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Part IV

Securities and Exchange Commission

**17 CFR Parts 239 and 274
Disclosure Regarding Market Timing and
Selective Disclosure of Portfolio Holdings;
Final Rule**

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239 and 274

[Release Nos. 33-8408; IC-26418; File No. S7-26-03]

RIN 3235-A199

Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting amendments to Form N-1A under the Securities Act of 1933 and the Investment Company Act of 1940 to require open-end management investment companies to disclose in their prospectuses both the risks to shareholders of frequent purchases and redemptions of investment company shares, and the investment company's policies and procedures with respect to such frequent purchases and redemptions. The Commission is also amending Forms N-3, N-4, and N-6 to require similar prospectus disclosure for insurance company separate accounts issuing variable annuity and variable life insurance contracts. In addition, the Commission is adopting amendments to Forms N-1A and N-3 to clarify that open-end management investment companies and insurance company managed separate accounts that offer variable annuities, other than money market funds, are required to explain both the circumstances under which they will use fair value pricing and the effects of using fair value pricing. Finally, the Commission is requiring open-end management investment companies and insurance company managed separate accounts that offer variable annuities to disclose both their policies and procedures with respect to the disclosure of their portfolio securities, and any ongoing arrangements to make available information about their portfolio securities.

DATES: *Effective Date:* May 28, 2004.

Compliance Date: All initial registration statements and post-effective amendments to effective registration statements filed on Form N-1A, N-3, N-4, or N-6 on or after December 5, 2004, must comply with the amendments. Section II.D. of this release contains more information on the compliance date.

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SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting amendments to Forms N-1A,¹ N-3,² N-4,³ and N-6,⁴ registration forms used by investment companies to register under the Investment Company Act of 1940 ("Investment Company Act") and to offer their securities under the Securities Act of 1933 ("Securities Act").⁵

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I. Introduction and Background

Millions of individual American investors hold shares of open-end management investment companies ("mutual funds"), relying on these funds for their retirements, their children's educations, and their other basic financial needs.⁶ The tremendous number of mutual fund investors reflects the trust that they have placed in both funds and the regulatory protections provided by the federal securities laws.

¹ 17 CFR 239.15A; 17 CFR 274.11A.

² 17 CFR 239.17a; 17 CFR 274.11b.

³ 17 CFR 239.17b; 17 CFR 274.11c.

⁴ 17 CFR 239.17c; 17 CFR 274.11d.

⁵ The Commission proposed these amendments in December 2003. Investment Company Act Release No. 26287 (Dec. 11, 2003) [68 FR 70402 (Dec. 17, 2003)] ("Proposing Release").

⁶ A management investment company is an investment company other than a unit investment trust or face-amount certificate company. See section 4 of the Investment Company Act [15 U.S.C. 80a-4]. Management investment companies typically issue shares representing an undivided proportionate interest in a changing pool of securities, and include open-end and closed-end companies. See T. Lemke, G. Lins, A. Smith III, Regulation of Investment Companies, Vol. I, ch. 4, section 4.04, at 4-5 (2002). An open-end company is a management company that is offering for sale or has outstanding any redeemable securities of which it is the issuer.

Recent scandals, however, have revealed instances where some in the mutual fund industry, and some intermediaries that sell fund shares, have violated the trust that has been placed in them and lost sight of their obligations to investors under the federal securities laws. Many of these abuses relate to "market timing," including the overriding of stated market timing policies by fund executives to benefit large investors at the expense of small investors, or to benefit the fund's investment adviser.⁷ Other abuses involve the selective disclosure by some fund managers of their funds' portfolio holdings in order to curry favor with large investors.⁸ This selective disclosure can facilitate fraud and have severe, adverse ramifications for a fund's investors if someone uses that portfolio information to trade against the fund, or otherwise uses the information in a way that would harm the fund.⁹

The Commission is extremely concerned by the abuses that have surfaced in the mutual fund industry, and we have taken vigorous enforcement action where violations of the federal securities laws have been uncovered. We also believe, however, that regulatory reforms are necessary to help prevent such abuses from occurring in the future. Thus, the Commission has pursued an aggressive regulatory reform agenda to address

⁷ See, e.g., *In re Massachusetts Financial Services Co.*, Investment Company Act Release No. 26347 (Feb. 5, 2004) (investment adviser and two of its executives violated federal securities laws by allowing widespread market timing trading in certain funds in contravention of those funds' prospectus disclosures); *In re Alliance Capital Management, L.P.*, Investment Company Act Release No. 26312 (Dec. 18, 2003) (investment adviser violated federal securities laws by allowing market timing in certain of its mutual funds in exchange for fee-generating investments in its hedge funds and other mutual funds); *In re James P. Connelly, Jr.*, Investment Company Act Release No. 26209 (Oct. 16, 2003) (executive of an investment adviser to a fund complex, in derogation of fund disclosures, violated federal securities laws by approving agreements that allowed select investors to market time certain funds in the complex).

⁸ See, e.g., *In the Matter of Alliance Capital Management, L.P.*, Investment Advisers Act Release No. 2205 (Dec. 18, 2003) and Investment Company Act Release No. 26312 (Dec. 18, 2003) (disclosure of material nonpublic information about certain mutual fund portfolio holdings permitted favored client to profit from market timing). More than 30% of mutual fund complexes that responded to a Commission examination request for information sent to 88 of the largest such complexes appear to have disclosed portfolio information in circumstances that may have provided certain fund shareholders with the ability to make advantageous decisions to place orders for fund shares.

⁹ See Section I, "Introduction and Background," of the Proposing Release for a fuller description of market timing and selective disclosure abuses. Proposing Release, *supra* note 5, 68 FR at 70402-70405.

these abuses.¹⁰ As part of this agenda, in December 2003, we proposed rules intended to shed more light on market timing and selective disclosure of portfolio holdings.

The Commission received 47 comment letters relating to the proposals from investors, participants in the fund industry, and others. The commenters generally supported the Commission's proposals to improve the disclosure provided to investors, although some expressed concerns regarding portions of the disclosure or suggested changes. Today, the Commission is adopting these proposals, with modifications to address commenters' concerns.

With respect to market timing, the amendments that the Commission is adopting will require improved disclosure in fund prospectuses of a mutual fund's risks, policies, and procedures.¹¹ The amendments will:

¹⁰ Investment Company Act Release No. 26363 (Mar. 11, 2004) [69 FR 12752 (Mar. 17, 2004)] (proposing requirements for enhanced disclosure regarding portfolio managers of registered management investment companies); Investment Company Act Release No. 26375A (Mar. 5, 2004) [69 FR 11762 (Mar. 11, 2004)] (proposing mandatory redemption fee on short-term trades); Investment Company Act Release No. 26372 (Feb. 27, 2004) [69 FR 11244 (Mar. 9, 2004)] (adopting requirements for expense disclosure in fund shareholder reports and quarterly portfolio disclosure); Investment Company Act Release No. 26356 (Feb. 24, 2004) [69 FR 9726 (Mar. 1, 2004)] (proposing to prohibit the use of brokerage commissions to finance distribution of fund shares); Investment Company Act Release No. 26350 (Feb. 11, 2004) [69 FR 7852 (Feb. 19, 2004)] (proposing to require improved disclosure regarding the reasons for fund directors' approval of investment advisory contracts); Investment Company Act Release No. 26341 (Jan. 29, 2004) [69 FR 6438 (Feb. 10, 2004)] (proposing point-of-sale disclosure and a new confirmation statement for brokers to use when selling fund shares); Investment Company Act Release No. 26337 (Jan. 20, 2004) [69 FR 4040 (Jan. 27, 2004)] (proposing requirement for investment adviser code of ethics); Investment Company Act Release No. 26323 (Jan. 15, 2004) [69 FR 3472 (Jan. 23, 2004)] (proposing amendments to enhance independence of fund boards of directors); Investment Company Act Release No. 26313 (Dec. 18, 2003) [68 FR 74820 (Dec. 24, 2003)] (requesting comment on measures to improve disclosure of mutual fund transaction costs); Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74713 (Dec. 24, 2003)] (adopting rules requiring funds and advisers to adopt and implement policies and procedures designed to prevent violations of the federal securities laws); Investment Company Act Release No. 26298 (Dec. 17, 2003) [68 FR 74732 (Dec. 24, 2003)] (proposing amendments that would require enhanced disclosure regarding breakpoint discounts on front-end sales loads); Investment Company Act Release No. 26288 (Dec. 11, 2003) [68 FR 70388 (Dec. 17, 2003)] (proposing amendments to rules governing pricing of mutual fund shares intended to prevent unlawful late trading in fund shares).

¹¹ Market timing may take many forms. In this release, we have used the term to refer to arbitrage activity involving the frequent buying and selling of mutual fund shares in order to take advantage of the fact that there may be a lag between a change

- Require a mutual fund to describe in its prospectus the risks, if any, that frequent purchases and redemptions of fund shares may present for other shareholders;

- Require a mutual fund to state in its prospectus whether or not the fund's board of directors has adopted policies and procedures with respect to frequent purchases and redemptions of fund shares and, if the board has not adopted any such policies and procedures, state the specific basis for the view of the board that it is appropriate for the fund not to have such policies and procedures;

- Require a mutual fund to describe in its prospectus any policies and procedures for deterring frequent purchases and redemptions of fund shares, and in its Statement of Additional Information ("SAI")¹² any arrangements to permit frequent purchases and redemptions of fund shares; and

- Require similar disclosure in prospectuses for insurance company separate accounts offering variable insurance contracts, with respect to frequent transfers among sub-accounts.

In addition, the amendments will clarify instructions to our registration forms to require all mutual funds (other than money market funds) and insurance company managed separate accounts that offer variable annuities to explain in their prospectuses both the circumstances under which they will use fair value pricing and the effects of using fair value pricing. Fair valuation of a fund's portfolio securities, which is required under certain circumstances, can serve to foreclose certain arbitrage opportunities available to market timers.

With respect to selective disclosure of portfolio holdings, the amendments will require mutual funds and insurance company managed separate accounts that offer variable annuities to disclose their policies with respect to disclosure of portfolio holdings information. The amendments will:

- Require a fund to describe in its SAI any policies and procedures with respect to the disclosure of the fund's portfolio securities to any person and any ongoing arrangements to make available information about the fund's portfolio securities to any person; and

in the value of a mutual fund's portfolio securities and the reflection of that change in the fund's share price.

¹² The SAI is part of a fund's registration statement and contains information about a fund in addition to that contained in the prospectus. The SAI is required to be delivered to investors upon request and is available on the Commission's Electronic Data Gathering, Analysis, and Retrieval System.

- Require a fund to state in its prospectus that a description of the policies and procedures is available in the fund's SAI, and on the fund's website, if applicable.

II. Discussion

A. Disclosure Concerning Frequent Purchases and Redemptions of Fund Shares

The Commission is adopting, with several modifications to reflect commenters' concerns, amendments to Form N-1A, the registration form used by mutual funds, that will require disclosure of both the risks to fund shareholders of frequent purchases and redemptions of fund shares, and a fund's policies and procedures with respect to such frequent purchases and redemptions.¹³ Market timing strategies often involve such frequent purchases and redemptions of fund shares. These amendments are intended to require mutual funds to describe with specificity the restrictions they place on frequent purchases and redemptions, if any, and the circumstances under which any such restrictions will not apply. Commenters generally supported the proposed requirements, and agreed that the additional disclosure will enable investors to assess mutual funds' risks, policies, and procedures in this area and determine if a fund's policies and procedures are in line with their expectations.¹⁴

1. Description of the Risks of Frequent Purchases and Redemptions of Fund Shares

We are adopting, as proposed, amendments that will require a mutual fund's prospectus to describe the risks, if any, that frequent purchases and redemptions of fund shares may present for other shareholders of the fund.¹⁵ These risks may include, among other things, dilution in the value of fund shares held by long-term shareholders, interference with the efficient management of the fund's portfolio, and increased brokerage and administrative

¹³ Item 6(e) of Form N-1A. The amendments to Form N-1A reflect the recent adoption of amendments to the Form that renumber Items 7 (Shareholder Information), 12 (Description of the Fund and Its Investments and Risks), and 18 (Purchase, Redemption, and Pricing of Shares) as Items 6, 11, and 17, respectively. See Investment Company Act Release No. 26372 (Feb. 27, 2004) [69 FR 11244 (Mar. 9, 2004)].

¹⁴ Under rule 38a-1 under the Investment Company Act [17 CFR 270.38a-1], a fund must have procedures reasonably designed to ensure compliance with its disclosed policies regarding market timing. See Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74714, 74720 (Dec. 24, 2003)].

