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THE REGISTRATION OF MUTUAL FUNDS

23rd EDITION

STRADLEY RONON

REGISTRATION OF MUTUAL FUNDS

February 2017

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INTRODUCTION

Stradley Ronon is proud to co-produce this important reference work with Donnelley Financial Solutions (DFIN). As one of the premier investment management practices in the United States, Stradley Ronon represents in some capacity more than 300 institutional and retail registered investment company clients with more than 1500 separate series/funds marketing shares through every distribution channel with assets under management over $2 trillion. We also represent retail and institutional investment companies marketing shares through every distribution channel, as well as investment advisers, hedge fund sponsors, managers, administrators and underwriters/distributors. In addition, Stradley Ronon serves as independent legal counsel to investment company independent directors/trustees, and as special counsel to other law firms with regard to complex issues arising under the Investment Company Act of 1940.

This is the twenty-third edition of our Book, Registration of Mutual Funds, and reflects recent revisions by the United States Securities and Exchange Commission ("SEC") to the Form N-1A. The Book is structured as follows:

This edition contains both an unannotated version of Form N-1A and an annotated version of Form N-1A. Following selective items of the Annotated Form N-1A, we have included an annotated section (in bordered text) which includes certain SEC guidance on the intended disclosure for that item. This guidance may come from the releases adopting revisions to Form N-1A, relevant sections of other releases and SEC Staff interpretative letters. Please note that the footnoting in the Form N-1A is the internal footnoting in the book and is not the footnote number in the related SEC materials. References to footnotes within the footnotes refer to the footnoting in the SEC materials. In some places, we have added in brackets the footnote in this book to which the footnote cross-reference corresponds.

As we noted in the prior editions of this Book, the SEC in the Adopting Release on the current Form N-1A indicated that, in large part, the Staff's prior disclosure guidance for the old Form N-1A was being replaced by the revised form and the revised instructions. The Adopting Release also indicated that the SEC Staff intended to prepare new disclosure guidelines. As of the date of the preparation of this Book, no new guidelines have been issued. In a separately bordered section, we have included selected prior generic comment letters, relevant SEC releases, and more recent SEC Division of Investment Management guidance updates. In those situations where the old letters continue to provide relevant regulatory interpretations on particular Investment Company Act issues, we have retained references to those materials.

In addition to the Form and annotations, we have included the following documents: (Appendix I)—the adopting release for revised Form N-1A, the adopting release for revised N-1A relating to the Summary Prospectus, and the adopting release regarding Independence of Investment Company Directors. (Appendix II)—the adopting releases for Rule 35d-1 (Investment Company Names), the adopting releases for after-tax disclosure and the Staff's related Q&A letters, the SEC's Plain English Handbook; along with other relevant disclosure releases. (Appendix III)—past SEC Staff Generic Comment Letters (including the Generic Comment Letters for Investment Company Chief Financial Officers) and selected SEC Division of Investment Management Guidance Updates. (Appendix IV)—the Internet and Use of Electronic

Media releases, (Appendix V)—selected rules under Regulation C of the Securities Act of 1933 for SEC filing procedures; and (Appendix VI)—Form N-8A and instructions.

The Editor would like to thank his colleagues, Kevin Ercoline, Jennifer Hillman, Claire Olivar, Kris Pietrzykowski, and Kathleen Sheehy for their assistance in the preparation of this edition.

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FABIO BATTAGLIA III (B.A. 1996, Villanova University; J.D. 2003, Villanova University) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Battaglia focuses his practice on counseling investment companies and investment advisers in connection with various regulatory, compliance and transactional issues. He assists clients with a variety of investment management and securities law matters, including: the formation, registration and ongoing operations of investment companies; the preparation of regulatory filings; and the drafting of compliance procedures and corporate policies. Mr. Battaglia also has extensive experience dealing with multi-manager and sub-advised mutual funds, exchange-traded funds and closed-end funds. While pursuing his J.D. at Villanova University School of Law, Mr. Battaglia worked in the legal advisory department of Merrill Lynch Investment Managers. While there, his responsibilities included researching issues arising under federal securities laws and preparing documents in connection with the organization and registration of investment companies.

E. CAROLAN BERKLEY (B.S. 1972, Tufts University; J.D. 1977, Temple University) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Berkley concentrates her practice in the areas of investment management, derivatives, finance, secured transactions, general corporate law and opinion practice. She represents investment management companies, open- and closed-end investment companies and registered advisers in a wide range of regulatory, corporate and transactional matters. Ms. Berkley provides regulatory, compliance and business advice, including on disclosure, compliance policies and reports, liquidity and leveraged loans, interfund and securities lending, derivatives, statutory trust issues and director's duties. She assisted in the

reorganization of a combination of unaffiliated open- and closed-end funds to an acquiring adviser's fund platform and service providers, followed by product rationalization of the expanded fund product range. She also represents business corporations and alternative entities in a variety of matters, including formation, reorganizations, secured and unsecured loans, derivatives, and general business advice. Ms. Berkley is an active member of a number of committees of the American Bar Association Business Law Section. She serves on the Task Force on Investment Company Use of Derivatives and Leverage of the American Bar Association Business Law Section. She has worked on American Bar Association, Pennsylvania Bar Association, and TriBar Opinion Committee projects on legal opinions, including as a member of the drafting group for the Pennsylvania Legal Opinion Deskbook and co-reporter for the ABA report on Closing Opinions of Inside Counsel. Ms. Berkley is a past chair of the American Bar Association's Business Law Section Legal Opinions Committee. She chaired the Article 9 Task Force of the Pennsylvania Bar Association Business Law Section, which was given the assignment of preparing revised Article 9 of the Uniform Commercial Code for adoption in Pennsylvania. Most recently she was a member of the Drafting Committee on amendments to Uniform Commercial Code Article 9. She is a member of Pennsylvania Bar Association committee redrafting the Pennsylvania alternative entity laws and an observer to the Uniform Law Commission Drafting Committee on Series of Unincorporated Business Entities. Consecutively since 2009, Ms. Berkley has been included in the *The Best Lawyers in America*, which is regarded as a definitive guide to legal excellence in the United States. In 2015, Ms. Berkley received the W. Edward Sell Business Lawyer Award presented by the Pennsylvania Business Law Section for her extraordinary contribution to the practice of business law in Pennsylvania and was appointed by the Secretary of the Commonwealth to the Advisory Committee for the Pennsylvania Department of State Corporations Bureau.

JOAN E. BOROS (B.A. George Washington University; J.D. University of Maryland, Order of the Coif) is counsel in Stradley Ronon's Investment Management Practice Group. She focuses her practice on securities, corporate and insurance law relating to all aspects of the formation or design, qualification, state and federal registration, regulation and compliance of retail investment companies, variable insurance products and related entities such as investment advisers and broker-dealers. Ms. Boros counsels clients regarding the ongoing changes with regard to the design and regulation of new investment products, regulation of entities, securities offerings, advisory and distribution issues. She provides analysis and advice regarding changes to relevant securities laws as they apply to various registered and unregistered offerings, including mutual funds, master/feeder funds, funds of funds, exchange traded funds, variable insurance products, traditional and fixed indexed insurance products, contingent deferred annuities, longevity products, deferred income annuities, and QLACs. A current focus has been on the implications and consequences of the Department of Labor's "Fiduciary Rule" on the various entities and their products and services. Ms. Boros attended Vassar College prior to George Washington University. She was a business promotion and marketing consultant before becoming a lawyer.

TAYLOR BRODY (B.A. 2003, Carleton College, J.D. 2006, University of Pennsylvania) is counsel in Stradley Ronon's Investment Management Practice Group. Ms. Brody advises investment companies and investment advisers on regulatory matters and state and federal securities law compliance. She has worked on a variety of matters for mutual fund clients,

including the preparation of annual updates to mutual fund registration statements; the preparation of proxy solicitation materials; the drafting and review of a variety of contracts for clients; and the preparation of materials in connection with the merger of investment companies. Ms. Brody has significant experience working with closed-end funds, including addressing shareholder proposals and conducting proxy fights, and the implementation of tender offers and managed distribution plans.

JANA L. CRESSWELL (B.A. 1995, University of Delaware; J.D. 1998, University of Pennsylvania) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Cresswell advises investment companies, investment advisers and broker-dealers on regulatory matters, state and federal securities law compliance and general corporate matters. She has worked on a variety of matters for mutual fund clients, including: preparing annual updates to mutual fund registration statements; reviewing and preparing proxy solicitation materials; drafting and reviewing a variety of contracts for clients, including various agreements between mutual funds and their service providers and investment advisers and solicitors; preparing materials in connection with the merger of investment companies, including the Registration Statement on Form N-14; and reviewing offering materials to be sent to closed-end investment company shareholders in connection with a fund's issuer tender offer.

MATTHEW R. DICLEMENTE (B.S. University of Delaware, 1992; J.D. Widener University School of Law, 2001) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. DiClemente represents investment advisers, registered investment companies and their boards, private funds and broker-dealers in a wide range of regulatory, corporate and transactional matters. Mr. DiClemente's experience includes advising on all aspects of open-end, closed-end and interval fund product development, regulation and disclosure, advising on the development and management of alternative asset products and strategies such as derivatives and other complex instruments, advising on SEC, CFTC, NFA and FINRA registration and regulation, assisting investment management firms navigate difficult SEC exams and enforcement proceedings, handling mergers and acquisitions involving investment companies and investment advisers, and negotiating all types of selling, revenue-sharing and other distribution agreements. Mr. DiClemente is the founder of the Philadelphia Young '40 Act Lawyers Roundtable and was recommended in the Legal 500 U.S. for mutual/registered funds.

LISA A. DUDA (B.A. 1981, University of Scranton; J.D. 1991, Widener University) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Duda counsels investment companies, investment advisers and independent directors on securities and corporate law matters relating to pooled investment vehicles, including registered investment companies and sub-advised and multi-manager mutual funds. She also counsels such clients on regulatory, transactional and compliance matters. Ms. Duda assisted in the implementation of a unique institutional complex of mutual funds involving fund-of-funds and asset allocation, which involved the receipt of three SEC exemptive orders, as well as in structuring and implementing an affiliated fund-of-funds product involving a master fund/feeder fund structure (including the preparation of the SEC exemptive application for such structure), and also in preparing the SEC exemptive application resulting in the first joint-trading account order extending the maturity

and types of instruments as permissible investments. She assisted in two complex-wide proxy solicitation projects in which each fund complex moved its entire complement of funds to the Delaware business trust format, which involved: drafting/reviewing of the shareholder proposal and preparing the corporate documentation necessary to accomplish the transactions; managing several investment company merger transactions, including both affiliated and non-affiliated fund complexes; and creating and preparing all documentation relating to the self-tender offer of two closed-end funds, which involved managing all aspects of the self-tender offer process.

RUTH S. EPSTEIN (B.A. 1974, Cornell University; J.D. 1977, Harvard Law School) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Epstein has more than 30 years of corporate, securities and financial services experience, including five years with the Securities and Exchange Commission in the Division of Enforcement and the Office of General Counsel. She concentrates on complex issues faced by participants in the investment management and variable insurance products industries and counsels financial services clients on a broad range of regulatory, governance, product development and enforcement issues. She is a frequent author and lecturer on topics affecting her clients. In recent years, she has co-authored four "friend of the Court briefs" in matters of critical importance to the industry, including two in the U.S. Supreme Court—*Jones v. Harris Associates LP* (standard for review of advisory fees) and *Janus Capital Group, Inc., et. al. v. First Derivative Traders* (responsibility for statements in mutual fund prospectuses). As co-chair of the American Bar Association's Sub-Committee on Securities Activities of Insurance Companies, Ms. Epstein has taken an active role in the debate surrounding a number of important regulatory initiatives affecting funds and variable products, including the SEC's summary prospectus and XBRL proposals. Since 2007, Ms. Epstein has been recognized as a leading lawyer for investment funds: registered funds by *Chambers USA*. She has also been included in *Best Lawyers in America* for her work in mutual funds law. Ms. Epstein has held a number of positions at the Securities and Exchange Commission, including in the Division of Enforcement (1978-81) and in the Office of the General Counsel (1981-84). She clerked for the Hon. William Wayne Justice of the U.S. District Court for the Eastern District of Texas (1977-1978).

