Agreement") that the staff concluded would materially alter the trust's credit risk. The staff's conclusion was based on two factors. First, under the Swap Agreement purchasers of the notes were required to look to the obligation of the swap counterparty to make scheduled payments and to pledge additional collateral. Second, although the notes were to be collateralized fully, if swap counterparty insolvency occurred, the anticipated Federal Deposit Insurance Corporation treatment would not mitigate the risks as to treat the notes as equivalent to Government Securities.

D. Rule 12b-1 Carry-Forwards

Under the NASD's Rules of Fair Practice, mutual funds calculate a "remaining amount", *i.e.*, the appropriate maximum aggregate sales charge minus the amount of sales charges paid or accrued, including asset-based sales charges, front-end and deferred sales charges, plus the permitted interest. *See* NASD Notice to Members 93-12, *Questions and Answers About New NASD Rules Governing Investment Company Sales Charges - Article III, Sections 26(b) and (d) of the Rules of Fair Practice* (February 1993). The staff will not raise objections under Section 17(d) of the 1940 Act or the rules thereunder if a Rule 12b-1 plan allows for the transfer of a portion of a mutual fund's "remaining amount" in the event of an exchange between series of the same mutual fund or between affiliated mutual funds (or a combination thereof), under the following conditions: (1) the arrangement is conducted in accordance with Section 26(d)(2)(D) of the NASD's Rules of Fair Practice, as described more fully in NASD Notice to Members 93-12; and (2) the carry-forward arrangement is implemented in accordance with Rule 12b-1 requirements. Specifically, Section 26(d)(2)(D) permits mutual funds to increase their "remaining amount" by treating the shares received through an exchange as new gross sales, provided the amount of the increase is deducted from the "remaining amount" of the mutual fund out of which the shares are exchanged.

F. Money Market Funds

The Commission and the Division have provided guidance concerning certain floating rate and other securities that are inappropriate for money market funds. *See* Investment Company Act Release No. 19959 (Dec. 17, 1993) and the letter dated June 30, 1994 from Barry Barbash, Director of the Division, to the Investment Company Institute.

The June 30, 1994 letter also states that, although acquisition of a particular security may not be expressly prohibited by Rule 2a-7 under the 1940 Act, this does not mean that the security is necessarily an appropriate investment for a money market fund. An advisor must determine not only that holding the security is not expressly prohibited by the Rule, but also that the security meets the general rule applicable to *all* investments by a money market fund: that investment in the security is consistent with maintaining a stable net asset value per share.

G. Bundling of Proxy Proposals

Issues have been raised recently with the staff about whether proposals presented for shareholder approvals may be "bundled", *i.e.*, submitted and voted upon together in fund proxies. In accordance with Rule 14a-4 under the 1934 Act, a matter should be voted upon separately if the 1940 Act, state law, or a fund's organizational documents (charter, by-laws) *require* a matter under consideration to be submitted to shareholders.

The staff has not objected to "bundling" proxy proposals in the following circumstances:

a. *Ministerial proposals.* Proposals involving editorial or non-substantive changes to fund documents.

b. *Inextricably Intertwined Proposals.* The staff has not required separate proposals if the proposals would be impractical to separate.

c. *Merger Proposals.* A vote to merge with another fund may carry with it approval of new advisory contracts, Rule 12b-1 plans, and other matters necessary to implement the merger.

* * *

The staff continues to strongly encourage registrants to take the initiative to review, simplify and improve fund prospectuses. *See* Comment II.A in the February 25, 1994 generic comment letter describing the staff's expedited review procedures for prospectuses in this regard.

We hope that this letter will assist you in preparing filings in 1995. Of course, it is not intended to replace the disclosure comment process. You should direct any questions about specific company filings to the staff member responsible for reviewing that company's documents.

Sincerely,

Carolyn B. Lewis

Carolyn B. Lewis
Assistant Director