¹⁵ Item 6(e)(1) of Form N-1A.

costs. The disclosure should be specific to the fund, taking into account its investment objectives, policies, and strategies. For example, we would generally expect a fund that invests in overseas markets to describe, among other things, the risks of time-zone arbitrage.

2. Adoption of Policies and Procedures by Fund's Board

We are also adopting, as proposed, amendments that require a mutual fund's prospectus to state whether the fund's board of directors has adopted policies and procedures with respect to frequent purchases and redemptions of fund shares by fund shareholders.¹⁶ If the fund's board of directors has not adopted any such policies and procedures, the fund's prospectus will be required to include a statement of the specific basis for the view of the board that it is appropriate for the fund not to have such policies and procedures.¹⁷

3. Description of Fund Policies and Procedures With Respect to Frequent Purchases and Redemptions

We are adopting, with one modification, a requirement that the fund's prospectus include a description of policies and procedures adopted by the board with respect to frequent purchases and redemptions, including:

- Whether or not the fund discourages frequent purchases and redemptions of fund shares by fund shareholders;
- Whether or not the fund accommodates frequent purchases and redemptions of fund shares by fund shareholders; and
- Any policies and procedures of the fund for deterring frequent purchases and redemptions of fund shares by fund shareholders.

The description of the mutual fund's policies and procedures, if any, for deterring frequent purchases and redemptions of fund shares by fund shareholders will be required to include any restrictions imposed by the fund to prevent or minimize such frequent purchases and redemptions, including:

- Any restrictions on the volume or number of purchases, redemptions, or exchanges that a shareholder may make within a given time period;
- Any exchange fee or redemption fee;
- Any costs or administrative or other fees or charges that are imposed on shareholders deemed to be engaged in frequent purchases and redemptions of fund shares, together with a description

of the circumstances under which such costs, fees, or charges will be imposed;

- Any minimum holding period that is imposed before an investor may make exchanges into another fund;
- Any restrictions imposed on exchange or purchase requests submitted by overnight delivery, electronically, or via facsimile or telephone; and
- Any right of the fund to reject, limit, delay, or impose other conditions on exchanges or purchases or to close or otherwise limit accounts based on a history of frequent purchases and redemptions of fund shares, including the circumstances under which such right will be exercised.

The amendments will require a fund's policies and procedures for deterring frequent purchases and redemptions, including any restrictions imposed to prevent or minimize such frequent purchases and redemptions, to be described with specificity.¹⁸ For example, a fund might state that a 2% redemption fee will be applied to all redemptions within five days after purchase or, in describing any restrictions on the volume or number of purchases, redemptions, or exchanges that a shareholder may make within a given time period, a fund might state that it prohibits more than five round-trips in and out of a particular fund per year. A fund will also be required to indicate whether each restriction applies uniformly in all cases, or whether the restriction will not be imposed under certain circumstances. If any restriction will not be imposed under certain circumstances, the fund will be required to describe with specificity the circumstances under which the restriction will not be imposed.

Commenters were divided on whether funds' policies, procedures, and restrictions on purchases and redemptions should be required to be described with specificity. Many commenters, including a number of investors and intermediaries, argued that requiring specific disclosure of a fund's policies, procedures, and restrictions is important in order to put investors on notice of what types of activities the fund considers harmful, and to encourage funds to apply their restrictions uniformly. On the other hand, several commenters from the fund industry argued that the specificity

requirement could have the unintended effect of assisting investors who wished to engage in frequent purchases and redemptions, and could deprive funds of flexibility in administering their policies and procedures to deter frequent purchases and redemptions. In addition, one commenter asked for clarification that a fund may reserve the right to reject any trade for any reason, because it is not possible to identify all types of potentially abusive trading in advance.

On balance, we continue to believe that it is important that a fund's prospectus describe with specificity its policies, procedures, and restrictions with respect to frequent purchases and redemptions of fund shares. We believe that requiring specificity in this disclosure will help investors both to assess mutual funds' policies and procedures with respect to frequent purchases and redemptions, and to assess whether such policies and procedures are in line with their expectations. We agree with those commenters who argued that requiring specific disclosure may discourage funds from applying or waiving their restrictions arbitrarily. We also believe, however, that funds will be able to more effectively deter abusive market timing if they have some flexibility to address abuses as they arise. To that end, a fund may reserve the right to reject a purchase or exchange request for any reason, provided that it discloses this policy in its prospectus.

We are removing the proposed requirement that a fund describe its policies and procedures for detecting frequent purchases and redemptions of fund shares.¹⁹ Many commenters who addressed this issue recommended either removing this requirement, or permitting the disclosure to be general in nature. These commenters argued that disclosure about how the fund detects frequent purchases and redemptions could be harmful to the fund, in that it might provide investors seeking to engage in market timing through frequent purchases and redemptions with a "road map" on how to avoid detection. Further, commenters argued that this disclosure would be of marginal utility to most investors. We agree.

In connection with removing this proposed requirement, we are adding a statement clarifying that a fund's disclosure regarding whether its restrictions to prevent or minimize frequent purchases and redemptions are uniformly applied must indicate whether each such restriction applies to

¹⁸ Item 6(e)(4)(iii) of Form N-1A. A fund need not repeat this disclosure to the extent that it is provided in the prospectus in response to other Items of Form N-1A, including Items 3 (redemption and exchange fees), 6(c) (restrictions on redemptions, and redemption charges), and 7(a)(2) (exchange privileges).

¹⁹ Proposed Item 7(e)(4)(iv) of Form N-1A.

¹⁶ Item 6(e)(2) of Form N-1A.

¹⁷ Item 6(e)(3) of Form N-1A.

trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker dealers, transfer agents, third party administrators, and insurance companies.²⁰ We continue to believe that investors should be informed about how a fund applies its restrictions on frequent purchases and redemptions to persons trading through omnibus accounts, which would have been addressed by the proposed disclosure regarding policies and procedures for detecting frequent purchases and redemptions. The overall effectiveness of a fund's restrictions on frequent purchases and redemptions may depend significantly on how effectively the fund can deter frequent purchases and redemptions made through such omnibus accounts.²¹

4. Inclusion of Disclosure Regarding Frequent Purchases and Redemptions in Prospectus

The amendments that we are adopting also clarify, as proposed, that the new disclosure that will be required within the prospectus regarding frequent purchases and redemptions of fund shares may not be omitted from the prospectus in reliance on Item 6(g), formerly designated as Item 6(f).²² Item 6(g) permits funds to omit from the

prospectus certain information concerning purchase and redemption procedures if, among other things, the information is included in a separate document that is incorporated by reference into, and filed and delivered with, the prospectus. We believe that the information required by new Item 6(e) is more appropriately included in the same document as the prospectus.

5. Description of Arrangements Permitting Frequent Purchases and Redemptions

We are adopting, substantially as proposed, the requirement that a mutual fund describe any arrangements with any person to permit frequent purchases and redemptions of fund shares, except that we are moving the required disclosure to the fund's SAI and requiring a cross-reference to this disclosure in the fund's prospectus.²³ The description of arrangements to permit frequent purchases and redemptions must include the identity of the persons permitted to engage in frequent purchases and redemptions and any compensation or other consideration received by the fund, its investment adviser, or any other party pursuant to such arrangements.²⁴ Several commenters objected to this proposed requirement, and in particular to the proposed requirement for specific identification of persons permitted to engage in frequent purchases and redemptions. These commenters argued that specific identification of these investors may violate such investors' privacy, and that a long list of names would not be useful to investors and might tend to obscure other, more basic information that is more important to an investment decision. In particular, these commenters suggested that identification of these investors would not be useful in the case of investors who are trading through a defined contribution plan or similar plan that has an arrangement with the fund to permit frequent purchases and redemptions.

We believe that disclosure of the persons who have arrangements with a fund to permit frequent purchases and redemptions is necessary in order to help investors assess the risks to fund shareholders of frequent purchases and redemptions. We are, however, modifying the requirement to permit a fund that has an arrangement to permit

frequent purchases and redemptions by a group of individuals, such as the participants in a defined contribution plan that meets the requirements for qualification under Section 401(k) of the Internal Revenue Code, to identify the group rather than identifying each individual group member. In addition, in order to address concerns that the description of the arrangements might be lengthy, and therefore that inclusion of this information in the prospectus might tend to obscure other, more basic information in the prospectus, we are permitting this disclosure to be included in the SAI.²⁵ A fund that includes this disclosure in its SAI will be required to include a statement in its prospectus, adjacent to the other disclosure regarding frequent purchases and redemptions, that the fund's SAI includes a description of all arrangements with any person to permit frequent purchases and redemptions of fund shares.²⁶

We reemphasize, as we stated in the Proposing Release, that a mutual fund that enters into an arrangement with any person to permit frequent purchases and redemptions of fund shares may only do so consistent with the antifraud provisions of the federal securities laws and the fiduciary duties of the fund and its investment adviser. Disclosure provided pursuant to these amendments will not make lawful conduct that is otherwise unlawful. For example, disclosure will not render lawful an arrangement whereby an investment adviser permits frequent purchases and redemptions of a mutual fund's shares in return for consideration that benefits the adviser, such as an agreement to maintain assets in other accounts managed by the adviser.

6. Applicability of Requirements to Exchange Traded Funds

As adopted, the amendments to Form N-1A will apply to all mutual funds. Some commenters argued that exchange traded funds ("ETFs") should be excluded from the proposed disclosure requirements. These commenters argued that market timing is generally not an issue for ETFs because, unlike traditional mutual funds, ETFs sell and redeem their shares at net asset value ("NAV") only in large blocks, generally in exchange for a basket of securities that mirrors the composition of the ETF's portfolio, plus a small amount of cash. Further, the commenters noted, shares issued by ETFs are listed for trading on stock exchanges, which allows retail investors to purchase and

²⁰ Item 6(e)(4)(iii) of Form N-1A.

Persons that are not registered as broker-dealers need to consider whether the securities activities that they are undertaking are brokerage activities that require them to register as broker-dealers. Section 3(a)(4) of the Securities Exchange Act of 1934 ("Exchange Act") defines a broker as a person engaged in the business of effecting transactions in securities. It includes several exceptions for certain bank activities. Section 15 of the Exchange Act essentially makes it unlawful for a broker or dealer "to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills)" unless the broker or dealer is registered with the Commission.

²¹ As part of our recent proposal for a mandatory redemption fee on short-term trades, we proposed a requirement that, on at least a weekly basis, each financial intermediary provide to a fund the Taxpayer Identification Number ("TIN") and the amount and dates of all purchases, redemptions, or exchanges for each shareholder within an omnibus account. Investment Company Act Release No. 26375A (Mar. 5, 2004) [69 FR 11762, 11766 (Mar. 11, 2004)] (proposed rule 22c-2(c) under the Investment Company Act). This information would assist funds in detecting market timers who a fund has prohibited from purchasing fund shares and who attempt to enter the fund through a different account. See also Jonas Max Ferris, *Next Scandal: Brokers?*, The Street.Com, Nov. 26, 2003 (noting that although omnibus account structure has many benefits, it can be used to hide questionable trades by market timers); Kathleen Pender, *401(k) Plans Face Scrutiny*, San Francisco Chronicle, Oct. 23, 2003, at B1 (discussing difficulty of mutual funds knowing when 401(k) participants are engaging in market timing because each retirement plan is usually one omnibus account).

²² Item 6(g) of Form N-1A.

²³ Items 6(e)(5) and 17(e) of Form N-1A.

²⁴ An instruction clarifies that the consideration required to be disclosed includes any agreement to maintain assets in the fund or in other investment companies or accounts managed by the investment adviser or by any affiliated person of the investment adviser. Instruction 1 to Item 17(e) of Form N-1A.

²⁵ Item 17(e) of Form N-1A.

²⁶ Item 6(e)(5) of Form N-1A.

sell individual ETF shares among themselves at market prices throughout the day.²⁷ However, we note that, in those cases when an ETF purchases and redeems its shares in cash rather than “in kind,” frequent purchases and redemptions may present risks for long-term shareholders of ETFs that are similar to the risks that frequent purchases and redemptions present for long-term mutual fund shareholders. Accordingly, we have determined not to exclude ETFs from the proposed disclosure requirements. If an ETF’s board has determined that there are no risks to fund shareholders as a result of frequent purchases and redemptions of ETF shares, and therefore has determined not to adopt policies and procedures with respect to frequent purchases and redemptions of fund shares, the fund may reflect these facts in its disclosure.