J. STEPHEN FEINOUR, JR. (B.A. 2002, University of Pennsylvania; J.D. 2006, William & Mary School of Law) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Feinour focuses his practice on counseling investment companies and investment advisers in connection with various regulatory, compliance and transactional issues. He regularly advises clients on matters such as the formation, registration and ongoing regulation of investment advisers and investment companies, including index-based and actively managed exchange-traded funds (ETFs). Mr. Feinour's legal representation includes preparing regulatory filings; drafting and reviewing registration statements and proxy solicitation materials; researching various securities and corporate law issues; drafting corporate policies and compliance procedures; counseling boards of trustees/directors on governance matters; assisting ETFs in obtaining exchange listing approvals; and negotiating service provider agreements. Prior to joining Stradley Ronon, Mr. Feinour served as a law clerk for the Hon. Bonnie Brigance Leadbetter of the Commonwealth Court of Pennsylvania.

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AMY C. FITZSIMMONS (B.A. 1998, Pennsylvania State University; J.D. 2005, Temple University) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Fitzsimmons focuses her practice on advising investment company and investment advisory clients on various regulatory, compliance and transactional matters under federal and state securities laws. Her practice includes assisting investment company clients with the registration and regulation of new and existing mutual funds; board meeting preparation and other board-related issues; fund restructurings; fund shareholder meetings and proxy materials; and other regulatory and compliance issues. Recently, Ms. Fitzsimmons has been significantly involved in the creation of various alternative funds including those that invest in complex instruments, utilize special structures and/or employ alternative strategies. With respect to investment advisory clients, she concentrates primarily on registration, regulation, contract and compliance matters under the Investment Advisers Act of 1940 and state securities laws. While pursuing her J.D. at Temple University Beasley School of Law, Ms. Fitzsimmons worked as a paralegal in the Investment Management Practice Group at Stradley Ronon.

ALISON M. FULLER (B.A. 1985, Williams College; J.D. 1991, Georgetown University) is a partner in Stradley Ronon's Investment Management Group Practice Group. Ms. Fuller regularly represents investment advisers, investment companies and their independent trustees. Prior to joining Stradley Ronon, Ms. Fuller served for eight years as Assistant Chief Counsel in the Securities and Exchange Commission's Division of Investment Management. At the SEC, Ms. Fuller and her staff developed a number of key positions relating to the investment management industry, including concerning affiliated transactions, assignments of investment advisory contracts and unique investment products. She received an award for supervisory excellence, Capital Markets Awards in 2005 as a member of the Asset-Backed Securities Rulemaking Team, and in 2001 as a member of the September 11, 2001 Recovery Team. Ms. Fuller has been included in *Best Lawyers in America* for her work in mutual fund law. Ms. Fuller is a member of the Board of Directors of the firm.

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ALAN R. GEDRICH (B.S. 1982, Pennsylvania State University; J.D. 1987, University of Pittsburgh) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Gedrich counsels investment funds - including mutual funds, exchange traded funds (ETFs), closed end funds, domestic and offshore hedge funds and private equity companies - and investment advisers with respect to registration, transactional and compliance matters. Mr. Gedrich has counseled investment companies, investment advisers, Boards of Trustees, and hedge funds, on formation, regulatory and compliance matters, acquisitions, corporate transactions, service provider agreements, and credit agreements. Additionally, Mr. Gedrich has been recognized as a leading lawyer for "Investment Funds: Hedge Funds" in *Chambers USA America's Leading Lawyers for Business* in 2011 and 2012. Mr. Gedrich is a speaker at numerous investment management industry conferences and webcasts, as well as author, on topics such as sub-advised mutual funds, Dodd-Frank, investment adviser compliance programs, conflicts of interest and the regulatory issues surrounding mutual funds investing in alternative investments. Prior to attending law school, Mr. Gedrich worked in public accounting for Coopers & Lybrand, the predecessor to PricewaterhouseCoopers, LLP. He is also a CPA.

DAVID P. GLATZ (B.S.C. 1990, DePaul University; J.D. 1999, Loyola University of Chicago) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Glatz focuses his practice on closed-end funds, with particular emphasis on securities offerings. His recent representations include several closed-end fund initial public offerings and public and private offerings of preferred shares. He also has represented several closed-end funds in connection with tender offers. As counsel to registered investment companies on securities law and regulatory matters, Mr. Glatz advises clients on issues arising under the federal securities laws, including the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Company Act of 1940, stock exchange rules and other regulatory topics.

ALAN P. GOLDBERG (B.A. 1986, University of Pennsylvania; J.D. 1989, Temple University Beasley School of Law) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Goldberg's practice focuses on representing registered investment companies and their independent board members, registered investment advisers, sponsors to unregistered investment pools and family offices. Alan handles all aspects of creating registered investment companies and registering new investment advisers, including the establishment of compliance policies and procedures. He regularly prepares regulatory filings and applications on behalf of investment companies, including mutual funds, exchange-traded funds, closed-end funds and investment advisers. He has performed numerous comprehensive compliance reviews of investment advisers and investment companies. Alan also routinely handles all aspects of investment adviser and fund merger transactions and all aspects of forming unregistered investment funds including those that rely upon Section 3(c)(11) of the Investment Company Act. Prior to joining Stradley Ronon, Alan worked at another law firm, where he represented investment companies, their boards and investment advisers. Alan was an associate at a major New York-based law firm, where he worked on regulatory and compliance matters for large institutional asset management clients. He also served as counsel to Price Waterhouse LLP's investment management and regulatory consulting services, and as an enforcement attorney in the investment management section of the New York Regional Office of the U.S. Securities and Exchange Commission where

he investigated and prosecuted violations of the federal securities laws. Alan is a frequent speaker on a variety of investment advisory, investment company and compliance topics.

KENNETH L. GREENBERG (B.A. 1987, Albright College; J.D. 1990, Harvard University) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Greenberg counsels investment companies, investment advisers, transfer agents, and broker-dealers on regulatory matters relating to separate accounts and pooled investment products, including registered and unregistered and open- and closed-end investment companies. With over 25 years of experience in federal and state securities law matters, he has provided advice to investment companies, investment advisers, transfer agents, and broker-dealers on: formation and registration of investment advisers and investment companies; preparation of disclosure documents (including Form ADV, Form N-1A, Form N-2, Form N-CSR and Form N-14); proxy materials; contracts; compliance manuals and advertising; cybersecurity; issues involving the distribution of investment company securities; questions regarding the FINRA Conduct Rules such as the asset-based sales-charge rule, cash/non-cash compensation rules and advertising rules; and acquisitions and mergers of investment companies and investment advisers. In addition, he has counseled on SEC inspections and regulatory and compliance matters arising under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Act of 1933, the Securities Exchange Act of 1934 and state "blue sky" securities and escheatment laws. Mr. Greenberg serves as editor of the following publications that are published by DFIN and Stradley Ronon: Mergers of Investment Companies, The Registration of Mutual Funds, The Investment Company Act of 1940 and Investment Advisers Act of 1940, Mutual Fund Record Retention Reference Guide and The Regulation of Commodity Pool Operators and Commodity Trading Advisors Under the Commodity Exchange Act: Regulatory Materials Relevant to the 1940 Act Practitioner. Prior to joining Stradley Ronon, Mr. Greenberg was an investment management partner at another Philadelphia law firm.

CORY O. HIPPLER (B.S. 1998, University of Richmond; J.D. 2006 Rutgers University School of Law) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Hippler focuses his practice on counseling registered investment companies, investment advisers and independent directors on various regulatory, compliance and transactional matters. He advises clients on matters such as the organization, registration and ongoing operations and compliance of open-end and closed-end funds (including multi-manager funds, master-feeder funds and interval funds); the preparation and review of regulatory filings, board materials and compliance policies and procedures; fiduciary oversight and fund governance issues; shareholder meetings and proxy solicitation materials; and various transactional matters, including reorganizations, mergers and acquisitions involving funds and investment advisers.

PETER M. HONG (B.A. 1989, Dickinson College; J.D. 1993, American University) advises clients in matters pertaining to the registration and regulation of registered and private investment companies, investment advisers, broker-dealers, commodity trading advisors and commodity pool operators under federal and state laws. His practice includes providing advice regarding compliance with regulations of federal and state securities and commodities regulatory authorities and self-regulatory organizations such as the Financial Industry Regulatory Authority (FINRA) and the National Futures Association (NFA). In addition, Mr. Hong also advises clients in the formation of domestic and off-

shore hedge funds, including preparation of private placement memoranda, operating agreements and subscription documents; preparation and negotiation of related service provider contracts; and compliance with state blue sky filing requirements. Prior to joining the firm, Mr. Hong served as special and senior counsel at the U.S. Securities and Exchange Commission (SEC). During his tenure as special counsel in the Division of Investment Management, he actively participated in and influenced positions taken with respect to legislation or rulemaking regarding investment company disclosure regulation. Mr. Hong also served as senior counsel in the Office of Chief Counsel for the SEC's Division of Enforcement. He also investigated and prosecuted violations of the Commodity Exchange Act and its related rules as a trial attorney for the U.S. Commodity Futures Trading Commission (CFTC), Division of Enforcement in Washington, D.C.

KRISTIN H. IVES (B.A. 1982, Kenyon College; J.D. 1985, Ohio State University) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Ives advises clients on all aspects of the Investment Company Act of 1940 and the Investment Advisers Act of 1940. She counsels investment companies and their boards of directors/trustees and investment advisers on securities, transactional and corporate matters relating to pooled investment products, including registered open-end and closed-end investment companies. Some of the matters on which Ms. Ives has assisted clients include: advising investment companies on structuring and ongoing operations of multi-manager funds employing alternative investment strategies; drafting and implementing complex compliance programs and procedures to bring clients into compliance with the SEC's recent regulatory initiatives; advising investment companies regarding all aspects of a wide array of derivative instruments under the Investment Company Act of 1940, including managing complex-wide revisions to disclosure and preparation of related compliance policies and procedures; managing complex-wide proxy solicitation projects, including one involving more than 120 mutual funds and four proxy statements in which an entire complex moved its funds to the Delaware business trust format, adopted updated charter documents and modernized all of the funds' investment restrictions; advising and assisting money market funds in connection with recent regulatory initiatives and market events; and managing multiple reorganizations of open-end funds into both affiliated and unaffiliated open-end funds. Prior to joining Stradley Ronon, Ms. Ives was a partner in the Columbus, Ohio law office of a national law firm.

JONATHAN M. KOPCSIK (B.A. 1992, Lafayette College; J.D. 1998, Temple University) is a partner in Stradley Ronon's Investment Management Group. Mr. Kopcsik's practice involves advising clients in matters relating to the registration and regulation of investment companies and investment advisers under federal and state securities laws. He has helped a number of investment firms launch their first registered and unregistered investment company products. Mr. Kopcsik has counseled proprietary, multi-series, multi-class and multi-manager funds on various regulatory and compliance matters, as well as restructurings, acquisitions and other corporate transactions. He has experience advising fund boards and their independent directors on issues relating to fiduciary duties, compliance and fund governance. Mr. Kopcsik also has experience counseling investment advisers on investment, regulatory and compliance matters such as SEC inspections, compliance policies and procedures, soft dollars and valuation of securities. He has assisted investment company and investment adviser clients in responding to SEC inquiries. Prior to joining Stradley Ronon, Mr. Kopcsik was an associate with another Philadelphia law firm.

MENA RYLEY LARMOUR (B.S. 2003, Colgate University; J.D. 2007, Temple University) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Larmour focuses her practice on advising investment company and investment advisory clients on various regulatory,

compliance and transactional matters under federal and state securities laws. She regularly counsels investment companies and their boards of directors/trustees and investment advisers on securities, transactional and corporate matters relating to registered open-end and closed-end investment companies. Some of the matters on which Ms. Larmour has assisted clients include: the formation of funds employing alternative investment strategies; fund restructurings; launching new share classes; board meeting preparation and board-related issues; drafting disclosure and compliance procedures to bring clients into compliance with the SEC's regulatory initiatives; managing complex-wide proxy solicitation projects; advising and assisting money market funds in connection with recent regulatory initiatives; and managing multiple reorganizations of open-end funds into both affiliated and unaffiliated open-end funds. While in law school, Ms. Larmour served as a judicial intern to the Hon. Kevin J. Carey in the U.S. Bankruptcy Court for the Eastern District.

BRUCE G. LETO (B.A. 1983, Haverford College; J.D. 1986, Villanova University) is chair of Stradley Ronon's Investment Management Practice Group. Mr. Leto counsels investment companies, investment advisers, independent trustees and broker-dealers on securities and corporate matters relating to pooled investment products, including registered and unregistered, open- and closed-end investment companies. He advises such clients on registration, transactional and compliance matters. Among many other projects, Mr. Leto recently supervised proxy solicitations for two large investment company complexes involving several hundred funds. He also recently advised on the launch of new mutual funds that combined the unique characteristics of using a master-feeder structure, a fund-of-fund strategy and a Cayman Islands-based subsidiary for tax purposes. Mr. Leto was involved in obtaining cutting edge no-action relief for a large investment company complex, allowing the funds to participate in the Term Asset-Backed Securities Loan Facility (TALF), and also helped obtain regulatory relief for that complex permitting the establishment of a $1 billion syndicated line of credit with global banks for use of its U.S. and non-U.S. funds alike. Mr. Leto has been included in the annual editions of The Best Lawyers in America consecutively since 2007, and was named as a leader nationally (ranked in "Band One" beginning in 2014) in "investment funds: registered funds" in the 2009 through 2016 editions of Chambers USA: America's Leading lawyers for Business. Mr. Leto's peers named him a Pennsylvania Super Lawyer® consecutively since 2004, and he was also named to SmartCEO magazine's 2010, 2011 and 2012 (last year published) Legal Elite List. Mr. Leto has also been given special mention in the Legal 500 from 2010 to 2016. Notably, in 2010, The Mutual Fund Wire named Mr. Leto as one of the "100 Most Influential People in '40 Act Funds." He was also selected by Ignites as a 2009 "Fund Titan." Mr. Leto was also appointed to the Advisory Board of Board IQ in 2007 and has served in that capacity since then. Mr. Leto lectures extensively at seminars sponsored by the Investment Company Institute, Independent Directors Council, and other organizations. In September 2009, he was a panelist at a Roundtable conducted by the SEC on the topic of securities lending. He is a member of Stradley Ronon's Board of Directors and has been chairman of the firm's Investment Management Group since 1994.

MICHAEL D. MABRY (B.G.S. 1984, University of Michigan; M.A. 1985, Bowling Green State University; J.D. 1991, University of Virginia) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Mabry counsels investment companies, investment advisers, broker-dealers and other financial service providers on a variety of securities and corporate matters. He regularly works with mutual funds, closed-end funds, exchange-traded funds, unit investment trusts, variable insurance products, offshore funds, hedge funds and investment adviser separate accounts. He has counseled boards of directors and investment advisers on regu-

latory and litigation matters, including SEC examinations, closed-end fund proxy fights, rescissions, and market-timing class-action suits, and has helped establish compliance programs for investment advisers and fund complexes of all sizes. He frequently helps clients develop and launch new and innovative investment products, and assists investment advisers and funds in complex transactions and instruments, including derivatives, credit arrangements, fund mergers, proxy solicitations, and closed-end and ETF IPOs. From 2007-2012, Mr. Mabry served as co-chair of the Investment Companies Committee of the Philadelphia Bar Association. He holds a Masters Degree in Economics and was a research assistant with the Division of International Finance of the Board of Governors of the Federal Reserve System from 1985 to 1988.

PRUFESH R. MODHERA (B.A. 1986, Rutgers University; M.B.A. 1990, Georgetown University; J.D. 1999, American University) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Modhera's practice involves counseling investment companies, investment advisers and independent directors on federal securities law matters. More specifically, Mr. Modhera counsels investment advisers on various compliance issues under the Investment Advisers Act of 1940, including Form ADV disclosure, personal securities trading, trade allocation practices, best execution, soft dollars, proxy voting and performance advertising. In addition, he advises clients on various issues under the Investment Company Act of 1940 including the formation, registration, regulation and reorganization of investment companies, assists investment company and investment adviser clients in responding to SEC inquiries, and advises boards of directors on governance issues. Mr. Modhera also advises clients on the formation of domestic and offshore private-equity funds, hedge funds and fund of hedge funds, including preparing private placement memoranda, operating agreements and subscription documents, preparing and/or reviewing contracts with service providers, and complying with state blue sky filing requirements. Mr. Modhera is the partner-in-charge of Stradley Ronon's Washington, D.C. office.

MICHAEL W. MUNDT (B.A. 1986, M.A. 1989 Louisiana State University; J.D. 1993, Georgetown University) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Mundt counsels investment companies and investment advisers on matters relating to legal issues under federal securities laws, with a particular focus on exchange-traded funds. Prior to joining Stradley Ronon, Mr. Mundt served for 13 years in various capacities at the U.S. Securities and Exchange Commission, including as Assistant Director of the Office of Investment Company Regulation in the Division of Investment Management. In that capacity, Mr. Mundt supervised the review of applications for a wide range of orders under the Investment Company Act of 1940, including complex matters relating to funds of funds and affiliated transactions. Most notably, Mr. Mundt was responsible for the regulatory review of all major ETF product innovations from 1999 until 2011. In recognition of his ETF work, Mr. Mundt received the SEC's prestigious Paul R. Carey Award, which honors a staff member who demonstrates exceptional personal commitment to a significant policy matter. Mr. Mundt received a number of additional awards while at the SEC, including the Martha Platt Award, which is presented to a member of the Division of Investment Management who displays outstanding dedication, enthusiasm and commitment to the mission of the SEC. Before working at the SEC, Mr. Mundt served as assistant counsel at ICI Mutual Insurance Company, the captive insurance company for the mutual fund industry, where he worked on insurance and risk management issues for funds and their investment advisers.

MICHAEL P. O'HARE (B.S. 1990, LaSalle University; J.D. 1994, Temple University) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. O'Hare represents investment companies, investment advisers and broker dealers with regard to securities, compliance and corporate law matters. In addition to serving the firm's traditional mutual fund clientele, Mr. O'Hare has helped a number of established investment firms launch their first registered and unregistered investment company products. He also is experienced in counseling clients on regulatory and compliance matters, restructurings, acquisitions and other corporate transactions, and structuring and negotiating new products and business relationships. Mr. O'Hare's clients include: multi-manager funds, broker-sold funds, bank-sponsored funds and no-load funds marketed through financial adviser channels.

ERIC S. PURPLE (B.A. 1990, Vanderbilt University; J.D. 1993, University of Alabama School of Law; LL.M. (Securities and Financial Regulation) 1996, Georgetown University Law Center) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Purple represents a broad range of exchange-traded funds, mutual funds, closed-end investment companies, business development companies, and other pooled investment vehicles (as well as their investment advisers) on matters arising under the U.S. federal securities laws. He also serves as a trusted counselor to the independent directors or trustees of a number of investment companies. Prior to entering private practice, Mr. Purple served for eight years in the U.S. Securities and Exchange Commission's Division of Investment Management in both the Office of Chief Counsel and the Office of Disclosure and Review. Prior to his government service, Mr. Purple served as the Chief Compliance Officer of a mutual fund complex, and was the lead in-house counsel for, and part of the original management team of, an internet financial services start-up that was subsequently acquired by a major on-line brokerage house. Mr. Purple sits on the editorial board of the Investment Lawyer, and has been included in both Best Lawyers in America for his work in mutual funds law and in Washington, DC Super Lawyers in the category of Securities and Corporate Finance.

MARK A. SHEEHAN (B.A. 1984, University of Virginia; J.D. 1989, University of Pittsburgh) is a partner in Stradley Ronon's Investment Management Practice Group. Mr. Sheehan focuses his practice on issues arising under the Investment Company Act of 1940, and the 1933 and 1934 Acts. Mr. Sheehan represents investment company and investment adviser clients in all facets of their operations and advises them on their legal requirements. Mr. Sheehan works closely with open- and closed-end investment companies, unregistered investment vehicles (such as hedge funds), and investment advisers. He also works extensively with master-feeder and multiple class structures in the context of investment companies. Prior to joining Stradley Ronon in 1995, Mr. Sheehan worked as an associate corporate counsel at Federated Investors in Pittsburgh, Pa. He was also an associate with a Washington, D.C., law firm practicing in the 1940 Act area.

AMY G. SMITH (B.S. 1999, University of North Carolina-Wilmington, J.D. 2005, Widener University School of Law) is counsel in Stradley Ronon's Investment Management Practice Group. Ms. Smith focuses on counseling investment companies, independent trustees and investment advisers in connection with regulatory, compliance and transactional issues. She assists clients with a variety of investment management and securities law matters, including: the formation, registration and ongoing operations of investment companies; the preparation of regulatory filings; the applicability and interpretation of federal and state securities laws; and

various transactional matters, such as open-end and closed-end fund mergers and acquisitions. While pursuing her J.D. at Widener University School of Law, Ms. Smith worked at AstraZeneca Pharmaceuticals as a financial analyst for global research and development.

LAWRENCE P. STADULIS (B.A. 1986, Boston College; J.D. 1989, Boston College) is a partner in the Washington, D.C. office of Stradley Ronon Stevens & Young, LLP. Mr. Stadulis advises clients in matters pertaining to the registration and regulation of investment advisers and investment companies under federal and state securities laws. He also manages related issues pertaining to investment advisers and investment companies including matters involving ERISA, broker-dealer regulation and banking laws. Mr. Stadulis is a frequent lecturer and author on legal matters pertaining to the investment management industry. He prepares a monthly column on recent SEC developments for *The Investment Lawyer*, a legal publication that focuses on the investment management industry. Before joining Stradley Ronon, Mr. Stadulis was a partner with another law firm. Prior to that, he was special counsel in the Office of Chief Counsel, Division of Investment Management, U.S. Securities and Exchange Commission. As special counsel, Mr. Stadulis was principally responsible for responding to no-action and interpretive requests under the Investment Company Act of 1940 and Investment Advisers Act of 1940. Mr. Stadulis was recommended as a national leader in "investment funds: registered funds" in the 2011, 2010, 2009 and 2008 editions of Chambers USA: America's Leading Lawyers for Business.

JOAN OHLBAUM SWIRSKY (A.B. 1978, Cornell University; J.D. 1981, Harvard University) is counsel in Stradley Ronon's Investment Management Practice Group. Ms. Swirsky has counseled clients for more than 30 years, including more than 20 years advising investment companies on regulatory compliance and general corporate matters under the Investment Company Act of 1940. Ms. Swirsky represents clients on a diverse range of investment company matters, with a specialty in issues related to money market funds operated in accordance with Rule 2a-7 under the Investment Company Act of 1940. Ms. Swirsky's projects relating to money market funds include: review securities for eligibility under Rule 2a-7 as money market fund investments; advise issuers desiring to structure Rule 2a-7 eligible securities; address troubled holdings in money market portfolios, including related communications with the SEC staff; develop and review money market compliance checklists and procedures; advise regarding responses to SEC examinations and inquiries relating to money market funds; present training sessions to portfolio personnel, board members and others relating to money market fund compliance; and handle day-to-day portfolio compliance issues for money market funds.