7. Amendments to Registration Forms for Variable Insurance Products

We are also adopting requirements for similar disclosure in Forms N-3,²⁸ N-4,²⁹ and N-6,³⁰ the registration forms for insurance company separate accounts that issue variable annuity and variable life insurance contracts, with respect to both the risks of frequent transfers of contract value among sub-accounts, and the separate account’s policies and procedures with respect to such frequent transfers. As discussed in the Proposing Release, these disclosure requirements are similar to those applicable to mutual funds with respect to frequent purchases and redemptions, with modifications to address the different structure of these issuers.³¹ We note that we are making the same modifications to the proposed requirements for Forms N-3, N-4, and N-6 that we are making with respect to Form N-1A.³²

²⁷ See Investment Company Act Release No. 25258 (Nov. 8, 2001) [66 FR 57614, 57614–57615 (Nov. 15, 2001)] (describing ETFs).

²⁸ Item 8(e) of Form N-3. Form N-3 is used by all insurance company separate accounts offering variable annuity contracts that are registered under the Investment Company Act as management investment companies.

²⁹ Item 7(e) of Form N-4. Form N-4 is used by all insurance company separate accounts offering variable annuity contracts that are registered under the Investment Company Act as unit investment trusts. See section 4(2) of the Investment Company Act [15 U.S.C. 80a-4(2)] (defining “unit investment trust”).

³⁰ Item 6(f) of Form N-6. Form N-6 is used by all insurance company separate accounts offering variable life insurance policies that are registered under the Investment Company Act as unit investment trusts.

³¹ Proposing Release, *supra* note 5, 68 FR at 70407.

³² Similar to the modification we are making to Item 6(e)(4)(iii) of Form N-1A, we are adding a

Separate accounts funding a variable insurance contract are generally divided into a number of sub-accounts, each of which invests in a different underlying mutual fund. Several commenters argued that certain aspects of the proposed disclosure requirements did not sufficiently take account of the unique nature of variable insurance contracts, in particular their two-tier structure. These commenters raised three concerns. First, they argued that the disclosure requirements will cause underlying funds to adopt new policies and procedures restricting frequent transfers. According to the commenters, these new policies and procedures of the underlying funds will be inconsistent with one another, and the separate accounts’ prospectus disclosure of these policies and procedures will therefore be voluminous and potentially confusing. Second, the commenters noted that the insurance company depositors for separate accounts will have the task of administering the policies and procedures of the underlying funds, and that in many cases an insurance company will not be able to administer all of the different variations of policies and procedures, and may as a result decide to limit the number of funds that the separate account offers. Third, the commenters argued that the ability of an insurance company to adopt corresponding restrictions on contractowners’ rights to engage in frequent transfers unilaterally at the separate account level will be limited by state insurance law and by provisions in existing contracts. In order to address these concerns, commenters asked that disclosure by both the separate account and the underlying fund be permitted to be general, or, in the alternative, that we clarify that underlying funds may rely on the restrictions on frequent transfers adopted by the insurance company depositor at the separate account level.

We believe that it is important for issuers of variable insurance contracts to provide disclosure regarding their policies and procedures with respect to transfers of contract value that is as specific as the disclosure that will be

statement clarifying that a separate account’s disclosure regarding whether its restrictions to prevent or minimize frequent transfers among sub-accounts are uniformly applied must indicate whether each such restriction applies to trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker dealers, transfer agents, and third party administrators. See Item 8(e)(iv)(C) of Form N-3; Item 7(e)(iv)(C) of Form N-4; Item 6(f)(4)(iii) of Form N-6. In some cases, this disclosure may not be relevant to insurance company separate accounts issuing variable insurance contracts because the contracts are held in the name of the contractowner and not an intermediary.

required for mutual funds with respect to frequent purchases and redemptions of fund shares. Market timing of mutual funds through a variable annuity or variable life insurance contract, in the form of tax-free transfers of contract value among sub-accounts,³³ can be as detrimental for investors in variable insurance products as market timing can be for investors in mutual funds. With respect to the concerns raised about the possible inconsistency of policies and procedures of different underlying funds and about potential limits on an insurer’s ability to restrict transfers at the separate account level, we note that the disclosure requirements do not require issuers of variable insurance contracts, or underlying funds, to adopt any particular restrictions on transfers of contract value. It is the responsibility of insurance company depositors for separate accounts and underlying funds to adopt and implement appropriate and workable policies, procedures, and restrictions with respect to frequent transfers among sub-accounts. The rules that we are adopting simply require disclosure of these policies, procedures, and restrictions in the variable insurance contract prospectus and the underlying fund prospectus.

B. Disclosure of Circumstances Under Which Funds Will Use Fair Value Pricing and the Effects of Such Use

The Commission is adopting, with one modification to address commenters’ concerns, proposed amendments to the Instruction to Item 6(a)(1) of Form N-1A, and adding a corresponding Instruction to Form N-3, to clarify that all mutual funds and managed separate accounts that offer variable annuities, other than money market funds, are required to explain briefly in their prospectuses both the circumstances under which they will use fair value pricing and the effects of using fair value pricing.³⁴ We are adopting these amendments to clearly reflect that funds are required to use fair value prices any time that market quotations for their portfolio securities are not readily available (including

³³ Increases in the cash values of variable annuity and variable life insurance contracts—known as the “inside buildup”—are tax-deferred until the contract’s surrender or maturity. See I.R.C. 7702(g) (1986).

³⁴ Instruction to Item 6(a)(1) of Form N-1A; Instruction to Item 11(c) of Form N-3. We are not amending Forms N-4 and N-6 because these forms are used by insurance company separate accounts that are organized as unit investment trusts and typically hold only securities issued by underlying mutual funds. These underlying mutual funds are responsible for valuing their own portfolio securities, including, as required, through fair valuation.

when they are not reliable).³⁵ Money market funds will not be subject to the requirement to disclose the circumstances under which they will use fair value pricing and the effects of such use, because such funds are subject to rule 2a-7 under the Investment Company Act, which contains its own detailed pricing requirements.³⁶ Commenters generally supported this proposed amendment.

The required disclosure regarding the circumstances under which a fund will use fair value pricing should be specific to the fund. For example, if a fund invests exclusively in frequently traded exchange listed securities of large capitalization domestic issuers and calculates its NAV as of the time the exchange typically closes, there may be very limited circumstances in which it will use fair value pricing (e.g., if the exchange on which a portfolio security is principally traded closes early or if trading in a particular portfolio security was halted during the day and did not resume prior to the fund's NAV calculation). By contrast, if a fund invests primarily in securities that are traded on overseas markets, we would expect a fuller discussion of the circumstances under which the fund will use fair value pricing, such as specific events occurring after the close of the overseas exchange that would cause the fund to use fair value pricing.³⁷ The instruction we are adopting will also require a fund to explain the effects of using fair value pricing, similar to the current instruction.³⁸

³⁵ See Investment Company Act Release No. 14244 (Nov. 21, 1984) [49 FR 46558, 46559-46660 n.7 (Nov. 27, 1984)] (proposing amendments to rule 22c-1).

³⁶ Rule 2a-7(c) under the Investment Company Act [17 CFR 270.2a-7(c)] (describing the requirements for calculating the share price of money market funds using the amortized cost and penny-rounding methods).

³⁷ We note that rule 38a-1 under the Investment Company Act [17 CFR 270.38a-1] requires funds to adopt policies and procedures that require a fund to monitor for circumstances that may necessitate the use of fair value prices, establish criteria for determining when market quotations are no longer reliable for a particular portfolio security, provide a methodology or methodologies by which the fund determines the current fair value of the portfolio security, and regularly review the appropriateness and accuracy of the method used in valuing securities and make any necessary adjustments. See Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74713, 74718 (Dec. 24, 2003)].

³⁸ See Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916 (Mar. 23, 1998)] (adopting Instruction to Item 7(a)(1) of Form N-1A requiring a brief explanation of the circumstances and the effects of using fair value pricing). In the Proposing Release, we stated that we would expect that the description of the effects of using fair value pricing would be fund specific, e.g., minimizing the possibilities for time-zone arbitrage, in the case of a fund investing in overseas markets. See Proposing

A number of commenters expressed concern that requiring specific disclosure of the circumstances under which a fund will use fair value pricing might help arbitrageurs to identify circumstances in which they could take unfair advantage of a fund's pricing policies. In addition, one such commenter argued that limiting funds to specific formulas that can be changed only by registration statement amendments or supplements may prove unworkable in volatile markets or business emergencies. These commenters recommended that the Commission require only general disclosure of the circumstances under which a fund will use fair value pricing. We wish to clarify that neither the requirement we are adopting, nor the current requirement, requires disclosure of the specific methodologies and formulas that a fund uses to determine fair value prices. For example, if a fund has a policy to fair value price securities traded on overseas markets in the event that there is a specific percentage change in the value of one or more domestic securities indices following the close of the overseas markets, the fund will not be required to disclose the specific percentage change that would trigger fair valuation. In addition, a fund's disclosure need not be so specific that the fund may not adjust the triggering events from time to time in response to market events or other causes.

Our amendments will require the fair value pricing disclosure to be included in a fund's prospectus, as proposed. Some commenters suggested that the required information about fair value pricing may be more appropriately included in a fund's SAI. In addition, some commenters suggested that the location of the disclosure should depend on the significance of market timing as a potential problem for the fund; thus, in cases where market timing is a more important concern, such as foreign stock funds that are subject to time-zone arbitrage, the information should be included in the prospectus itself. We continue to believe, however, that information about the circumstances under which a fund will use fair value pricing and the effects of using fair value pricing should be included in the prospectus together with other key information about a fund. We also believe that it is preferable for investors if the

Release, *supra* note 5, 68 FR at 70408. As one commenter noted, minimizing the possibilities for time-zone arbitrage may be more appropriately characterized as an objective of fair value pricing than a guaranteed result or effect.

information is uniformly located in one document, rather than located in the prospectus for some funds and the SAI for others. In addition, the instruction requires the disclosure regarding fair value pricing to be brief, and, as noted above, funds will not be required to provide detailed information about their fair value pricing methodologies and formulas.

One commenter also requested clarification regarding how the instruction would apply in the case of a mutual fund that invests in other mutual funds, such as a fund of funds. The commenter noted that each mutual fund in which a fund is invested will have to include in its own prospectus a brief explanation of the circumstances under which it will use fair value pricing and the effects of such use. We are adding language to the instruction to clarify that, with respect to any portion of a fund's assets that are invested in one or more mutual funds, the fund may briefly explain that the fund's NAV is calculated based upon the NAVs of the mutual funds in which the fund invests, and that the prospectuses for those funds explain the circumstances under which they will use fair value pricing and the effects of using fair value pricing.³⁹

C. Selective Disclosure of Fund Portfolio Holdings

We are adopting, with modifications to address commenters' concerns, amendments to Form N-1A that will require mutual funds to disclose both their policies and procedures with respect to the disclosure of their portfolio securities and any ongoing arrangements to make available information about their portfolio securities.⁴⁰ We are also adopting parallel amendments to Form N-3 for managed separate accounts that issue variable annuities.⁴¹ These amendments are intended to provide greater transparency of fund practices with respect to the disclosure of the fund's portfolio holdings, and to reinforce funds' and advisers' obligations to

³⁹ Instruction to Item 6(a)(1) of Form N-1A; Instruction to Item 11(c) of Form N-3.

⁴⁰ Items 4(d) and 11(f) of Form N-1A. A fund's compliance policies and procedures under rule 38a-1 under the Investment Company Act should address potential misuses of nonpublic information, including the disclosure to third parties of material information about the fund's portfolio, its trading strategies, or pending transactions. Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74714, 74719 (Dec. 24, 2003)].

⁴¹ Items 5(f) and 19(e) of Form N-3. We are not amending Forms N-4 and N-6 because these forms are used by insurance company separate accounts that are organized as unit investment trusts, which typically hold only securities issued by underlying mutual funds.

prevent the misuse of material, nonpublic information.

We reemphasize, as we stated in the Proposing Release, that a mutual fund or investment adviser that discloses the fund's portfolio securities may only do so consistent with the antifraud provisions of the federal securities laws and the fund's or adviser's fiduciary duties. Disclosure provided pursuant to these amendments would not make lawful conduct that is otherwise unlawful. Divulging nonpublic portfolio holdings to selected third parties is permissible only when the fund has legitimate business purposes for doing so and the recipients are subject to a duty of confidentiality, including a duty not to trade on the nonpublic information.⁴² Examples of instances in which selective disclosure of a fund's portfolio securities may be appropriate, subject to confidentiality agreements and trading restrictions, include disclosure for due diligence purposes to an investment adviser that is in merger or acquisition talks with the fund's current adviser, disclosure to a newly hired investment adviser or sub-adviser prior to commencing its duties, or disclosure to a rating agency for use in developing a rating.