Additionally, Ms. Swirsky has counseled investment company clients regarding governance and federal securities law issues, reorganization and start-up of new portfolios, issues concerning exemptive applications under the Investment Company Act, the preparation of registration statements, compliance policies and procedures, reports to shareholders and board meeting materials, SEC filings, proxy statements and staff examinations. Ms. Swirsky is the author of *The Guide to Rule 2a-7: A Map Through the Maze for the Money Market Professional*, which is now in its second edition—a 200+-page handbook that addresses the complex requirements of Rule 2a-7 and offers direction on how to evaluate and revise products being offered for investment by money funds. She is frequently quoted by national media including *The Wall Street Journal, The New York Times, USA Today, Bloomberg* and *Reuters,* etc., on money

market fund issues. Ms. Swirsky is a frequent lecturer and author on matters related to money market funds operated in accordance with Rule 2a-7 under the Investment Company Act of 1940. Prior to joining Stradley Ronon, Ms. Swirsky was investment management counsel at another Philadelphia firm.

NICOLE TRUDEAU (B.A. 2002 University of California, Berkeley, J.D. 2007, University of Michigan) is a partner in Stradley Ronon's Investment Management Practice Group. Ms. Trudeau counsels investment companies and their independent directors, as well as investment advisers and other service providers, on complex matters arising under U.S. federal securities laws, particularly the Investment Company Act of 1940. Ms. Trudeau regularly counsels open- and closed-end funds, exchange-traded funds, unit investment trusts, and business development companies, and serves as issuer's counsel to closed-end funds when conducting their initial public offerings. Ms. Trudeau also works with chief compliance officers and boards of directors to develop board and compliance policies and procedures and to resolve regulatory-related issues. She counsels clients on a wide range of investment company and investment adviser matters, such as obtaining exemptive relief and responding to regulatory inquiries raised by the staff of the Securities and Exchange Commission during examinations and otherwise. Ms. Trudeau frequently speaks on such topics. Prior to law school, Ms. Trudeau worked for the U.S. Embassy in Sarajevo, Bosnia and Herzegovina; the Bureau of Democracy, Human Rights and Labor at the U.S. Department of State; and the Office of Information and Privacy at the U.S. Department of Justice. Ms. Trudeau has served as Vice Chair of the Investment Management Committee within the Corporate, Finance and Securities Law Section of the District of Columbia Bar Association since 2014, was recognized by Super Lawyers consecutively since 2015, and in the Legal 500 in 2016.

PETER L. TSIRIGOTIS (B.A. 1990, Boston University; J.D. 1997, Catholic University; L.L.M. International Business and Economic Law 2018 (expected), Georgetown University) is counsel in Stradley Ronon's Investment Management Group. Mr. Tsirigotis' practice focuses on providing legal advice to financial institutions, asset managers and investment advisers to help them develop and maintain various investment management products while navigating the regulatory landscape. He brings to each client representation a unique perspective on the financial services industry, having served in several senior-level legal, compliance, operations and risk roles, including as regulator, inside counsel, outside counsel, chief compliance officer and chief operating officer. He has advised clients on a broad spectrum of products including: separately managed accounts, registered investment companies, hedge funds, private equity funds, business development companies, UCITS, etc. Prior to joining Stradley Ronon, Mr. Tsirigotis was senior vice president at Brown Brothers Harriman & Co ("BBH"), where he led the investment management funds risk, operations and governance group and was responsible for the structuring and launch of BBH's proprietary funds. Mr. Tsirigotis has also served as chief operating officer and chief compliance officer for a Greenwich based hedge fund. He was senior vice president and associate general counsel for U.S. Trust Company, where he oversaw U.S. Trust's private funds and registered funds and served on U.S. Trust's private funds investment company, and became assistant general counsel for Bank of America when it acquired U.S. Trust Company in 2007. Mr. Tsirigotis also worked as corporate counsel for Prudential Financial and as an attorney in the SEC's Division of Investment Management.

CHRISTOPHER J. ZIMMERMAN (B.A. 1998, University of Maryland—College Park; J.D. 2003, American University) is a partner in Stradley Ronon's Investment Management Group/ Mutual Funds Practice Group. He focuses his practice on assisting investment companies, investment advisers, and independent directors/trustees on federal and state securities law matters. Mr. Zimmerman provides advice and counsel for investment management clients on various issues arising under these securities laws. Among other things, he advises investment companies and investment advisers with respect to their organization, registration and regulation. In addition, he counsels investment advisers on issues under the Investment Adviser Act of 1940, including with respect to best execution and soft dollars. He counsels investment companies on issues under the Investment Company Act of 1940, including with respect to changes in control, securities lending, and derivatives, and further counsels boards of directors/trustees on governance and other issues.

FORM N-1A
(Unannotated)
See page 131 for Annotated Form N-1A

You may not send a completed printout of this form to the SEC to satisfy a filing obligation. You can only satisfy an SEC filing obligation by submitting the information required by this form to the SEC in electronic format online at https://www.edgarfiling.sec.gov.

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

FORM N-1A

OMB APPROVAL
OMB Number: 3235-0307 Expires: February 28, 2018 Estimated average burden hours per response 263

Check appropriate box or boxes

❒ REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

❒ Pre-Effective Amendment No. _____

❒ Post-Effective Amendment No. _____

and/or

❒ REGISTRATION STATEMENT UNDER THE INVESTMENT COMPANY ACT OF 1940

❒ Amendment No. _____

_____

Registrant Exact Name as Specified in Charter

_____

Address of Principal Executive Offices (Number, Street, City, State, Zip Code)

Registrant's Telephone Number, including Area Code _____

_____

Name and Address (Number, Street, City, State, Zip Code) of Agent for Service

Approximate Date of Proposed Public Offering _____

It is proposed that this filing will become effective (check appropriate box)

❒ immediately upon filing pursuant to paragraph (b)
❒ on (date) pursuant to paragraph (b)
❒ 60 days after filing pursuant to paragraph (a)
❒ on (date) pursuant to paragraph (a)
❒ 75 days after filing pursuant to paragraph (a)(2)
❒ on (date) pursuant to paragraph (a)(2) of rule 485

If appropriate, check the following box:
❒ This post-effective amendment designates a new effective date for a previously filed post-effective amendment.

Omit from the facing sheet reference to the other Act if the Registration Statement or amendment is filed under only one of the Acts. Include the "Approximate Date of Proposed Public Offering" and "Title of Securities Being Registered" only where securities are being registered under the Securities Act of 1933.

Form N-1A is to be used by open-end management investment companies, except insurance company separate accounts and small business investment companies licensed under the United States Small Business Administration, to register under the Investment Company Act of 1940 and to offer their shares under the Securities Act of 1933. The Commission has designed Form N-1A to provide investors with information that will assist them in making a decision about investing in an investment company eligible to use the Form. The Commission also may use the information provided on Form N-1A in its regulatory, disclosure review, inspection, and policy making roles.

A Registrant is required to disclose the information specified by Form N-1A, and the Commission will make this information public. A Registrant is not required to respond to the collection of information contained in Form N-1A unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

SEC 2052 (10/16) **Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.**

CONTENTS OF [UNANNOTATED] FORM N-1A

GENERAL INSTRUCTIONS

A. Definitions

References to sections and rules in this Form N-1A are to the Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.] (the "Investment Company Act"), unless otherwise indicated. Terms used in this Form N-1A have the same meaning as in the Investment Company Act or the related rules, unless otherwise indicated. As used in this Form N-1A, the terms set out below have the following meanings:

"Class" means a class of shares issued by a Multiple Class Fund that represents interests in the same portfolio of securities under rule 18f-3 [17 CFR 270.18f-3] or under an order exempting the Multiple Class Fund from sections 18(f), 18(g), and 18(i) [15 U.S.C. 80a- 18(f), 18(g), and 18(i)].

"Exchange-Traded Fund" means a Fund or Class, the shares of which are listed and traded on a national securities exchange, and that has formed and operates under an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission.

"Fund" means the Registrant or a separate Series of the Registrant. When an item of Form N-1A specifically applies to Registrant or a Series, those terms will be used.

"Market Price" refers to the last reported sale price at which Exchange-Traded Fund shares trade on the principal U.S. market on which the Fund's shares are traded during a regular trading session or, if it more accurately reflects the current market value of the Fund's shares at the time the Fund uses to calculate its net asset value, a price within the range of the highest bid and lowest offer on the principal U.S. market on which the Fund's shares are traded during a regular trading session.

"Master-Feeder Fund" means a two-tiered arrangement in which one or more Funds (each a "Feeder Fund") holds shares of a single Fund (the "Master Fund") in accordance with section 12(d)(1)(E) [15 U.S.C. 80a-12(d)(1)(E)].

"Money Market Fund" means a registered open-end management investment company, or series thereof, that is regulated as a money market fund pursuant to rule 2a-7 [17 CFR 270.2a-7] under the Investment Company Act of 1940.

"Multiple Class Fund" means a Fund that has more than one Class.

"Registrant" means an open-end management investment company registered under the Investment Company Act.

"SAI" means the Statement of Additional Information required by Part B of this Form.

"Securities Act" means the Securities Act of 1933 [15 U.S.C. 77a et seq.].

"Securities Exchange Act" means the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq.].

"Series" means shares offered by a Registrant that represent undivided interests in a portfolio of investments and that are preferred over all other series of shares for assets specifically allocated to that series in accordance with rule 18f-2(a) [17 CFR 270.18f-2(a)].

B. Filing and Use of Form N-1A

1. What is Form N-1A used for?

Form N-1A is used by Funds, except insurance company separate accounts and small business investment companies licensed under the United States Small Business Administration, to file:

(a) An initial registration statement under the Investment Company Act and amendments to the registration statement, including amendments required by rule 8b-16 [17 CFR 270.8b-16];

(b) An initial registration statement under the Securities Act and amendments to the registration statement, including amendments required by section 10(a)(3) of the Securities Act [15 U.S.C. 77j(a)(3)]; or

(c) Any combination of the filings in paragraph (a) or (b).

2. What is included in the registration statement?

(a) For registration statements or amendments filed under both the Investment Company Act and the Securities Act or only under the Securities Act, include the facing sheet of the Form, Parts A, B, and C, and the required signatures.

(b) For registration statements or amendments filed only under the Investment Company Act, include the facing sheet of the Form, responses to all Items of Parts A (except Items 1, 2, 3, 4 and 13), B, and C (except Items 28(e) and (i) – (k)), and the required signatures.

3. What are the fees for Form N-1A?

No registration fees are required with the filing of Form N-1A to register as an investment company under the Investment Company Act or to register securities under the Securities Act. See section 24(f) [15 U.S.C. 80a-24(f)] and related rule 24f-2 [17 CFR 270.24f-2].

4. What rules apply to the filing of a registration statement on Form N-1A?

(a) For registration statements and amendments filed under both the Investment Company Act and the Securities Act or only under the Securities Act, the general rules regarding the filing of registration statements in Regulation C under the Securities Act [17 CFR 230.400 – 230.497] apply to the filing of Form N-1A. Specific requirements concerning Funds appear in rules 480 – 485 and 495 – 497 of Regulation C.

(b) For registration statements and amendments filed only under the Investment Company Act, the general provisions in rules 8b-1 – 8b-33 [17 CFR 270.8b-1 – 270.8b-33] apply to the filing of Form N-1A.