1. Policies and Procedures

Under the amendments we are adopting, a fund will be required to describe its policies and procedures with respect to the disclosure of its portfolio securities in its SAI, and to state in its prospectus that a description of the fund's policies and procedures is available in its SAI and, if applicable, on its Web site (*i.e.*, if the fund posts this description on its Web site).⁴³ Commenters generally supported these proposed requirements, including the proposed inclusion of the fund's policies and procedures in the SAI.

Under our amendments, the SAI description of the mutual fund's policies and procedures with respect to the disclosure of its portfolio securities will be required to include:

- How the policies and procedures apply to disclosure to different categories of persons, including individual investors, institutional investors, intermediaries that distribute the fund's shares, third-party service

providers, rating and ranking organizations, and affiliated persons of the fund;⁴⁴

- Any conditions or restrictions placed on the use of information about portfolio securities that is disclosed, including any requirement that the information be kept confidential or prohibitions on trading based on the information, and any procedures to monitor the use of this information;⁴⁵

- The frequency with which information about portfolio securities is disclosed, and the length of the lag, if any, between the date of the information and the date on which the information is disclosed;⁴⁶

- Any policies and procedures with respect to the receipt of compensation or other consideration by the fund, its investment adviser, or any other party in connection with the disclosure of information about portfolio securities;⁴⁷

- The individuals or categories of individuals who may authorize disclosure of the fund's portfolio securities;⁴⁸

- The procedures that the fund uses to ensure that disclosure of information about portfolio securities is in the best interests of fund shareholders, including procedures to address conflicts between the interests of fund shareholders, on the one hand, and those of the fund's investment adviser; principal underwriter; or any affiliated person of the fund, its investment adviser, or its principal underwriter, on the other;⁴⁹ and

⁴⁴ Item 11(f)(1)(i) of Form N-1A. With respect to managed separate accounts issuing variable annuity contracts registered on Form N-3, the categories will include contractowners, participants, annuitants, and beneficiaries. Item 19(e)(i)(A) of Form N-3.

⁴⁵ Item 11(f)(1)(ii) of Form N-1A; Item 19(e)(i)(B) of Form N-3.

⁴⁶ Item 11(f)(1)(iii) of Form N-1A; Item 19(e)(i)(C) of Form N-3.

⁴⁷ Item 11(f)(1)(iv) of Form N-1A. With respect to managed separate accounts issuing variable annuity contracts registered on Form N-3, this description will also be required to include any policies and procedures with respect to the receipt of compensation or other consideration by the sponsoring insurance company. Item 19(e)(i)(D) of Form N-3. See Section II.C.2., "Arrangements to Make Portfolio Holdings Available," below (discussing restrictions on receipt of consideration in connection with disclosure of portfolio holdings).

⁴⁸ Item 11(f)(1)(v) of Form N-1A; Item 19(e)(i)(E) of Form N-3.

⁴⁹ Item 11(f)(1)(vi) of Form N-1A. With respect to managed separate accounts issuing variable annuity contracts registered on Form N-3, this description will be required to include the procedures that are used to ensure that disclosure of information about portfolio securities is in the best interests of contractowners, participants, annuitants, and beneficiaries, including procedures to address conflicts between the interests of such persons, on the one hand, and those of the separate account's investment adviser or principal underwriter; the

- The manner in which the board of directors exercises oversight of disclosure of the fund's portfolio securities.⁵⁰

A mutual fund's disclosure of its policies and procedures with respect to the disclosure of its portfolio securities will be required to include any policies and procedures of the fund's investment adviser, or any other third party, that the fund uses or that are used on the fund's behalf.⁵¹

We are clarifying that a fund may satisfy the requirement to disclose the persons who may authorize disclosure of the fund's portfolio holdings by describing either the individuals or categories of individuals who may authorize disclosure.⁵² We agree with one commenter that disclosure of these persons by category may provide investors with more relevant information than the names of select individuals. We emphasize, however, that funds will be required to identify either individuals (*e.g.*, a fund's chief executive officer) or categories of individuals (*e.g.*, a fund's executive officers) and not entities or categories of entities. Thus, it would not suffice for a fund to disclose that the fund's investment adviser or its service providers may authorize disclosure of portfolio holdings.

2. Arrangements To Make Portfolio Holdings Available

We are also adopting, with modifications, a requirement that a mutual fund describe in its SAI any ongoing arrangements to make available information about the fund's portfolio securities to any person, including the identity of the persons who receive information pursuant to such arrangements and any compensation or other consideration received by the fund, its investment adviser, or any other party in connection with each such arrangement.⁵³ An instruction to this requirement clarifies that the consideration required to be disclosed includes any agreement to maintain assets in the fund or in other investment

sponsoring insurance company; or any affiliated person of the separate account, its investment adviser or principal underwriter, or the sponsoring insurance company, on the other. Item 19(e)(i)(F) of Form N-3.

⁵⁰ Item 11(f)(1)(vii) of Form N-1A; Item 19(e)(i)(G) of Form N-3.

⁵¹ Instruction to Item 11(f)(1) of Form N-1A; Instruction to Item 19(e)(i) of Form N-3.

⁵² Item 11(f)(1)(v) of Form N-1A; Item 19(e)(i)(E) of Form N-3.

⁵³ Item 11(f)(2) of Form N-1A. With respect to managed separate accounts issuing variable annuity contracts registered on Form N-3, disclosure of any compensation or other consideration received by the sponsoring insurance company will also be required. Item 19(e)(ii) of Form N-3.

⁴² Cf. Investment Company Act Release No. 24209 (Dec. 20, 1999) [64 FR 72590, 72595 (Dec. 28, 1999)] (proposing exemption from Regulation FD for disclosure of material information to persons who have expressly agreed to maintain the information in confidence, and noting that such a confidentiality agreement would also include an agreement not to trade on the nonpublic information).

⁴³ Items 4(d) and 11(f)(1) of Form N-1A; Items 5(F) and 19(e)(i) of Form N-3.

companies or accounts managed by the fund's investment adviser or by any affiliated person of the investment adviser.⁵⁴ As indicated above, however, divulging portfolio holdings to selected third parties is permissible only when the fund has legitimate business purposes for doing so. The Commission is not aware of any situation where the receipt of consideration by the fund's investment adviser or its affiliates in connection with an arrangement to make available information about the fund's portfolio securities would be a legitimate business purpose. With respect to any ongoing arrangements, a fund will also be required to describe:

- Any conditions or restrictions placed on the use of information about portfolio securities that is disclosed, including any requirement that the information be kept confidential or prohibitions on trading based on the information, and any procedures to monitor the use of this information;
- The frequency with which information about portfolio securities is disclosed, and the length of the lag, if any, between the date of the information and the date on which the information is disclosed; and
- The individuals or categories of individuals who may authorize disclosure of the fund's portfolio securities.⁵⁵

Several commenters objected to the application of the proposed requirement for disclosure of ongoing arrangements to a number of different types of potential recipients of portfolio holdings information, including third-party providers of auditing, custody, proxy voting, and other services for the fund, as well as rating and ranking organizations. These commenters argued that detailed information about the fund's sharing of portfolio holdings information with these third-party service providers, where necessary to enable the provider to perform services for the fund, would not be useful to investors. The commenters also argued that a fund could have arrangements to provide portfolio holdings information to other types of recipients, such as financial planners for use in providing asset allocation services to their clients, or institutional investors who are

considering whether to invest in a fund, and that individual identification of these recipients would be burdensome and could raise confidentiality concerns.

We have determined not to modify the proposed requirement as suggested by these commenters, because we believe that investors have a significant interest in knowing how widely and with whom the fund shares its portfolio holdings information. Further, we do not believe that the required disclosure of arrangements to make available information about the fund's portfolio securities will be overly burdensome, because circumstances in which the fund may have legitimate business purposes for entering into an arrangement to selectively disclose its portfolio holdings information typically would be limited. In most cases, these arrangements would be with a relatively small number of service providers to the fund.

One commenter recommended that the Commission clarify that any arrangement in which a fund provides publicly available portfolio holdings information to any person would not be covered by the requirement to disclose ongoing arrangements. Another commenter asked that the Commission confirm that posting information to a Web site constitutes public disclosure.

We are adding two exceptions from the requirement to describe ongoing arrangements which we believe will address these commenters' concerns. First, a mutual fund will not be required to describe an ongoing arrangement to make available information about the fund's portfolio securities if, not later than the time that the fund makes available the portfolio securities information to any person pursuant to the arrangement, the fund discloses the information in a publicly available filing with the Commission that is required to include the information.⁵⁶ A fund may not satisfy this exception by making a voluntary filing of its portfolio information with the Commission, *e.g.*, a filing on Form N-Q to disclose month-end portfolio holdings.

Second, a fund will not be required to describe an ongoing arrangement to make available information about its portfolio securities if it (i) makes that information available on its Web site; and (ii) discloses in its prospectus the

availability of the information on its Web site.⁵⁷ Specifically, a fund will not be required to describe such an arrangement if it makes the portfolio securities information available to any person pursuant to the arrangement no earlier than the day next following the day on which the fund makes the information available on its website in the manner specified in its prospectus.⁵⁸ In order to rely on this exception, a fund will be required to disclose in its current prospectus that the portfolio securities information will be available on its website, including (i) the nature of the information that will be available, including both the date as of which the information will be current (*e.g.*, month-end) and the scope of the information (*e.g.*, complete portfolio holdings, largest 20 holdings); (ii) the date when the information will first become available and the period for which the information will remain available, which shall end no earlier than the date on which the fund files a Form N-CSR or Form N-Q for the period that includes the date as of which the Web site information is current; and (iii) the location on the fund's website where either the information or a prominent hyperlink (or series of prominent hyperlinks) to the information will be available.⁵⁹

These exceptions will permit a fund to omit disclosure of arrangements to make portfolio information available in these two specific situations, when the information is, in any event, either publicly available in a required filing with the Commission or readily accessible on the fund's Web site.⁶⁰ This will permit a fund, for example, to e-mail its portfolio holdings information regularly to investors who had requested this information without being required to disclose the names of all the investors on the e-mail list, provided that the information is also available through one of the two means specified in the rule.

D. Compliance Date

The effective date for these amendments is May 28, 2004. All initial registration statements on Forms N-1A, N-3, N-4, and N-6, and all post-effective amendments to effective registration statements on these forms,

⁵⁴ Instruction 1 to Item 11(f)(2) of Form N-1A. With respect to managed separate accounts issuing variable annuity contracts registered on Form N-3, the consideration required to be disclosed will also include any agreement to maintain assets in other investment companies or accounts managed or sponsored by the sponsoring insurance company of the registrant or by an affiliated person of such sponsoring insurance company. Instruction 1 to Item 19(e)(ii) of Form N-3.

⁵⁵ Item 11(f)(2) of Form N-1A; Item 19(e)(ii) of Form N-3.

⁵⁶ Instruction 2 to Item 11(f)(2) of Form N-1A; Instruction 2 to Item 19(e)(ii) of Form N-3.

Currently, filings that are required to include portfolio securities information would include a fund's required semi-annual filings on Form N-CSR [17 CFR 249.331; 17 CFR 274.128] and required filings for the first and third fiscal quarters on Form N-Q [17 CFR 249.332; 17 CFR 274.130].

⁵⁷ Instruction 3 to Item 11(f)(2) of Form N-1A; Instruction 3 to Item 19(e)(ii) of Form N-3.

⁵⁸ Instruction 3(a) to Item 11(f)(2) of Form N-1A; Instruction 3.a. to Item 19(e)(ii) of Form N-3.

⁵⁹ Instruction 3(b) to Item 11(f)(2) of Form N-1A; Instruction 3.b. to Item 19(e)(ii) of Form N-3.