(c) The plain English requirements of rule 421 under the Securities Act [17 CFR 230.421] apply to prospectus disclosure in Part A of Form N-1A. The information required by Items 2 through 8 must be provided in plain English under rule 421(d) under the Securities Act.

(d) Regulation S-T [17 CFR 232.10 – 232.903] applies to all filings on the Commission's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR").

C. Preparation of the Registration Statement

1. Administration of the Form N-1A requirements

(a) The requirements of Form N-1A are intended to promote effective communication between the Fund and prospective investors. A Fund's prospectus should clearly disclose the fundamental characteristics and investment risks of the Fund, using concise, straightforward, and easy to understand language. A Fund should use document design techniques that promote effective communication. The prospectus should emphasize the Fund's overall investment approach and strategy.

(b) The prospectus disclosure requirements in Form N-1A are intended to elicit information for an average or typical investor who may not be sophisticated in legal or financial matters. The prospectus should help investors to evaluate the risks of an investment and to decide whether to invest in a Fund by providing a balanced disclosure of positive and negative factors. Disclosure in the prospectus should be designed to assist an investor in comparing and contrasting the Fund with other funds.

(c) Responses to the Items in Form N-1A should be as simple and direct as reasonably possible and should include only as much information as is necessary to enable an average or typical investor to understand the particular characteristics of the Fund. The prospectus should avoid: including lengthy legal and technical discussions; simply restating legal or regulatory requirements to which Funds generally are subject; and disproportionately emphasizing possible investments or activities of the Fund that are not a significant part of the Fund's investment operations. Brevity is especially important in describing the practices or aspects of the Fund's operations that do not differ materially from those of other investment companies. Avoid excessive detail, technical or legal terminology, and complex language. Also avoid lengthy sentences and paragraphs that may make the prospectus difficult for many investors to understand and detract from its usefulness.

(d) The requirements for prospectuses included in Form N-1A will be administered by the Commission in a way that will allow variances in disclosure or presentation if appropriate for the circumstances involved while remaining consistent with the objectives of Form N-1A.

2. Form N-1A is divided into three parts

(a) Part A. Part A includes the information required in a Fund's prospectus under section 10(a) of the Securities Act. The purpose of the prospectus is to provide essential information about the Fund in a way that will help investors to make informed decisions about whether to purchase the Fund's shares described in the prospectus. In responding to the Items in Part A, avoid cross-references to the SAI or shareholder reports. Cross-references within the prospectus are most useful when their use assists investors in understanding the information presented and does not add complexity to the prospectus.

(b) Part B. Part B includes the information required in a Fund's SAI. The purpose of the SAI is to provide additional information about the Fund that the Commission has concluded is not necessary or appropriate in the public interest or for the protection of investors to be in the prospectus, but that some investors may find useful. Part B affords the Fund an opportunity to expand discussions of the matters described in the prospectus by including additional information that the Fund believes may be of interest to some investors. The Fund should not duplicate in the SAI information that is provided in the prospectus, unless necessary to make the SAI comprehensible as a document independent of the prospectus.

(c) Part C. Part C includes other information required in a Fund's registration statement.

3. Additional Matters

(a) Organization of Information. Organize the information in the prospectus and SAI to make it easy for investors to understand. Notwithstanding rule 421(a) under the Securities Act regarding the order of information required in a prospectus, disclose the information required by Items 2 through 8 in numerical order at the front of the prospectus. Do not precede these Items with any other Item except the Cover Page (Item 1) or a table of contents meeting the requirements of rule 481(c) under the Securities Act. Information that is included in response to Items 2 through 8 need not be repeated elsewhere in the prospectus. Disclose the information required by Item 12 (Distribution Arrangements) in one place in the prospectus.

(b) Other Information. A Fund may include, except in response to Items 2 through 8, information in the prospectus or the SAI that is not other-

wise required. For example, a Fund may include charts, graphs, or tables so long as the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of the information that is required to be included. Items 2 through 8 may not include disclosure other than that required or permitted by those Items.

(c) Use of Form N-1A by More Than One Registrant, Series, or Class. Form N-1A may be used by one or more Registrants, Series, or Classes.

(i) When disclosure is provided for more than one Fund or Class, the disclosure should be presented in a format designed to communicate the information effectively. Except as required by paragraph (c)(ii) for Items 2 through 8, Funds may order or group the response to any Item in any manner that organizes the information into readable and comprehensible segments and is consistent with the intent of the prospectus to provide clear and concise information about the Funds or Classes. Funds are encouraged to use, as appropriate, tables, side-by-side comparisons, captions, bullet points, or other organizational techniques when presenting disclosure for multiple Funds or Classes.

(ii) Paragraph (a) requires Funds to disclose the information required by Items 2 through 8 in numerical order at the front of the prospectus and not to precede Items 2 through 8 with other information. Except as permitted by paragraph (c)(iii), a prospectus that contains information about more than one Fund must present all of the information required by Items 2 through 8 for each Fund sequentially and may not integrate the information for more than one Fund together. That is, a prospectus must present all of the information for a particular Fund that is required by Items 2 through 8 together, followed by all of the information for each additional Fund, and may not, for example, present all of the Item 2 (Risk/Return Summary: Investment Objectives/Goals) information for several Funds followed by all of the Item 3 (Risk/Return Summary: Fee Table) information for several Funds. If a prospectus contains information about multiple Funds, clearly identify the name of the relevant Fund at the beginning of the information for the Fund that is required by Items 2 through 8. A Multiple Class Fund may present the information required by Items 2 through 8 separately for each Class or may integrate the information for multiple Classes, although the order of the in-

formation must be as prescribed in Items 2 through 8. For example, the prospectus may present all of the Item 2 (Risk/ Return Summary: Investment Objectives/Goals) information for several Classes followed by all of the Item 3 (Risk/ Return Summary: Fee Table) information for the Classes, or may present Items 2 and 3 for each of several Classes sequentially. Other presentations of multiple Class information also would be acceptable if they are consistent with the Form's intent to disclose the information required by Items 2 through 8 in a standard order at the beginning of the prospectus. For a Multiple Class Fund, clearly identify the relevant Classes at the beginning of the Items 2 through 8 information for those Classes.

(iii) A prospectus that contains information about more than one Fund may integrate the information required by any of Items 6 through 8 for all of the Funds together, provided that the information contained in any Item that is integrated is identical for all Funds covered in the prospectus. If the information required by any of Items 6 through 8 is integrated pursuant to this paragraph, the integrated information should be presented immediately following the separate presentations of Item 2 through 8 information for individual Funds. In addition, include a statement containing the following information in each Fund's separate presentation of Item 2 through 8 information, in the location where the integrated information is omitted: "For important information about [purchase and sale of fund shares], [tax information], and [financial intermediary compensation], please turn to [identify section heading and page number of prospectus]."

(d) Modified Prospectuses for Certain Funds.

(i) A Fund may modify or omit, if inapplicable, the information required by Items 6, 11(b)-(d) and 12(a)(2)-(5) for funds used as investment options for:

(A) 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));

(B) a tax-deferred arrangement under sections 403(b) or 457 of the Internal Revenue Code (26 U.S.C. 403(b) and 457); and

(C) a variable contract as defined in section 817(d) of the Internal Revenue Code (26 U.S.C. 817(d)), if covered in a separate account prospectus.

(ii) A Fund that uses a modified prospectus under Instruction (d)(i) may:

(A) alter the legend required on the back cover page by Item 1(b)(1) to state, as applicable, that the prospectus is intended for use in connection with a defined contribution plan, tax-deferred arrangement, or variable contract; and

(B) modify other disclosure in the prospectus consistent with offering the Fund as a specific investment option for a defined contribution plan, tax-deferred arrangement, or variable contract.

(iii) A Fund may omit the information required by Items 4(b)(2)(iii)(B) and (C) and 4(b)(2)(iv) if the Fund's prospectus will be used exclusively to offer Fund shares as investment options for one or more of the following:

(A) 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)), a tax-deferred arrangement under section 403(b) or 457 of the Internal Revenue Code (26 U.S.C. 403(b) or 457), a variable contract as defined in section 817(d) of the Internal Revenue Code (26 U.S.C. 817(d)), or a similar plan or arrangement pursuant to which an investor is not taxed on his or her investment in the Fund until the investment is sold; or

(B) persons that are not subject to the federal income tax imposed under section 1 of the Internal Revenue Code (26 U.S.C. 1), or any successor to that section.

(iv) A Fund that omits information under Instruction (d)(iii) may alter the legend required on the back cover page by Item 1(b)(1) to state, as applicable, that the prospectus is intended for use in connection with a defined contribution plan, tax-deferred arrangement, variable contract, or similar plan or arrangement, or persons described in Instruction (d)(iii)(B).

(e) Dates. Rule 423 under the Securities Act [17 CFR 230.423] applies to the dates of the prospectus and the SAI. The SAI should be made available at the same time that the prospectus becomes available for purposes of rules 430 and 460 under the Securities Act [17 CFR 230.430 and 230.460].

(f) Sales Literature. A Fund may include sales literature in the prospectus so long as the amount of this information does not add substantial

length to the prospectus and its placement does not obscure essential disclosure.

(g) Interactive Data File.

(i) An Interactive Data File (§ 232.11 of this chapter) is required to be submitted to the Commission and posted on the Fund's Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§ 232.405 of this chapter) for any registration statement or post-effective amendment thereto on Form N-1A that includes or amends information provided in response to Items 2, 3, or 4. The Interactive Data File must be submitted as an amendment to the registration statement to which the Interactive Data File relates. The amendment must be submitted after the registration statement or post-effective amendment that contains the related information becomes effective but not later than 15 business days after the effective date of that registration statement or post-effective amendment.

(ii) An Interactive Data File is required to be submitted to the Commission and posted on the Fund's Web site, if any, in the manner provided by Rule 405 of Regulation S-T for any form of prospectus filed pursuant to rule 497(c) or (e) under the Securities Act [17 CFR 230.497(c) or (e)] that includes information provided in response to Items 2, 3, or 4 that varies from the registration statement. The Interactive Data File may be submitted with or up to 15 business days subsequent to the filing made pursuant to rule 497.

(iii) An Interactive Data File is required to be posted on the Fund's Web site for as long as the registration statement or post-effective amendment to which the Interactive Data File relates remains current.

(iv) An Interactive Data File must be submitted as an exhibit to Form N-1A, under paragraph (i) of this Instruction, or as an exhibit to the filing made pursuant to rule 497, under paragraph (ii) of this Instruction. The Interactive Data File must be submitted in such a manner that will permit the information for each Series and, for any information that does not relate to all of the Classes in a filing, each Class of the Fund to be separately identified.

D. Incorporation by Reference

1. Specific rules for incorporation by reference in Form N-1A

(a) A Fund may not incorporate by reference into a prospectus information that Part A of this Form requires to be included in a prospectus, except as specifically permitted by Part A of the Form.

(b) A Fund may incorporate by reference any or all of the SAI into the prospectus (but not to provide any information required by Part A to be included in the prospectus) without delivering the SAI with the prospectus.

(c) A Fund may incorporate by reference into the SAI or its response to Part C, information that Parts B and C require to be included in the Fund's registration statement.

2. General Requirements

All incorporation by reference must comply with the requirements of this Form and the following rules on incorporation by reference: rule 10(d) of Regulation S-K under the Securities Act [17 CFR 229.10(d)] (general rules on incorporation by reference, which, among other things, prohibit, unless specifically required by this Form, incorporating by reference a document that includes incorporation by reference to another document, and limits incorporation to documents filed within the last 5 years, with certain exceptions); rule 411 under the Securities Act [17 CFR 230.411] (general rules on incorporation by reference in a prospectus); rule 303 of Regulation S-T [17 CFR 232.303] (specific requirements for electronically filed documents); and rules 0-4, 8b-23 and 8b-32 [17 CFR 270.0-4, 270.8b- 23 and 270.8b-32] (additional rules on incorporation by reference for Funds).

Part A—INFORMATION REQUIRED IN A PROSPECTUS

Item 1. Front and Back Cover Pages

(a) *Front Cover Page*. Include the following information, in plain English under rule 421(d) under the Securities Act, on the outside front cover page of the prospectus:

(1) The Fund's name and the Class or Classes, if any, to which the prospectus relates.

(2) The exchange ticker symbol of the Fund's shares or, if the prospectus relates to one or more Classes of the Fund's shares, adjacent to each such Class, the exchange ticker symbol of such Class of the Fund's shares. If the Fund is an Exchange-Traded Fund, also identify the principal U.S. market or markets on which the Fund shares are traded.

(3) The date of the prospectus.

(4) The statement required by rule 481(b)(1) under the Securities Act.

Instruction. A Fund may include on the front cover page a statement of its investment objectives, a brief (e.g., one sentence) description of its operations, or any additional information, subject to the requirement set out in General Instruction c.3(b).

(b) *Back Cover Page*. Include the following information, in plain English under rule 421(d) under the Securities Act, on the outside back cover page of the prospectus:

(1) A statement that the SAI includes additional information about the Fund, and a statement to the following effect:

Additional information about the Fund's investments is available in the Fund's annual and semi-annual reports to shareholders. In the Fund's annual report, you will find a discussion of the market conditions and investment strategies that significantly affected the Fund's performance during its last fiscal year.

Explain that the SAI and the Fund's annual and semi-annual reports are available, without charge, upon request, and explain how shareholders in the Fund may make inquiries to the Fund. Provide a toll-free (or collect) telephone number for investors to call: to request the SAI; to request the Fund's annual report; to request the Fund's semi-annual report; to request other information about the Fund; and to make shareholder inquiries. Also, state whether the Fund makes available its SAI and annual and semi-annual reports, free of charge, on or through the Fund's Web site at a specified Internet address. If the Fund does not make its SAI and shareholder reports available in this manner, disclose the reasons why it does not do so (including, where applicable, that the Fund does not have an Internet Web site).

Instructions

1. A Fund may indicate, if applicable, that the SAI, annual and semi-annual reports, and other information are available by email request.

2. A Fund may indicate, if applicable, that the SAI and other information are available from a financial intermediary (such as a broker-dealer or bank) through which shares of the Fund may be purchased or sold.

3. When a Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for the SAI, the annual report, or the semi-annual report, the Fund (or financial intermediary) must send the requested document within 3 business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

4. A Fund that has not yet been required to deliver an annual or semi-annual report to shareholders under rule 30e-1 [17 CFR 270.30e-1] may omit the statements required by this paragraph regarding the reports.

5. A Money Market Fund may omit the sentence indicating that a reader will find in the Fund's annual report a discussion of the market conditions and investment strategies that significantly affect the Fund's performance during its last fiscal year.

(2) A statement whether and from where information is incorporated by reference into the prospectus as permitted by General Instruction D. Unless the information is delivered with the prospectus, explain that the Fund will provide the information without charge, upon request (referring to the telephone number provided in response to paragraph (b)(1)).

Instruction. The Fund may combine the information about incorporation by reference with the statements required under paragraph (b)(1).

(3) A statement that information about the Fund (including the SAI) can be reviewed and copied at the Commission's Public Reference Room in Washington, DC, and that information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-202-551-8090. State that reports and other information about the Fund are available on the EDGAR Database on the Commission's Internet site at http://www.sec.gov, and that copies of this information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the Commission's Public Reference Section, Washington, DC 20549-1520.

(4) The Fund's Investment Company Act file number on the bottom of the back cover page in type size smaller than that generally used in the prospectus (e.g., 8-point modern type).

Item 2. Risk/Return Summary: Investment Objectives/Goals

Disclose the Fund's investment objectives or goals. A Fund also may identify its type or category (e.g., that it is a Money Market Fund or a balanced fund).

Item 3. Risk/Return Summary: Fee Table

Include the following information, in plain English under rule 421(d) under the Securities Act, after Item 2:

Fees and Expenses of the Fund

This table describes the fees and expenses that you may pay if you buy and hold shares of the Fund. You may qualify for sales charge discounts if you and your family invest, or agree to invest in the future, at least $[ ] in [name of fund family] funds. More information about these and other discounts is available from your financial professional and in [identify section heading and page number] of the Fund's prospectus and [identify section heading and page number] of the Fund's statement of additional information.

Shareholder Fees (fees paid directly from your investment)

Maximum Sales Charge (Load) Imposed on Purchases (as a percentage of offering price)	_____%
Maximum Deferred Sales Charge (Load) (as a percentage of _____)	_____%
Maximum Sales Charge (Load) Imposed on Reinvested Dividends [and other Distributions] (as a percentage of _____)	_____%
Redemption Fee (as a percentage of amount redeemed, if applicable)	_____%
Exchange Fee	_____%
Maximum Account Fee	_____%

Annual Fund Operating Expenses (expenses that you pay each year as a percentage of the value of your investment)

Management Fees	_____%
Distribution [and/or Service] (12b-1) Fees	_____%
Other Expenses	_____%
_____	_____%
_____	_____%
_____	_____%
Total Annual Fund Operating Expenses	_____%

Example

This Example is intended to help you compare the cost of investing in the Fund with the cost of investing in other mutual funds.

The Example assumes that you invest $10,000 in the Fund for the time periods indicated and then redeem all of your shares at the end of those periods. The Example also assumes that your investment has a 5% return each year and that the Fund's operating expenses remain the same.

	1 year	3 years	5 years	10 years
Although your actual costs may be higher or lower, based on these assumptions your costs would be:	$_____	$_____	$_____	$_____

	1 year	3 years	5 years	10 years
You would pay the following expenses if you did not redeem your shares:	$_____	$_____	$_____	$_____

The Example does not reflect sales charges (loads) on reinvested dividends [and other distributions]. If these sales charges (loads) were included, your costs would be higher.

Portfolio Turnover

The Fund pays transaction costs, such as commissions, when it buys and sells securities (or "turns over its portfolio). A higher portfolio turnover rate may indicate higher transaction costs and may result in higher taxes when Fund shares are held in a taxable account. These costs, which are not reflected in annual fund operating expenses or in the example, affect the Fund's performance. During the most recent fiscal year, the Fund's portfolio turnover rate was __% of the average value of its portfolio.

Instructions

1. General

(a) Round all dollar figures to the nearest dollar and all percentages to the nearest hundredth of one percent.

(b) Include the narrative explanations in the order indicated. A Fund may modify the narrative explanations if the explanation contains comparable information to that shown. The narrative explanation regarding sales charge discounts is only required by a Fund that offers such discounts and should specify the minimum level of investment required to qualify for a discount as disclosed in the table required by Item 12(a)(1).

(c) Include the caption "Maximum Account Fees" only if the Fund charges these fees. A Fund may omit other captions if the Fund does not charge the fees or expenses covered by the captions.

(d) (i) If the Fund is a Feeder Fund, reflect the aggregate expenses of the Feeder Fund and the Master Fund in a single fee table using the captions provided. In a footnote to the fee table, state that the table and Example reflect the expenses of both the Feeder and Master Funds.

(ii) If the prospectus offers more than one Class of a Multiple Class Fund or more than one Feeder Fund that invests in the

same Master Fund, provide a separate response for each Class or Feeder Fund.

(e) If the Fund is an Exchange-Traded Fund,

(i) Modify the narrative explanation to state that investors may pay brokerage commissions on their purchases and sales of Exchange-Traded Fund shares, which are not reflected in the example; and

(ii) If the Fund issues or redeems shares in creation units of not less than 25,000 shares each, exclude any fees charged for the purchase and redemption of the Fund's creation units.

2. *Shareholder Fees*

(a) (i) "Maximum Deferred Sales Charge (Load)" includes the maximum total deferred sales charge (load) payable upon redemption, in installments, or both, expressed as a percentage of the amount or amounts stated in response to Item 12(a), except that, for a sales charge (load) based on net asset value at the time of purchase, show the sales charge (load) as a percentage of the offering price at the time of purchase. A Fund may include in a footnote to the table, if applicable, a tabular presentation showing the amount of deferred sales charges (loads) over time or a narrative explanation of the sales charges (loads) (e.g., _____% in the first year after purchase, declining to _____% in the _____year and eliminated thereafter).

(ii) If more than one type of sales charge (load) is imposed (e.g., a deferred sales charge (load) and a front-end sales charge (load)), the first caption in the table should read "Maximum Sales Charge (Load)" and show the maximum cumulative percentage. Show the percentage amounts and the terms of each sales charge (load) comprising that figure on separate lines below.

(iii) If a sales charge (load) is imposed on shares purchased with reinvested capital gains distributions or returns of capital, include the bracketed words in the third caption.

(b) "Redemption Fee" includes a fee charged for any redemption of the Fund's shares, but does not include a deferred sales charge (load) imposed upon redemption, and, if the Fund is a Money Market Fund, does not include a liquidity fee imposed upon the sale of Fund shares in accordance with rule 2a-7(c)(2).

(c) "Exchange Fee" includes the maximum fee charged for any exchange or transfer of interest from the Fund to another fund. The Fund may in-

clude in a footnote to the table, if applicable, a tabular presentation of the range of exchange fees or a narrative explanation of the fees.

(d) "Maximum Account Fees." Disclose account fees that may be charged to a typical investor in the Fund; fees that apply to only a limited number of shareholders based on their particular circumstances need not be disclosed. Include a caption describing the maximum account fee (e.g., "Maximum Account Maintenance Fee" or "Maximum Cash Management Fee"). State the maximum annual account fee as either a fixed dollar amount or a percentage of assets. Include in a parenthetical to the caption the basis on which any percentage is calculated. If an account fee is charged only to accounts that do not meet a certain threshold (e.g., accounts under $5,000), the Fund may include the threshold in a parenthetical to the caption or footnote to the table. The Fund may include an explanation of any non-recurring account fee in a parenthetical to the caption or in a footnote to the table.

3. Annual Fund Operating Expenses

(a) "Management Fees" include investment advisory fees (including any fees based on the Fund's performance), any other management fees payable to the investment adviser or its affiliates, and administrative fees payable to the investment adviser or its affiliates that are not included as "Other Expenses."

(b) "Distribution [and/or Service] (12b-1) Fees" include all distribution or other expenses incurred during the most recent fiscal year under a plan adopted pursuant to rule 12b-1 [17 CFR 270.12b-1]. Under an appropriate caption or a subcaption of "Other Expenses," disclose the amount of any distribution or similar expenses deducted from the Fund's assets other than pursuant to a rule 12b-1 plan.

(c) (i) "Other Expenses" include all expenses not otherwise disclosed in the table that are deducted from the Fund's assets or charged to all shareholder accounts. The amount of expenses deducted from the Fund's assets are the amounts shown as expenses in the Fund's statement of operations (including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X [17 CFR 210.6-07]).

(ii) "Other Expenses" do not include extraordinary expenses as determined under generally accepted accounting principles (see FASB ASC Subtopic 225-20, Income Statement-Extraordinary and Unusual Items). If extraordinary expenses were incurred that materially affected the Fund's "Other Expenses," disclose in a footnote to the table what "Other Expenses" would have been had the extraordinary expenses been included.

(iii) The Fund may subdivide this caption into no more than three subcaptions that identify the largest expense or expenses comprising "Other Expenses," but must include a total of all "Other Expenses." Alternatively, the Fund may include the components of "Other Expenses" in a parenthetical to the caption.