⁶⁰ Except where specifically provided by Commission rule, making information accessible on a website is not necessarily adequate disclosure under the federal securities laws.

filed on or after December 5, 2004, must include the disclosure required by the amendments. We are selecting this compliance date in order to coordinate with the compliance date for new rule 38a-1 under the Investment Company Act, which is October 5, 2004. Rule 38a-1 requires fund boards to adopt policies and procedures with respect to market timing, pricing of portfolio securities, and misuses of nonpublic information, including the disclosure to third parties of material information about the fund's portfolio.⁶¹ A compliance date of December 5, 2004, will provide sufficient time for funds and their boards to review and update their policies and procedures in connection with the implementation of rule 38a-1, and to draft new disclosure to reflect these updated policies and procedures. Generally, a fund should file its first post-effective amendment complying with the new disclosure requirements pursuant to rule 485(a) under the Securities Act because such post-effective amendments typically will involve a number of material changes that do not fall within the scope of rule 485(b).⁶²

III. Paperwork Reduction Act

As explained in the Proposing Release, certain provisions of the amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 [44 U.S.C. 3501, *et seq.*]. The titles for the collections of information are: (1) "Form N-1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies"; (2) "Form N-3—Registration Statement of Separate Accounts Organized as Management Investment Companies"; (3) "Form N-4—Registration Statement of Separate Accounts Organized as Unit Investment Trusts"; and (4) "Form N-6 under the Investment Company Act of 1940 and the Securities Act of 1933, Registration Statement of Insurance Company Separate Accounts Registered as Unit Investment Trusts that Offer Variable

⁶¹ See Investment Company Act Release No. 26287 (Dec. 11, 2003) [68 FR 70402 (Dec. 17, 2003)].

⁶² A post-effective amendment may only be filed under rule 485(b) [17 CFR 230.485(b)] if it is filed for one or more specified purposes, including to make non-material changes to the registration statement. A post-effective amendment filed for any purpose not specified in rule 485(b) must be filed pursuant to rule 485(a) under the Securities Act [17 CFR 230.485(a)]. A post-effective amendment filed under rule 485(b) may become effective immediately upon filing, while a post-effective amendment filed under rule 485(a) generally becomes effective either 60 days or 75 days after filing, unless the effective date is accelerated by the Commission.

Life Insurance Policies." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Form N-1A (OMB Control No. 3235-0307), Form N-3 (OMB Control No. 3235-0316), Form N-4 (OMB Control No. 3235-0318), and Form N-6 (OMB Control No. 3235-0503) were adopted pursuant to section 8(a) of the Investment Company Act [15 U.S.C. 80a-8(a)] and section 5 of the Securities Act [15 U.S.C. 77e]. We published notice soliciting comments on the collection of information requirements in the Proposing Release and submitted these proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. OMB approved the collections of information for the amendments to Forms N-1A, N-3, N-4 and N-6. We received no comments on the proposed collection of information requirements.

The amendments adopted in this release will amend Form N-1A to require mutual funds to provide improved disclosure regarding their policies and procedures with respect to frequent purchases and redemptions of fund shares. The amendments will also amend Forms N-3, N-4, and N-6 to require similar disclosure in prospectuses for insurance company separate accounts offering variable insurance contracts, with respect to frequent transfers among sub-accounts. In addition, the Commission is adopting amendments to instructions to Forms N-1A and N-3 that clarify that all mutual funds and managed separate accounts that issue variable annuities (other than money market funds) are required to explain in their prospectuses the circumstances under which they will use fair value pricing, and the effects of using fair value pricing. Finally, the Commission is adopting amendments to Form N-1A to require disclosure regarding mutual funds' policies and procedures with respect to the selective disclosure of their portfolio holdings to any person, and parallel amendments to Form N-3 for managed separate accounts that issue variable annuities.

Form N-1A

Form N-1A, including the amendments, contains collection of information requirements. The likely respondents to this information collection are open-end funds registering with the Commission. Compliance with the disclosure requirements of Form N-1A is

mandatory. Responses to the disclosure requirements are not confidential.

We continue to estimate that the amendments will increase the hour burden per portfolio per filing of an initial registration statement by 10 hours and will increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 4 hours. The estimated total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments to Form N-1A is 1,142,296 hours.⁶³

Form N-3

Form N-3, including the amendments, contains collection of information requirements. The likely respondents to this information collection are separate accounts, organized as management investment companies offering variable annuities, registering with the Commission on Form N-3. Compliance with the disclosure requirements of Form N-3 is mandatory. Responses to the disclosure requirements are not confidential.

We continue to estimate that the amendments will increase the hour burden per portfolio per filing of an initial registration statement on Form N-3 by 10 hours and will increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement on Form N-3 by 4 hours. The estimated total annual hour burden for all funds for preparation and filing of initial registration statements and post-effective amendments on Form N-3 is 34,832 hours.⁶⁴

⁶³ This estimate differs from the estimate of 1,107,078 hours contained in the Proposing Release due to the following additional annual hour burdens for Form N-1A that were not taken into account in the Proposing Release: 2,252 hours resulting from the proposed rules relating to sales load breakpoint disclosure; 1,968 hours resulting from the proposed rules relating to disclosure of sales loads and revenue sharing in connection with the proposals for new mutual fund confirmation and point of sale disclosure; and 30,998 hours resulting from proposed amendments relating to portfolio manager disclosure. The estimate is based on the following calculation: (822.5 hours per portfolio per initial registration statement × 483 portfolios) + (108.5 hours per portfolio per post-effective amendment × 6,542 portfolios) + 2,252 hours + 1,968 hours + 30,998 hours = 1,142,296 hours.

⁶⁴ This estimate differs from the estimate of 34,662 hours contained in the Proposing Release due to an additional annual hour burden of 170 hours for Form N-3 resulting from proposed amendments relating to portfolio manager disclosure that was not taken into account in the Proposing Release. The estimate is based on the following calculation: (11,144.4 hours for filing initial registration statements) + (23,517.8 hours for filing post-effective amendments) + 170 hours = 34,832 hours.

Form N-4

Form N-4, including the amendments, contains collection of information requirements. The likely respondents to this information collection are separate accounts, organized as unit investment trusts that offer variable annuity contracts, registering with the Commission on Form N-4. Compliance with the disclosure requirements of Form N-4 is mandatory. Responses to the disclosure requirements are not confidential.

We continue to estimate that the amendments will increase the hour burden per filing of an initial registration statement on Form N-4 by 5 hours and will increase the hour burden per filing of a post-effective amendment to a registration statement on Form N-4 by 2 hours. The estimated total annual hour burden for separate accounts for preparation and filing of initial registration statements and post-effective amendments on Form N-4 is 288,701 hours.⁶⁵

Form N-6

Form N-6, including the amendments, contains collection of information requirements. The likely respondents to this information collection are separate accounts, organized as unit investment trusts that offer variable life insurance policies, registering with the Commission on Form N-6. Compliance with the disclosure requirements of Form N-6 is mandatory. Responses to the disclosure requirements are not confidential.

We continue to estimate that the amendments will increase the hour burden per filing of an initial registration statement on Form N-6 by 5 hours, and will increase the hour burden per filing of a post-effective amendment that is an annual update on Form N-6 by 2 hours. The estimated total annual hour burden for separate accounts for preparation and filing of initial registration statements and post-effective amendments on Form N-6 is 52,100 hours.⁶⁶

IV. Cost/Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. The amendments that the Commission

⁶⁵ This estimate is the same as the estimate in the Proposing Release. This estimate is based on the following calculation: (43,717 hours for filing initial registration statements) + (244,984 hours for filing post-effective amendments) = 288,701 hours.

⁶⁶ This estimate is the same as the estimate in the Proposing Release. This estimate is based on the following calculation: (38,512 hours for filing initial registration statements) + (10,088 hours for filing post-effective amendments that are annual updates) + (3,500 hours for other post-effective amendments) = 52,100 hours.

is adopting will require mutual funds to provide enhanced disclosure about their policies and procedures with respect to frequent purchases and redemptions of fund shares. Specifically, the amendments:

- Require a mutual fund to describe in its prospectus the risks, if any, that frequent purchases and redemptions of fund shares may present for other shareholders;
- Require a mutual fund to state in its prospectus whether or not the fund's board of directors has adopted policies and procedures with respect to frequent purchases and redemptions of fund shares and, if the board has not adopted any such policies and procedures, state the specific basis for the view of the board that it is appropriate for the fund not to have such policies and procedures;
- Require a mutual fund to describe in its prospectus any policies and procedures for deterring frequent purchases and redemptions of fund shares, and in its SAI any arrangements to permit frequent purchases and redemptions of fund shares; and
- Require similar disclosure in prospectuses for insurance company separate accounts offering variable insurance contracts, with respect to frequent transfers among sub-accounts.

The Commission is also adopting amendments to clarify instructions to its registration forms for mutual funds and insurance company managed separate accounts that offer variable annuities to require that all such funds (other than money market funds) explain in their prospectuses both the circumstances under which they will use fair value pricing and the effects of using fair value pricing.

In addition, the amendments require mutual funds, and insurance company managed separate accounts that offer variable annuities, to disclose their policies with respect to the disclosure of portfolio holdings information. The amendments:

- Require a fund to describe in its SAI any policies and procedures with respect to the disclosure of the fund's portfolio securities to any person and any ongoing arrangements to make available information about the fund's portfolio securities to any person; and
- Require a fund to state in its prospectus that a description of the policies and procedures is available in the fund's SAI, and on the fund's website, if applicable.

A. Benefits

The amendments we are adopting to our registration forms will benefit investors in a number of respects. First,

the amendments will benefit fund investors by providing them with more detailed information about mutual fund practices relating to frequent purchases and redemptions of fund shares (or, in the case of insurance company separate accounts offering variable insurance products, frequent transfers of contract value among sub-accounts). The amendments are intended to require mutual funds and insurance company separate accounts to describe with specificity the restrictions they place on frequent purchases and redemptions (or frequent transfers among sub-accounts), if any, and the circumstances under which each such restriction will not apply. Market timing arbitrage strategies often involve such frequent purchases and redemptions of mutual fund shares or frequent transfers among sub-accounts of insurance company separate accounts. By increasing transparency of funds' policies and procedures in this area, the amendments are designed to help restore investor confidence in the fairness of fund operations and in the practices and procedures of intermediaries selling fund shares. This additional disclosure will enable investors to assess funds' risks, policies, and procedures in this area and determine if a fund's policies and procedures are in line with the investor's expectations. In addition, increasing transparency regarding arrangements to permit frequent purchases and redemptions of fund shares (or frequent transfers among sub-accounts) and selective disclosure of portfolio holdings information may benefit fund shareholders by deterring arrangements motivated by considerations of the interests of the fund's adviser rather than the interests of fund shareholders.

Second, the amendments to Forms N-1A and N-3 relating to fair value pricing will benefit investors by clarifying that all mutual funds and managed separate accounts that offer variable annuities, other than money market funds, are required to explain both the circumstances under which they will use fair value pricing and the effects of using such pricing. These amendments will clearly reflect that funds are required to use fair value prices any time that market quotations for their portfolio securities are not readily available (including when they are not reliable). Fair valuation of a fund's portfolio securities, which is required under certain circumstances, can serve to foreclose arbitrage opportunities available to market timers.

Finally, the amendments to Forms N-1A and N-3 relating to funds' policies and procedures with respect to the

selective disclosure of portfolio holdings information may benefit investors by providing greater transparency of fund practices relating to the disclosure of the fund's portfolio holdings, and by reinforcing funds' and advisers' obligations to prevent the misuse of material, non-public information.

B. Costs

The amendments will impose new requirements on mutual funds to provide disclosure of their policies and procedures with respect to frequent purchases and redemptions of fund shares (or frequent transfers of contract value among sub-accounts, in the case of insurance company separate accounts offering variable insurance contracts), and selective disclosure of portfolio holdings information. We estimate that complying with the new disclosure requirements will entail a relatively small financial burden. The information regarding a fund's policies and procedures in these areas should be readily available to management and the board of directors of a fund. Therefore, we expect that the cost of compiling and reporting this information should be limited.