(d) (i) Base the percentages of "Annual Fund Operating Expenses" on amounts incurred during the Fund's most recent fiscal year, but include in expenses amounts that would have been incurred absent expense reimbursement or fee waiver arrangements. If the Fund has changed its fiscal year and, as a result, the most recent fiscal year is less than three months, use the fiscal year prior to the most recent fiscal year as the basis for determining "Annual Fund Operating Expenses."

(ii) If there have been any changes in "Annual Fund Operating Expenses" that would materially affect the information disclosed in the table:

(A) Restate the expense information using the current fees as if they had been in effect during the previous fiscal year; and

(B) In a footnote to the table, disclose that the expense information in the table has been restated to reflect current fees.

(iii) A change in "Annual Fund Operating Expenses" means either an increase or a decrease in expenses that occurred during the most recent fiscal year or that is expected to occur during the current fiscal year. A change in "Annual Fund Operating Expenses" does not include a decrease in operating expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in the Fund's assets.

(e) If there are expense reimbursement or fee waiver arrangements that will reduce any Fund operating expenses for no less than one year from the effective date of the Fund's registration statement, a Fund may add two captions to the table: one caption showing the amount of the expense reimbursement or fee waiver, and a second caption showing the Fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. The Fund should place these additional captions directly below the "Total Annual Fund Operating Expenses" caption of the table and should use appropriate descriptive captions, such as "Fee Waiver [and/or Expense Reimbursement]" and

"Total Annual Fund Operating Expenses After Fee Waiver [and/or Expense Reimbursement]," respectively. If the Fund provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, including the expected termination date, and briefly describe who can terminate the arrangement and under what circumstances.

(f) (i) If the Fund (unless it is a Feeder Fund) invests in shares of one or more Acquired Funds, add a subcaption to the "Annual Fund Operating Expenses" portion of the table directly above the subcaption titled "Total Annual Fund Operating Expenses." Title the additional subcaption: "Acquired Fund Fees and Expenses." Disclose in the subcaption fees and expenses incurred indirectly by the Fund as a result of investment in shares of one or more Acquired Funds. For purposes of this item, an "Acquired Fund" means any company in which the Fund invests or has invested during the relevant fiscal period that (A) is an investment company or (B) would be an investment company under section 3(a) of the Investment Company Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the Investment Company Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)). If a Fund uses another term in response to other requirements of this Form to refer to Acquired Funds, it may include that term in parentheses following the subcaption title. In the event the fees and expenses incurred indirectly by the Fund as a result of investment in shares of one or more Acquired Funds do not exceed 0.01 percent (one basis point) of average net assets of the Fund, the Fund may include these fees and expenses under the subcaption "Other Expenses" in lieu of this disclosure requirement.

(ii) Determine the "Acquired Fund Fees and Expenses" according to the following formula:

$$AFFE = \frac{[(F_1/FY)*AI_1*D_1+[(F_2/FY)*AI_2*D_2]+[(F_3/FY)*AI_3*D_3] + \text{Transaction Fees} + \text{Incentive Allocations}}{\text{Average Net Assets of the Registrant}}$$

Where:

AFFE	=	Acquired Fund fees and expenses;
$F_1, F_2, F_3, \ldots$	=	Total annual operating expense ratio for each Acquired Fund;
FY	=	Number of days in the relevant fiscal year;
$AI_1, AI_2, AI_3, \ldots$	=	Average invested balance in each Acquired Fund;

$D_1, D_2, D_3, \ldots$	=	Number of days invested in each Acquired Fund;
"Transaction Fees"	=	The total amount of sales loads, redemption fees, or other transaction fees paid by the Fund in connection with acquiring or disposing of shares in any Acquired Funds during the most recent fiscal year.
"Incentive Allocations"	=	Any allocation of capital from the Acquiring Fund to the adviser of the Acquired Fund (or its affiliate) based on a percentage of the Acquiring Fund's income, capital gains and/or appreciation in the Acquired Fund.

(iii) Calculate the average net assets of the Fund for the most recent fiscal year, as provided in Item 13(a) (see Instruction 4 to Item 13(a)).

(iv) The total annual operating expense ratio used for purposes of this calculation (F1) is the annualized ratio of operating expenses to average net assets for the Acquired Fund's most recent fiscal period as disclosed in the Acquired Fund's most recent shareholder report. If the ratio of expenses to average net assets is not included in the most recent shareholder report or the Acquired Fund is a newly formed fund that has not provided a shareholder report, then the ratio of expenses to average net assets of the Acquired Fund is the ratio of total annual operating expenses to average annual net assets of the Acquired Fund for its most recent fiscal period as disclosed in the most recent communication from the Acquired Fund to the Fund. For purposes of this Instruction: (i) Acquired Fund expenses include increases resulting from brokerage service and expense offset arrangements and reductions resulting from fee waivers or reimbursements by the Acquired Funds' investment advisers or sponsors; and (ii) Acquired Fund expenses do not include expenses (i.e., performance fees) that are incurred solely upon the realization and/or distribution of a gain. If an Acquired Fund has no operating history, include in the Acquired Funds' expenses any fees payable to the Acquired Fund's investment adviser or its affiliates stated in the Acquired Fund's registration statement, offering memorandum or other similar communication without giving effect to any performance.

(v) To determine the average invested balance (AI_1), the numerator is the sum of the amount initially invested in an Acquired Fund during the most recent fiscal year (if the investment was held at

the end of the previous fiscal year, use the amount invested as of the end of the previous fiscal year) and the amounts invested in the Acquired Fund no less frequently than monthly during the period the investment is held by the Fund (if the investment was held through the end of the fiscal year, use each month-end through and including the fiscal year end). Divide the numerator by the number of measurement points included in the calculation of the numerator (i.e., if an investment is made during the fiscal year and held for 3 succeeding months, the denominator would be 4).

(vi) A New Fund should base the Acquired Fund fees and expenses on assumptions as to the specific Acquired Funds in which the New Fund expects to invest. Disclose in a footnote to the table that Acquired Fund fees and expenses are based on estimated amounts for the current fiscal year.

(vii) The Fund may clarify in a footnote to the fee table that the Total Annual Fund Operating Expenses under Item 3 do not correlate to the ratio of expenses to average net assets given in response to Item 13, which reflects the operating expenses of the Fund and does not include Acquired Fund fees and expenses.

4. *Example*

(a) Assume that the percentage amounts listed under "Total Annual Fund Operating Expenses" remain the same in each year of the 1-, 3-, 5-, and 10-year periods, except that an adjustment may be made to reflect any expense reimbursement or fee waiver arrangements that will reduce any Fund operating expenses for no less than one year from the effective date of the Fund's registration statement. An adjustment to reflect any expense reimbursement or fee waiver arrangement may be reflected only in the period(s) for which the expense reimbursement or fee waiver arrangement is expected to continue.

(b) For any breakpoint in any fee, assume that the amount of the Fund's assets remains constant as of the level at the end of the most recently completed fiscal year.

(c) Assume reinvestment of all dividends and distributions.

(d) Reflect recurring and non-recurring fees charged to all investors other than any exchange fees or any sales charges (loads) on shares purchased with reinvested dividends or other distributions. If sales charges (loads) are imposed on reinvested dividends or other distributions, include the narrative explanation following the Example and include the bracketed

words when sales charges (loads) are charged on reinvested capital gains distributions or returns of capital. Reflect any shareholder account fees collected by more than one Fund by dividing the total amount of the fees collected during the most recent fiscal year for all Funds whose shareholders are subject to the fees by the total average net assets of the Funds. Add the resulting percentage to "Annual Fund Operating Expenses" and assume that it remains the same in each of the 1-, 3-, 5-, and 10-year periods. A Fund that charges account fees based on a minimum account requirement exceeding $10,000 may adjust its account fees based on the amount of the fee in relation to the Fund's minimum account requirement.

(e) Reflect any deferred sales charge (load) by assuming redemption of the entire account at the end of the year in which the sales charge (load) is due. In the case of a deferred sales charge (load) that is based on the Fund's net asset value at the time of payment, assume that the net asset value at the end of each year includes the 5% annual return for that and each preceding year.

(f) Include the second 1-, 3-, 5-, and 10-year periods and related narrative explanation only if a sales charge (load) or other fee is charged upon redemption.

5. *Portfolio Turnover.* Disclose the portfolio turnover rate provided in response to Item 13(a) for the most recent fiscal year (or for such shorter period as the Fund has been in operation). Disclose the period for which the information is provided if less than a full fiscal year. A Fund that is a Money Market Fund may omit the portfolio turnover information required by this Item.

6. *New Funds.* For purposes of this Item, a "New Fund" is a Fund that does not include in Form N-1A financial statements reporting operating results or that includes financial statements for the Fund's initial fiscal year reporting operating results for a period of 6 months or less. The following Instructions apply to New Funds.

(a) Base the percentages expressed in "Annual Fund Operating Expenses" on payments that will be made, but include in expenses, amounts that will be incurred without reduction for expense reimbursement or fee waiver arrangements, estimating amounts of "Other Expenses." Disclose in a footnote to the table that "Other Expenses" are based on estimated amounts for the current fiscal year.

(b) Complete only the 1- and 3-year period portions of the Example and estimate any shareholder account fees collected.

Item 4. Risk/Return Summary: Investments, Risks, and Performance

Include the following information, in plain English under rule 421(d) under the Securities Act, in the order and subject matter indicated:

(a) Principal Investment Strategies of the Fund.

Based on the information given in response to Item 9(b), summarize how the Fund intends to achieve its investment objectives by identifying the Fund's principal investment strategies (including the type or types of securities in which the Fund invests or will invest principally) and any policy to concentrate in securities of issuers in a particular industry or group of industries.

(b) *Principal Risks of Investing in the Fund.*

(1) Narrative Risk Disclosure.

(i) Based on the information given in response to Item 9(c), summarize the principal risks of investing in the Fund, including the risks to which the Fund's portfolio as a whole is subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, and total return. Unless the Fund is a Money Market Fund, disclose that loss of money is a risk of investing in the Fund.

Instruction. A Fund may, in responding to this Item, describe the types of investors for whom the Fund is intended or the types of investment goals that may be consistent with an investment in the Fund.

(ii) (A) If the Fund is a Money Market Fund that is not a government Money Market Fund, as defined in §270.2a-7(a)(16) or a retail Money Market Fund, as defined in § 270.2a-7(a)(25), include the following statement:

You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

(B) If the Fund is a Money Market Fund that is a government Money Market Fund, as defined in §

270.2a-7(a)(16), or a retail Money Market Fund, as defined in § 270.2a-7(a)(25), and that is subject to the requirements of §§ 270.2a-7(c)(2)(i) and/or (ii) of this chapter (or is not subject to the requirements of §§ 270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to § 270.2a-7(c)(2)(iii) of this chapter, but has chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §§ 270.2a-7(c)(2)(i) and/or (ii)), include the following statement:

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The Fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

(C) If the Fund is a Money Market Fund that is a government Money Market Fund, as defined in § 270.2a-7(a)(16), that is not subject to the requirements of §§ 270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to § 270.2a-7(c)(2)(iii) of this chapter, and that has not chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §§ 270.2a-7(c)(2)(i) and/or (ii), include the following statement:

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

Instruction. If an affiliated person, promoter, or principal underwriter of the Fund, or an affiliated person of such a person, has contractually committed to provide financial support to the Fund, and the term of the agreement will extend for at least one year following the effective date of the Fund's registration statement, the statement specified in Item 4(b)(1)(ii)(A), Item 4(b)(1)(ii)(B), or Item 4(b)(1)(ii)(C) may omit the last sentence ("The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time."). For purposes of this Instruction, the term "financial support" includes any capital contribution, purchase of a security from the Fund in reliance on § 270.17a-9, purchase of any defaulted or devalued security at par, execution of letter of credit or letter of indemnity, capital support agreement (whether or not the Fund ultimately received support), performance guarantee, or any other similar action reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio; however, the term "financial support" excludes any routine waiver of fees or reimbursement of fund expenses, routine inter-fund lending, routine inter-fund purchases of fund shares, or any action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio.