The amendments will require additional prospectus disclosure by a mutual fund regarding its policies and procedures relating to frequent purchases and redemptions by fund shareholders and additional prospectus disclosure by an insurance company separate account that issues variable insurance contracts regarding its policies and procedures relating to frequent transfers among sub-accounts. In addition, the amendments will require disclosure in the SAI for these registrants of arrangements to permit frequent purchases and redemptions (or frequent transfers among sub-accounts, in the case of insurance company separate accounts issuing variable insurance contracts). In addition, the amendments will require each mutual fund and insurance company managed separate account to describe in its SAI any policies and procedures regarding the disclosure of the fund's portfolio holdings information, and to state in its prospectus that a description of those policies and procedures is available in the fund's SAI.⁶⁷ These costs may include both internal costs (for attorneys and other non-legal staff of a fund, such as computer programmers, to prepare and review the required disclosure) and

⁶⁷ The amendments clarifying mutual funds' and insurance company managed separate accounts' disclosure requirements with respect to fair value pricing are not expected to result in any significant costs.

external costs (for printing and typesetting of the disclosure).⁶⁸ For purposes of the Paperwork Reduction Act, we have estimated that the new disclosure requirements will add 35,545 hours to the burden of completing Forms N-1A, N-3, N-4, and N-6.⁶⁹ We estimate that this additional burden will equal total internal costs of \$2,977,605 annually, or approximately \$784 per fund.⁷⁰

The external costs of providing the new prospectus disclosure relating to frequent purchases and redemptions of mutual fund shares and frequent transfers among sub-accounts of insurance company separate accounts may or may not be significant, depending on the complexity of a fund's policies and procedures in these areas, the extent to which restrictions on frequent purchases and redemptions or transfers among sub-accounts apply uniformly in all cases or will not be imposed under certain circumstances, and the extent to which a fund currently provides specific disclosure in this area. We expect that the external costs of providing disclosure regarding arrangements to permit frequent purchases and redemptions of mutual fund shares and frequent transfers among sub-accounts of insurance

⁶⁸ We note that, with respect to the amendments regarding mutual funds' policies and procedures with respect to frequent purchases and redemptions and insurance company separate accounts' policies and procedures with respect to frequent transfers among sub-accounts, in many cases funds currently provide disclosure in their prospectuses or elsewhere of the limitations that they place on frequent trading in order to discourage market timing.

⁶⁹ This represents 30,998 additional hours for Form N-1A, 728 additional hours for Form N-3, 3,269 additional hours for Form N-4, and 550 additional hours for Form N-6.

⁷⁰ These figures are based on a Commission estimate that approximately 3,800 investment companies will be subject to the amendments and an estimated hourly wage rate of \$83.77. The estimate of the number of investment companies is based on data derived from the Commission's EDGAR filing system. The estimated wage rate is a blended rate, based on published hourly wage rates for assistant/associate general counsels (\$82.05) and programmers (\$42.05) in New York City, and the estimate that professional and non-professional staff will divide time equally on compliance with the disclosure requirements, yielding a weighted wage rate of \$62.05 $((\$82.05 \times .50) + (\$42.05 \times .50)) = \$62.05$. See Securities Industry Association, *Report on Management & Professional Earnings in the Securities Industry* 2003 (Sept. 2003). This weighted wage rate was then adjusted upward by 35% for overhead, reflecting the costs of supervision, space, and administrative support, to obtain the total per hour internal cost of \$83.77 $(\$62.05 \times 1.35) = \83.77 . This estimate differs from the estimate in the Proposing Release, which was based on published compensation for compliance attorneys (\$37.60) and programmers (\$29.44) outside New York City, contained in the Securities Industry Association's *Report on Management and Professional Earnings in the Securities Industry* 2002.

company separate accounts will be minimal, because this disclosure will be included in the SAI, which is delivered to investors upon request. We also expect that the external costs of providing the new disclosure relating to each mutual fund's and insurance company managed separate account's policies and procedures with respect to disclosure of portfolio holdings information will be minimal, because the required description of a fund's policies and procedures with respect to the disclosure of the fund's portfolio securities to any person and any ongoing arrangements to make available information about the fund's portfolio securities will be required in the fund's SAI.⁷¹

V. Consideration of Effects on Efficiency, Competition, and Capital Formation

Section 2(c) of the Investment Company Act [15 U.S.C. 80a-2(c)] and section 2(b) of the Securities Act [15 U.S.C. 77(b)] require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The amendments are intended to provide greater transparency for mutual fund shareholders regarding a fund's policies and procedures with respect to frequent purchases and redemptions of fund shares (or frequent transfers of contract value among sub-accounts, in the case of insurance company separate accounts offering variable insurance contracts), and selective disclosure of portfolio holdings information.⁷² These changes may improve efficiency. The enhanced disclosure requirements are intended to enable shareholders to make a more informed assessment as to whether a particular fund is in line with shareholders' investment objectives, which could promote more efficient allocation of investments by investors and more efficient allocation of assets among competing funds. The amendments may also improve competition, as enhanced disclosure may prompt funds to compete to provide investors with policies and

⁷¹ A fund will be required to state in its prospectus that a description of its policies and procedures is available in the fund's SAI, and on the fund's website, if applicable.

⁷² The amendments clarifying mutual funds' and insurance company managed separate accounts' disclosure requirements with respect to fair value pricing are not expected to have a significant effect on efficiency, competition, and capital formation.

procedures that effectively protect long-term investors from harmful market timing, and from the misuse of portfolio holdings information through selective disclosure. Finally, the effects of the amendments on capital formation are unclear.

Although, as noted above, we believe that the amendments will benefit investors, the magnitude of the effect of the amendments on efficiency, competition, and capital formation, and the extent to which they will be offset by the costs of the amendments, are difficult to quantify. We note that, with respect to the amendments regarding funds' policies and procedures with respect to frequent purchases and redemptions (or frequent transfers among sub-accounts), in many cases funds currently provide disclosure in their prospectuses or elsewhere of the limitations that they place on frequent trading in order to discourage market timing.

We received one comment on the possible effects of the proposed amendments on competition, from a trade association affiliated with the variable life insurance industry. The commenter urged the Commission to modify the rule to prevent any anticompetitive impact, by implementing constructive market timing solutions that operate fairly across all product platforms. As discussed above, we believe that it is important for issuers of variable insurance contracts to provide disclosure regarding their policies and procedures with respect to transfers of contract value that is as specific as the disclosure that will be required for mutual funds with respect to frequent purchases and redemptions of fund shares. Market timing of mutual funds through a variable annuity or variable life insurance contract, in the form of tax-free transfers of contract value among sub-accounts, can be as detrimental for investors in variable insurance products as market timing can be for investors in mutual funds.

VI. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis ("Analysis") has been prepared in accordance with 5 U.S.C. 604, and relates to the form amendments under the Securities Act and the Investment Company Act that require funds to provide additional disclosure about their policies and procedures with respect to frequent purchases and redemptions of mutual fund shares (or, with respect to insurance company separate accounts, frequent transfers among sub-accounts) and selective

disclosure of fund portfolio holdings to any person. An Initial Regulatory Flexibility Analysis ("IRFA"), which was prepared in accordance with 5 U.S.C. 603, was published in the Proposing Release.

A. Reasons for, and Objectives of, the Amendments

Sections I and II of this Release describe the reasons for and objectives of the amendments. As discussed in detail above, the amendments adopted by the Commission include disclosure reforms intended to shed more light on market timing and selective disclosure of portfolio holdings information.

B. Significant Issues Raised by Public Comment

In the IRFA for the proposed amendments, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed amendments, the likely impact of the proposal on small entities, and the nature of any impact, and we asked commenters to provide any empirical data supporting the extent of the impact. We received no comment letters specifically on the IRFA, but one commenter requesting an extension of the compliance date stated that the Commission should be mindful of the costs that would be incurred by small mutual funds if successive disclosure changes are required, particularly in light of the compliance costs these funds face currently.

C. Small Entities Subject to the Rule

The amendments adopted by the Commission will affect registered investment companies that are small entities. For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.⁷³ Approximately 145 investment companies registered on Form N-1A meet this definition.⁷⁴ We estimate that few, if any, registered separate accounts registered on Form N-3, N-4, or N-6 are small entities.⁷⁵

⁷³ 17 CFR 270.0-10.

⁷⁴ This estimate is based on analysis by the Division of Investment Management staff of information from databases compiled by third-party information providers, including Morningstar, Inc. and Lipper.

⁷⁵ This estimate is based on figures compiled by Division of Investment Management staff regarding separate accounts registered on Forms N-3, N-4, and N-6. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are

D. Reporting, Recordkeeping, and Other Compliance Requirements

The amendments will require a mutual fund to disclose in its prospectus both the risks to shareholders of the frequent purchase and redemption of fund shares, and the fund's policies and procedures with respect to frequent purchases and redemptions of fund shares. The amendments will require similar prospectus disclosure for insurance company separate accounts issuing variable insurance contracts. The amendments also clarify that all mutual funds and insurance company managed separate accounts that issue variable annuities, other than money market funds, are required to explain both the circumstances under which they will use fair value pricing, and the effects of using fair value pricing. Finally, the amendments require mutual funds and insurance company managed separate accounts that issue variable annuities to disclose their policies and procedures with respect to the disclosure of their portfolio securities to any person and any ongoing arrangements to make available information about their portfolio securities.

The Commission estimates some one-time formatting and ongoing costs and burdens that will be imposed on all funds, including funds that are small entities. We note, however, that in many cases funds currently provide disclosure in their prospectuses of the limitations that they place on frequent trading in order to discourage market timing. For purposes of the Paperwork Reduction Act, we have estimated that the new disclosure requirements will increase the hour burden per portfolio per filing of an initial registration statement on Forms N-1A and N-3 by 10 hours each and will increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement on each such form by 4 hours. For purposes of the Paperwork Reduction Act, we have estimated that the new disclosure requirements will increase the hour burden per portfolio per filing of an initial registration statement on Forms N-4 and N-6 by 5 hours each and will increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement on each such form by 2 hours. We estimate that this additional burden will increase total internal costs per fund by approximately \$838 annually per portfolio for funds filing initial registration statements, and \$335

aggregated with the assets of their sponsoring insurance companies. Rule 0-10(b) under the Investment Company Act [17 CFR 270.0-10(b)].

annually per portfolio for funds filing post-effective amendments, on Forms N-1A and N-3. We estimate that this additional burden will increase total internal costs per separate account by approximately \$419 annually for filing an initial registration statement, and \$168 annually for filing a post-effective amendment, on Forms N-4 and N-6.⁷⁶

The external costs of providing the new prospectus disclosure relating to frequent purchases and redemptions of mutual fund shares and frequent transfers among sub-accounts of insurance company separate accounts that issue variable insurance contracts may or may not be significant, depending on the complexity of a fund's policies and procedures in these areas, the extent to which restrictions on frequent purchases and redemptions or frequent transfers among sub-accounts apply uniformly in all cases or will not be imposed under certain circumstances, and the extent to which a fund currently provides specific disclosure in this area. We expect that the external costs of providing disclosure regarding arrangements to permit frequent purchases and redemptions of mutual fund shares and frequent transfers among sub-accounts of insurance company separate accounts will be minimal, because this disclosure will be included in the SAI, which is delivered to investors upon request. We also expect that the external costs of providing the new disclosure relating to a mutual fund's or insurance company managed separate account's policies and procedures with respect to disclosure of portfolio holdings information will be minimal, because the required description of a fund's policies and procedures with respect to the disclosure of the fund's portfolio securities to any person and any ongoing arrangements to make available information about the fund's portfolio securities will be required in the fund's SAI.⁷⁷

E. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small issuers. In connection with the proposed amendments, the Commission considered the following alternatives: (i)

The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed amendments for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The Commission believes at the present time that special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, would not be appropriate or consistent with investor protection. The disclosure amendments will provide shareholders with greater transparency with respect to mutual funds' policies and procedures regarding frequent purchases and redemptions of fund shares (and, in the case of insurance company separate accounts that issue variable insurance contracts, frequent transfers among sub-accounts) and mutual funds' and insurance company managed separate accounts' policies and procedures regarding selective disclosure of their portfolio holdings. Different disclosure requirements for funds that are small entities may create the risk that the shareholders in these funds would not be as able as investors in larger funds to assess a fund's risks, policies, and procedures with respect to frequent purchases and redemptions of fund shares, as well as a fund's practices with respect to the disclosure of its portfolio holdings. We believe it is important for the disclosure that will be required by the amendments to be provided to shareholders by all funds, not just funds that are not considered small entities.

We have endeavored through these amendments to minimize the regulatory burden on all funds, including small entities, while meeting our regulatory objectives. For example, we have modified our proposal to extend the compliance date to December 5, 2004, to coordinate with the compliance date for new rule 38a-1 under the Investment Company Act. In addition, we have modified our proposals to include disclosure of arrangements by a fund to permit frequent purchases and redemptions in the SAI, rather than the prospectus. Small entities should benefit from the Commission's reasoned approach to the amendments to the same degree as other investment companies. Further clarification, consolidation, or simplification of the amendments for funds that are small entities would be inconsistent with the

Commission's concern for investor protection. Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context. Based on our past experience, we believe that the disclosure required by the amendments will be more useful to investors if there are enumerated informational requirements.

VII. Statutory Authority

The Commission is adopting amendments to Forms N-1A, N-3, N-4, and N-6 pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)] and sections 8, 22, 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a-8, 80a-22, 80a-24(a), 80a-29, and 80a-37].

List of Subjects

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rule and Form Amendments

■ For the reasons set out in the preamble, Title 17, Chapter II, of the Code of Federal Regulations is amended as follows.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

■ 1. The authority citation for Part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79m, 79n, 79q, 79t, 80a-8, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

■ 2. The authority citation for Part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

Note: The text of Forms N-1A, N-3, N-4, and N-6 do not, and these amendments will not, appear in the Code of Federal Regulations.

■ 3. Form N-1A (referenced in §§ 239.15A and 274.11A) is amended by:

⁷⁶ These figures are based on an estimated hourly wage rate of \$83.77. See *supra* note 70.

⁷⁷ The amendments clarifying mutual funds' and insurance company managed separate accounts' disclosure requirements with respect to fair value pricing are not expected to result in any significant costs.

- a. In Instruction 6 to Item 1(b)(1), revising the reference “Item 6(f)” to read “Item 6(g)”;
- b. In Instruction 6 to Item 1(b)(1), revising the reference “Item 6(f)(3)” to read “Item 6(g)(3)”;
- c. In Item 4, revising the title and adding new paragraph (d);
- d. In Item 6, revising the Instruction to paragraph (a)(1);
- e. In Item 6, redesignating paragraphs (e) and (f) as paragraphs (f) and (g), respectively;
- f. In Item 6, adding paragraph (e);
- g. In newly redesignated Item 6(f)(2)(i), revising the reference “paragraph (e)(1)” to read “paragraph (f)(1)”;
- h. In newly redesignated paragraph (g) of Item 6, revising the introductory text;
- i. In paragraph (a)(2) of Item 7, revising the reference “Item 6(f)” to read “Item 6(g)”;
- j. In Item 11, adding paragraph (f); and
- k. In Item 17, adding paragraph (e).

The additions and revisions read as follows:

Form N-1A

* * * * *

Item 4. Investment Objectives, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings

* * * * *

(d) *Portfolio Holdings.* State that a description of the Fund’s policies and procedures with respect to the disclosure of the Fund’s portfolio securities is available (i) in the Fund’s SAI; and (ii) on the Fund’s website, if applicable.

* * * * *

Item 6. Shareholder Information

- (a) * * *
- (1) * * *

Instruction: A Fund (other than a Money Market Fund) must provide a brief explanation of the circumstances under which it will use fair value pricing and the effects of using fair value pricing. With respect to any portion of a Fund’s assets that are invested in one or more open-end management investment companies that are registered under the Investment Company Act, the Fund may briefly explain that the Fund’s net asset value is calculated based upon the net asset values of the registered open-end management investment companies in which the Fund invests, and that the prospectuses for these companies explain the circumstances under which those companies will use fair value pricing and the effects of using fair value pricing.

* * * * *

(e) *Frequent Purchases and Redemptions of Fund Shares.*

(1) Describe the risks, if any, that frequent purchases and redemptions of Fund shares by Fund shareholders may present for other shareholders of the Fund.

(2) State whether or not the Fund’s board of directors has adopted policies and procedures with respect to frequent purchases and redemptions of Fund shares by Fund shareholders.

(3) If the Fund’s board of directors has not adopted any such policies and procedures, provide a statement of the specific basis for the view of the board that it is appropriate for the Fund not to have such policies and procedures.

(4) If the Fund’s board of directors has adopted any such policies and procedures, describe those policies and procedures, including:

(i) Whether or not the Fund discourages frequent purchases and redemptions of Fund shares by Fund shareholders;

(ii) Whether or not the Fund accommodates frequent purchases and redemptions of Fund shares by Fund shareholders; and

(iii) Any policies and procedures of the Fund for deterring frequent purchases and redemptions of Fund shares by Fund shareholders, including any restrictions imposed by the Fund to prevent or minimize frequent purchases and redemptions. Describe each of these policies, procedures, and restrictions with specificity. Indicate whether each of these restrictions applies uniformly in all cases or whether the restriction will not be imposed under certain circumstances, including whether each of these restrictions applies to trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker-dealers, transfer agents, third party administrators, and insurance companies. Describe with specificity the circumstances under which any restriction will not be imposed. Include a description of the following restrictions, if applicable:

(A) Any restrictions on the volume or number of purchases, redemptions, or exchanges that a shareholder may make within a given time period;

(B) Any exchange fee or redemption fee;

(C) Any costs or administrative or other fees or charges that are imposed on shareholders deemed to be engaged in frequent purchases and redemptions of Fund shares, together with a description of the circumstances under which such costs, fees, or charges will be imposed;

(D) Any minimum holding period that is imposed before an investor may make exchanges into another Fund;

(E) Any restrictions imposed on exchange or purchase requests submitted by overnight delivery, electronically, or via facsimile or telephone; and

(F) Any right of the Fund to reject, limit, delay, or impose other conditions on exchanges or purchases or to close or otherwise limit accounts based on a history of frequent purchases and redemptions of Fund shares, including the circumstances under which such right will be exercised.

(5) If applicable, include a statement, adjacent to the disclosure required by paragraphs (e)(1) through (e)(4) of this Item, that the SAI includes a description of all arrangements with any person to permit frequent purchases and redemptions of Fund shares.

* * * * *

(g) *Separate Disclosure Document.* A Fund may omit from the prospectus information about purchase and redemption procedures required by Items 6(b)–(d) and 7(a)(2), other than information that is also required by Item 6(e), and provide it in a separate document if the Fund:

* * * * *

Item 11. Description of the Fund and Its Investments and Risks

* * * * *

(f) *Disclosure of Portfolio Holdings.*

(1) Describe the Fund’s policies and procedures with respect to the disclosure of the Fund’s portfolio securities to any person, including:

(i) How the policies and procedures apply to disclosure to different categories of persons, including individual investors, institutional investors, intermediaries that distribute the Fund’s shares, third-party service providers, rating and ranking organizations, and affiliated persons of the Fund;

(ii) Any conditions or restrictions placed on the use of information about portfolio securities that is disclosed, including any requirement that the information be kept confidential or prohibitions on trading based on the information, and any procedures to monitor the use of this information;

(iii) The frequency with which information about portfolio securities is disclosed, and the length of the lag, if any, between the date of the information and the date on which the information is disclosed;

(iv) Any policies and procedures with respect to the receipt of compensation or other consideration by the Fund, its

investment adviser, or any other party in connection with the disclosure of information about portfolio securities;

(v) The individuals or categories of individuals who may authorize disclosure of the Fund's portfolio securities (e.g., executive officers of the Fund);

(vi) The procedures that the Fund uses to ensure that disclosure of information about portfolio securities is in the best interests of Fund shareholders, including procedures to address conflicts between the interests of Fund shareholders, on the one hand, and those of the Fund's investment adviser; principal underwriter; or any affiliated person of the Fund, its investment adviser, or its principal underwriter, on the other; and

(vii) The manner in which the board of directors exercises oversight of disclosure of the Fund's portfolio securities.

Instruction: Include any policies and procedures of the Fund's investment adviser, or any other third party, that the Fund uses, or that are used on the Fund's behalf, with respect to the disclosure of the Fund's portfolio securities to any person.

(2) Describe any ongoing arrangements to make available information about the Fund's portfolio securities to any person, including the identity of the persons who receive information pursuant to such arrangements. Describe any compensation or other consideration received by the Fund, its investment adviser, or any other party in connection with each such arrangement, and provide the information described by paragraphs (f)(1)(ii), (iii), and (v) of this Item with respect to such arrangements.

Instructions:

1. The consideration required to be disclosed by Item 11(f)(2) includes any agreement to maintain assets in the Fund or in other investment companies or accounts managed by the investment adviser or by any affiliated person of the investment adviser.

2. The Fund is not required to describe an ongoing arrangement to make available information about the Fund's portfolio securities pursuant to this Item, if, not later than the time that the Fund makes the portfolio securities information available to any person pursuant to the arrangement, the Fund discloses the information in a publicly available filing with the Commission that is required to include the information.

3. The Fund is not required to describe an ongoing arrangement to make available information about the

Fund's portfolio securities pursuant to this Item if:

(a) the Fund makes the portfolio securities information available to any person pursuant to the arrangement no earlier than the day next following the day on which the Fund makes the information available on its website in the manner specified in its prospectus pursuant to paragraph (b); and

(b) the Fund has disclosed in its current prospectus that the portfolio securities information will be available on its website, including (1) the nature of the information that will be available, including both the date as of which the information will be current (e.g., month-end) and the scope of the information (e.g., complete portfolio holdings, Fund's largest 20 holdings); (2) the date when the information will first become available and the period for which the information will remain available, which shall end no earlier than the date on which the Fund files its Form N-CSR or Form N-Q with the Commission for the period that includes the date as of which the website information is current; and (3) the location on the Fund's website where either the information or a prominent hyperlink (or series of prominent hyperlinks) to where the information will be available.

Item 17. Purchase, Redemption, and Pricing of Shares

(e) *Arrangements Permitting Frequent Purchases and Redemptions of Fund Shares.* Describe any arrangements with any person to permit frequent purchases and redemptions of Fund shares, including the identity of the persons permitted to engage in frequent purchases and redemptions pursuant to such arrangements, and any compensation or other consideration received by the Fund, its investment adviser, or any other party pursuant to such arrangements.

Instructions:

1. The consideration required to be disclosed by Item 17(e) includes any agreement to maintain assets in the Fund or in other investment companies or accounts managed by the investment adviser or by any affiliated person of the investment adviser.

2. If the Fund has an arrangement to permit frequent purchases and redemptions by a group of individuals, such as the participants in a defined contribution plan that meets the requirements for qualification under Section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), the Fund may identify the group rather than

identifying each individual group member.

* * * * *

■ 4. Form N-3 (referenced in §§ 239.17a and 274.11b) is amended by:

- a. In Item 5, adding paragraph (f);
- b. In Item 8, adding paragraph (e);
- c. In Item 11, adding an Instruction to paragraph (c);
- d. In Item 19, adding paragraph (e); and
- e. In Item 23, adding paragraph (f).

The additions read as follows:

Form N-3

* * * * *

Item 5. General Description of Registrant and Insurance Company

* * * * *

(f) State that a description of the Registrant's policies and procedures with respect to the disclosure of the Registrant's portfolio securities is available (A) in the Registrant's Statement of Additional Information; and (B) on the Registrant's website, if applicable.

* * * * *

Item 8. General Description of Variable Annuity Contracts

* * * * *

(e)(i) Describe the risks, if any, that frequent transfers of contract value among sub-accounts of the Registrant may present for other contractowners and other persons (e.g., participants, annuitants, or beneficiaries) who have material rights under the variable annuity contracts.

(ii) State whether or not the Registrant's board of managers has adopted policies and procedures with respect to frequent transfers of contract value among sub-accounts of the Registrant.

(iii) If the Registrant's board of managers has not adopted any such policies and procedures, provide a statement of the specific basis for the view of the board that it is appropriate for the Registrant not to have such policies and procedures.

(iv) If the Registrant's board of managers has adopted any such policies and procedures, describe those policies and procedures, including:

(A) whether or not the Registrant discourages frequent transfers of contract value among sub-accounts of the Registrant;

(B) whether or not the Registrant accommodates frequent transfers of contract value among sub-accounts of the Registrant; and

(C) any policies and procedures of the Registrant for deterring frequent

transfers of contract value among sub-accounts of the Registrant, including any restrictions imposed by the Registrant to prevent or minimize frequent transfers. Describe each of these policies, procedures, and restrictions with specificity. Indicate whether each of these restrictions applies uniformly in all cases or whether the restriction will not be imposed under certain circumstances, including whether each of these restrictions applies to trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker-dealers, transfer agents, and third party administrators. Describe with specificity the circumstances under which any restriction will not be imposed. Include a description of the following restrictions, if applicable:

- (1) any restrictions on the volume or number of transfers that may be made within a given time period;
 - (2) any transfer fee;
 - (3) any costs or administrative or other fees or charges that are imposed on persons deemed to be engaged in frequent transfers of contract value among sub-accounts of the Registrant, together with a description of the circumstances under which such costs, fees, or charges will be imposed;
 - (4) any minimum holding period that is imposed before a transfer may be made from a sub-account into another sub-account of the Registrant;
 - (5) any restrictions imposed on transfer requests submitted by overnight delivery, electronically, or via facsimile or telephone; and
 - (6) any right of the Registrant to reject, limit, delay, or impose other conditions on transfers or to terminate or otherwise limit contracts based on a history of frequent transfers among sub-accounts, including the circumstances under which such right will be exercised.
- (v) If applicable, include a statement, adjacent to the disclosure required by paragraphs (e)(i) through (e)(iv) of this Item, that the Statement of Additional Information includes a description of all arrangements with any person to permit frequent transfers of contract value among sub-accounts of the Registrant.

* * * * *

Item 11. Purchases and Contract Value

* * * * *

(c) * * *

Instruction: A Registrant (other than a money market fund or sub-account) must provide a brief explanation of the circumstances under which it will use fair value pricing and the effects of using fair value pricing. With respect to any portion of a Registrant's assets that are invested in one or more open-end

management investment companies that are registered under the Investment Company Act, the Registrant may briefly explain that the Registrant's net asset value is calculated based upon the net asset values of the registered open-end management investment companies in which the Registrant invests, and that the prospectuses for these companies explain the circumstances under which those companies will use fair value pricing and the effects of using fair value pricing.

* * * * *

Item 19. Investment Objectives and Policies

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(e)(i) Describe the Registrant's policies and procedures with respect to the disclosure of the Registrant's portfolio securities to any person, including:

(A) how the policies and procedures apply to disclosure to different categories of persons, including contractowners, participants, annuitants, beneficiaries, institutional investors, intermediaries that distribute the Registrant's contracts, third-party service providers, rating and ranking organizations, and affiliated persons of the Registrant;

(B) any conditions or restrictions placed on the use of information about portfolio securities that is disclosed, including any requirement that the information be kept confidential or prohibitions on trading based on the information, and any procedures to monitor the use of this information;

(C) the frequency with which information about portfolio securities is disclosed, and the length of the lag, if any, between the date of the information and the date on which the information is disclosed;

(D) any policies and procedures with respect to the receipt of compensation or other consideration by the Registrant, its investment adviser, the Insurance Company, or any other party in connection with the disclosure of information about portfolio securities;

(E) the individuals or categories of individuals who may authorize disclosure of the Registrant's portfolio securities (e.g., executive officers of the Registrant's investment adviser);

(F) the procedures that the Registrant uses to ensure that disclosure of information about portfolio securities is in the best interests of contractowners, participants, annuitants, and beneficiaries, including procedures to address conflicts between the interests of such persons, on the one hand, and those of the Registrant's investment adviser or principal underwriter; the Insurance Company; or any affiliated

person of the Registrant, its investment adviser or principal underwriter, or the Insurance Company, on the other; and

(G) the manner in which the board of managers exercises oversight of disclosure of the Registrant's portfolio securities.

Instruction: Include any policies and procedures of the Registrant's investment adviser, or any other third party, that the Registrant uses, or that are used on the Registrant's behalf, with respect to the disclosure of the Registrant's portfolio securities to any person.

(ii) Describe any ongoing arrangements to make available information about the Registrant's portfolio securities to any person, including the identity of the persons who receive information pursuant to such arrangements. Describe any compensation or other consideration received by the Registrant, its investment adviser, the Insurance Company, or any other party in connection with each such arrangement, and provide the information described by paragraphs (e)(i)(B), (C), and (E) of this Item with respect to such arrangements.

Instructions:

1. The consideration required to be disclosed by Item 19(e)(ii) includes any agreement to maintain assets in the Registrant or in other investment companies or accounts managed or sponsored by the investment adviser, the Insurance Company, or any affiliated person of the investment adviser or the Insurance Company.

2. The Registrant is not required to describe an ongoing arrangement to make available information about the Registrant's portfolio securities pursuant to this Item, if, not later than the time that the Registrant makes the portfolio securities information available to any person pursuant to the arrangement, the Registrant discloses the information in a publicly available filing with the Commission that is required to include the information.

3. The Registrant is not required to describe an ongoing arrangement to make available information about the Registrant's portfolio securities pursuant to this Item if:

a. the Registrant makes the portfolio securities information available to any person pursuant to the arrangement no earlier than the next day following the day on which the Registrant makes the information available on its website in the manner specified in its prospectus pursuant to paragraph b.; and

b. the Registrant has disclosed in its current prospectus that the portfolio securities information will be available

on its website, including (1) the nature of the information that will be available, including both the date as of which the information will be current (e.g., month-end) and the scope of the information (e.g., complete portfolio holdings, Registrant's largest 20 holdings); (2) the date when the information will first become available and the period for which the information will remain available, which shall end no earlier than the date on which the Registrant files its Form N-CSR or Form N-Q with the Commission for the period that includes the date as of which the website information is current; and (3) the location on the Registrant's website where either the information or a prominent hyperlink (or series of prominent hyperlinks) to the information will be available.

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Item 23. Purchase and Pricing of Securities Being Offered

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(f) Describe any arrangements with any person to permit frequent transfers of contract value among sub-accounts of the Registrant, including the identity of the persons permitted to engage in frequent transfers pursuant to such arrangements, and any compensation or other consideration received by the Registrant, its investment adviser, the Insurance Company, or any other party pursuant to such arrangements.

Instructions:

1. The consideration required to be disclosed by Item 23(f) includes any agreement to maintain assets in the Registrant or in other investment companies or accounts managed or sponsored by the investment adviser, the Insurance Company, or any affiliated person of the investment adviser or the Insurance Company.

2. If the Registrant has an arrangement to permit frequent transfers of contract value among sub-accounts of the Registrant by a group of individuals, such as the participants in a defined contribution plan that meets the requirements for qualification under Section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), the Registrant may identify the group rather than identifying each individual group member.

* * * * *

■ 5. Form N-4 (referenced in §§ 239.17b and 274.11c) is amended by:

- a. In Item 7, adding paragraph (e); and
■ b. In Item 19, adding paragraph (c).

The additions read as follows:

Form N-4

* * * * *

Item 7. General Description of Variable Annuity Contracts

* * * * *

(e)(i) Describe the risks, if any, that frequent transfers of contract value among sub-accounts of the Registrant may present for other contractowners and other persons (e.g., participants, annuitants, or beneficiaries) who have material rights under the variable annuity contracts.

(ii) State whether or not the Registrant or depositor has policies and procedures with respect to frequent transfers of contract value among sub-accounts of the Registrant.

(iii) If neither the Registrant nor the depositor has any such policies and procedures, provide a statement of the specific basis for the view of the depositor that it is appropriate for the Registrant and depositor not to have such policies and procedures.

(iv) If the Registrant or depositor has any such policies and procedures, describe those policies and procedures, including:

(A) whether or not the Registrant or depositor discourages frequent transfers of contract value among sub-accounts of the Registrant;

(B) whether or not the Registrant or depositor accommodates frequent transfers of contract value among sub-accounts of the Registrant; and

(C) any policies and procedures of the Registrant or depositor for deterring frequent transfers of contract value among sub-accounts of the Registrant, including any restrictions imposed by the Registrant or depositor to prevent or minimize frequent transfers. Describe each of these policies, procedures, and restrictions with specificity. Indicate whether each of these restrictions applies uniformly in all cases or whether the restriction will not be imposed under certain circumstances, including whether each of these restrictions applies to trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker-dealers, transfer agents, and third party administrators. Describe with specificity the circumstances under which any restriction will not be imposed. Include a description of the following restrictions, if applicable:

(1) any restrictions on the volume or number of transfers that may be made within a given time period;

(2) any transfer fee;

(3) any costs or administrative or other fees or charges that are imposed on persons deemed to be engaged in frequent transfers of contract value among sub-accounts of the Registrant, together with a description of the

circumstances under which such costs, fees, or charges will be imposed;

(4) any minimum holding period that is imposed before a transfer may be made from a sub-account into another sub-account of the Registrant;

(5) any restrictions imposed on transfer requests submitted by overnight delivery, electronically, or via facsimile or telephone; and

(6) any right of the Registrant or depositor to reject, limit, delay, or impose other conditions on transfers or to terminate or otherwise limit contracts based on a history of frequent transfers among sub-accounts, including the circumstances under which such right will be exercised.

(v) If applicable, include a statement, adjacent to the disclosure required by paragraphs (e)(i) through (e)(iv) of this Item, that the Statement of Additional Information includes a description of all arrangements with any person to permit frequent transfers of contract value among sub-accounts of the Registrant.

* * * * *

Item 19. Purchase of Securities Being Offered

* * * * *

(c) Describe any arrangements with any person to permit frequent transfers of contract value among sub-accounts of the Registrant, including the identity of the persons permitted to engage in frequent transfers pursuant to such arrangements, and any compensation or other consideration received by the Registrant, the depositor, or any other party pursuant to such arrangements.

Instructions:

1. The consideration required to be disclosed by Item 19(c) includes any agreement to maintain assets in the Registrant or in other investment companies or accounts managed or sponsored by the depositor, any investment adviser of a portfolio company, or any affiliated person of the depositor or of any such investment adviser.

2. If the Registrant has an arrangement to permit frequent transfers of contract value among sub-accounts of the Registrant by a group of individuals, such as the participants in a defined contribution plan that meets the requirements for qualification under Section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), the Registrant may identify the group rather than identifying each individual group member.

* * * * *

■ 6. Form N-6 (referenced in §§ 239.17c and 274.11d) is amended by:

- a. In Item 6, adding paragraph (f); and

- b. In Item 19, adding paragraph (d).
The additions read as follows:

Form N-6

* * * * *

Item 6. General Description of Contracts

* * * * *

(f) Frequent Transfers Among Sub-Accounts of the Registrant.

(1) Describe the risks, if any, that frequent transfers of Contract value among sub-accounts of the Registrant may present for other Contractowners and other persons (e.g., the insured or beneficiaries) who have material rights under the Contract.

(2) State whether or not the Registrant or Depositor has policies and procedures with respect to frequent transfers of Contract value among sub-accounts of the Registrant.

(3) If neither the Registrant nor the Depositor has any such policies and procedures, provide a statement of the specific basis for the view of the Registrant and Depositor not to have such policies and procedures.

(4) If the Registrant or Depositor has any such policies and procedures, describe those policies and procedures, including:

(i) whether or not the Registrant or Depositor discourages frequent transfers of Contract value among sub-accounts of the Registrant;

(ii) whether or not the Registrant or Depositor accommodates frequent transfers of Contract value among sub-accounts of the Registrant; and

(iii) any policies and procedures of the Registrant or Depositor for deterring frequent transfers of Contract value among sub-accounts of the Registrant, including any restrictions imposed by the Registrant or Depositor to prevent or minimize frequent transfers. Describe each of these policies, procedures, and

restrictions with specificity. Indicate whether each of these restrictions applies uniformly in all cases or whether the restriction will not be imposed under certain circumstances, including whether each of these restrictions applies to trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker-dealers, transfer agents, and third party administrators. Describe with specificity the circumstances under which any restriction will not be imposed. Include a description of the following restrictions, if applicable:

(A) any restrictions on the volume or number of transfers that may be made within a given time period;

(B) any transfer fee;

(C) any costs or administrative or other fees or charges that are imposed on persons deemed to be engaged in frequent transfers of Contract value among sub-accounts of the Registrant, together with a description of the circumstances under which such costs, fees, or charges will be imposed;

(D) any minimum holding period that is imposed before a transfer may be made from a sub-account into another sub-account of the Registrant;

(E) any restrictions imposed on transfer requests submitted by overnight delivery, electronically, or via facsimile or telephone; and

(F) any right of the Registrant or Depositor to reject, limit, delay, or impose other conditions on transfers or to terminate or otherwise limit Contracts based on a history of frequent transfers among sub-accounts, including the circumstances under which such right will be exercised.

(5) If applicable, include a statement, adjacent to the disclosure required by paragraphs (f)(1) through (f)(4) of this Item, that the Statement of Additional Information includes a description of all arrangements with any person to permit

frequent transfers of Contract value among sub-accounts of the Registrant.

* * * * *

Item 19. Additional Information About Operation of Contracts and Registrant

* * * * *

(d) Describe any arrangements with any person to permit frequent transfers of Contract value among sub-accounts of the Registrant, including the identity of the persons permitted to engage in frequent transfers pursuant to such arrangements, and any compensation or other consideration received by the Registrant, the Depositor, or any other party pursuant to such arrangements.

Instructions:

1. The consideration required to be disclosed by Item 19(d) includes any agreement to maintain assets in the Registrant or in other investment companies or accounts managed or sponsored by the Depositor, any investment adviser of a Portfolio Company, or any affiliated person of the Depositor or of any such investment adviser.

2. If the Registrant has an arrangement to permit frequent transfers of Contract value among sub-accounts of the Registrant by a group of individuals, such as the participants in a defined contribution plan that meets the requirements for qualification under Section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), the Registrant may identify the group rather than identifying each individual group member.

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Dated: April 16, 2004.

By the Commission.

Jill M. Peterson,

Assistant Secretary.

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