(iii) If the Fund is advised by or sold through an insured depository institution, state that:

An investment in the Fund is not a deposit of the bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Instruction. A Money Market Fund that is advised by or sold through an insured depository institution should combine the disclosure required by Items 4(b)(1)(ii) and (iii) in a single statement.

(iv) If applicable, state that the Fund is non-diversified, describe the effect of non-diversification (e.g., disclose that, compared with other funds, the Fund may invest a greater percentage of its assets in a particular issuer), and summarize the risks of investing in a non-diversified fund.

(2) Risk/Return Bar Chart and Table.

(i) Include the bar chart and table required by paragraphs (b)(2)(ii) and (iii) of this section. Provide a brief explanation of how the information illustrates the variability of the Fund's returns (e.g., by stating that the information provides some indication of the risks of investing in the Fund by showing changes in the Fund's performance from year to year and by showing how the Fund's average annual returns for 1, 5, and 10 years compare with those of a broad measure of market performance). Provide a statement to the effect that the Fund's past performance (before and after taxes) is not necessarily an indication of how the Fund will perform in the future. If applicable, include a statement explaining that updated performance information is available and providing a Web site address and/or toll-free (or collect) telephone number where the updated information may be obtained.

(ii) If the Fund has annual returns for at least one calendar year, provide a bar chart showing the Fund's annual total returns for each of the last 10 calendar years (or for the life of the Fund if less than 10 years), but only for periods subsequent to the effective date of the Fund's registration statement. Present the corresponding numerical return adjacent to each bar. If the Fund's fiscal year is other than a calendar year, include the year-to-date return information as of the end of the most recent quarter in a footnote to the bar chart. Following the bar chart, disclose the Fund's highest and lowest return for a quarter during the 10 years or other period of the bar chart.

[**amendment effective November 19, 2018:** If swing pricing policies and procedures were applied during any of the periods, include a general description of the effects of swing pricing on the Fund's annual total returns for the applicable period(s) presented in a footnote to the bar chart.]

(iii) If the Fund has annual returns for at least one calendar year, provide a table showing the Fund's (A) average annual total return; (B) average annual total return (after taxes on distributions); and (C) average annual total return (after taxes on distributions and redemption). A Money Market Fund should show only the returns described in clause (A) of the preceding sentence. All returns should be shown for 1-, 5-, and 10- calendar year periods ending on the date of the most recently completed calendar year (or for the life of the Fund, if shorter), but only for periods subsequent to the effective date of the Fund's registration statement. The table also should show the returns of an appropriate broad-based securities market index as defined in Instruction 5 to Item 27(b) (7) for the same periods. A Fund that has been in existence for more than 10 years also may include returns for the life of the Fund. A

Money Market Fund may provide the Fund's 7-day yield ending on the date of the most recent calendar year or disclose a toll-free (or collect) telephone number that investors can use to obtain the Fund's current 7-day yield. For a Fund (other than a Money Market Fund or a Fund described in General Instruction C.3.(d)(iii)), provide the information in the following table with the specified captions:

AVERAGE ANNUAL TOTAL RETURNS
(For the periods ended December 31, _____)

	1 year	5 years (or Life of Fund)	10 years (or Life of Fund)
Return Before Taxes %	____%	____%	____%
Return After Taxes on Distributions	____%	____%	____%
Return After Taxes on Distributions and Sale of Fund Shares	____%	____%	____%
Index % *(reflects no deduction for [fees, expenses, or taxes])*	____%	____%	____%

(iv) Adjacent to the table required by paragraph 4(b)(2)(iii), provide a brief explanation that:

(A) After-tax returns are calculated using the historical highest individual federal marginal income tax rates and do not reflect the impact of state and local taxes;

(B) Actual after-tax returns depend on an investor's tax situation and may differ from those shown, and after-tax returns shown are not relevant to investors who hold their Fund shares through tax-deferred arrangements, such as 401(k) plans or individual retirement accounts;

(C) If the Fund is a Multiple Class Fund that offers more than one Class in the prospectus, after-tax returns are shown for only one Class and after-tax returns for other Classes will vary; and

(D) If average annual total return (after taxes on distributions and redemption) is higher than average annual total return, the reason for this result may be explained.

[(E) If swing pricing policies and procedures were applied during any of the periods, include a general description of the effects of swing pricing on the Fund's average annual total returns for the applicable period(s) presented. **amendment effective November 19, 2018**]

Instructions

1. *Bar Chart.*

   (a) Provide annual total returns beginning with the earliest calendar year. Calculate annual returns using the Instructions to Item 13(a), except that the calculations should be based on calendar years. If a Fund's shares are sold subject to a sales load or account fees, state that sales loads or account fees are not reflected in the bar chart and that, if these amounts were reflected, returns would be less than those shown.

   (b) For a Fund that provides annual total returns for only one calendar year or for a Fund that does not include the bar chart because it does not have annual returns for a full calendar year, modify, as appropriate, the narrative explanation required by paragraph (b)(2)(i) (e.g., by stating that the information gives some indication of the risks of an investment in the Fund by comparing the Fund's performance with a broad measure of market performance).

2. *Table.*

   (a) Calculate a Money Market Fund's 7-day yield under Item 26(a); the Fund's average annual total return under Item 26(b)(1); and the Fund's average annual total return (after taxes on distributions) and average annual total return (after taxes on distributions and redemption) under Items 26(b)(2) and (3), respectively.

   (b) A Fund may include, in addition to the required broad-based securities market index, information for one or more other indexes as permitted by Instruction 6 to Item 27(b)(7). If an additional index is included, disclose information about the additional index in the narrative explanation accompanying the bar chart and table (e.g., by stating that the information shows how the Fund's performance compares with the returns of an index of funds with similar investment objectives).

   (c) If the Fund selects an index that is different from the index used in a table for the immediately preceding period, explain the reason(s) for the selection of a different index and provide information for both the newly selected and the former index.

   (d) A Fund (other than a Money Market Fund) may include the Fund's yield calculated under Item 26(b)(2). Any Fund may include its tax-equivalent yield calculated under Item 26. If a Fund's yield is included, provide a toll-free (or collect) telephone number that investors can use to obtain current yield information.

   (e) Returns required by paragraphs 4(b)(2)(iii)(A), (B), and (C) for a Fund or Series must be adjacent to one another and appear in that order. The returns for a broad-based securities market index, as required by paragraph 4(b)(2)(iii), must precede or follow all of the returns for a Fund or Series rather than be interspersed with the returns of the Fund or Series.

3. *Multiple Class Funds.*

(a) When a Multiple Class Fund presents information for more than one Class together in response to Item 4(b)(2), provide annual total returns in the bar chart for only one of those Classes. The Fund can select which Class to include (e.g., the oldest Class, the Class with the greatest net assets) if the Fund:

(i) Selects the Class with 10 or more years of annual returns if other Classes have fewer than 10 years of annual returns;

(ii) Selects the Class with the longest period of annual returns when the Classes all have fewer than 10 years of returns; and

(iii) If the Fund provides annual total returns in the bar chart for a Class that is different from the Class selected for the most immediately preceding period, explain in a footnote to the bar chart the reasons for the selection of a different Class.

(b) When a Multiple Class Fund offers a new Class in a prospectus and separately presents information for the new Class in response to Item 4(b)(2), include the bar chart with annual total returns for any other existing Class for the first year that the Class is offered. Explain in a footnote that the returns are for a Class that is not presented that would have substantially similar annual returns because the shares are invested in the same portfolio of securities and the annual returns would differ only to the extent that the Classes do not have the same expenses. Include return information for the other Class reflected in the bar chart in the performance table.

(c) When a Multiple Class Fund presents information for more than one Class together in response to Item 4(b)(2):

(i) Provide the returns required by paragraph 4(b)(2)(iii)(A) of this Item for each of the Classes;

(ii) Provide the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item for only one of those Classes. The Fund may select the Class for which it provides the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item, provided that the Fund:

(A) Selects a Class that has been offered for use as an investment option for accounts other than those described in General Instruction C.3.(d)(iii)(A);

(B) Selects a Class described in paragraph (c)(ii)(A) of this Instruction with 10 or more years of annual returns if other Classes described in paragraph (c)(ii)(A) of this Instruction have fewer than 10 years of annual returns;

(C) Selects the Class described in paragraph (c)(ii)(A) of this Instruction with the longest period of annual returns if the Classes described in paragraph (c)(ii)(A) of this Instruction all have fewer than 10 years of returns; and

(D) If the Fund provides the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item for a Class that is different from the Class selected for the most immediately preceding period, explain in a footnote to the table the reasons for the selection of a different Class;

(iii) The returns required by paragraphs 4(b)(2)(iii)(A), (B), and (C) of this Item for the Class described in paragraph (c)(ii) of this Instruction should be adjacent and should not be interspersed with the returns of other Classes; and

(iv) All returns shown should be identified by Class.

(d) If a Multiple Class Fund offers a Class in the prospectus that converts into another Class after a stated period, compute average annual total returns in the table by using the returns of the other Class for the period after conversion.

4. *Change in Investment Adviser*. If the Fund has not had the same investment adviser during the last 10 calendar years, the Fund may begin the bar chart and the performance information in the table on the date that the current adviser began to provide advisory services to the Fund subject to the conditions in Instruction 11 of Item 27(b)(7).

Item 5. Management

(a) *Investment Adviser(s)*. Provide the name of each investment adviser of the Fund, including sub-advisers.

Instructions

1. A Fund need not identify a sub-adviser whose sole responsibility for the Fund is limited to day-to-day management of the Fund's holdings of cash and cash equivalent instruments, unless the Fund is a Money Market Fund or other Fund with a principal investment strategy of regularly holding cash and cash equivalent instruments.

2. A Fund having three or more sub-advisers, each of which manages a portion of the Fund's portfolio, need not identify each such sub-adviser, except that the Fund must identify any sub-adviser that is (or is reason-

ably expected to be) responsible for the management of a significant portion of the Fund's net assets. For purposes of this paragraph, a significant portion of a Fund's net assets generally will be deemed to be 30% or more of the Fund's net assets.

(b) *Portfolio Manager(s).* State the name, title, and length of service of the person or persons employed by or associated with the Fund or an investment adviser of the Fund who are primarily responsible for the day-to-day management of the Fund's portfolio ("Portfolio Manager").

Instructions

1. This requirement does not apply to a Money Market Fund.

2. If a committee, team, or other group of persons associated with the Fund or an investment adviser of the Fund is jointly and primarily responsible for the day-to-day management of the Fund's portfolio, information in response to this Item is required for each member of such committee, team, or other group. If more than five persons are jointly and primarily responsible for the day-to-day management of the Fund's portfolio, the Fund need only provide information for the five persons with the most significant responsibility for the day-to-day management of the Fund's portfolio.

Item 6. Purchase and Sale of Fund Shares

(a) *Purchase of Fund Shares.* Disclose the Fund's minimum initial or subsequent investment requirements.

(b) *Sale of Fund Shares.* Also disclose that the Fund's shares are redeemable and briefly identify the procedures for redeeming shares (e.g., on any business day by written request, telephone, or wire transfer).

(c) *Exchange-Traded Funds.* If the Fund is an Exchange-Traded Fund,

(i) Specify the number of shares that the Fund will issue (or redeem) in exchange for the deposit or delivery of basket assets (i.e., the securities or other assets the Fund specifies each day in name and number as the securities or assets in exchange for which it will issue or in return for which it will redeem Fund shares) and explain that:

(A) Individual Fund shares may only be purchased and sold on a national securities exchange through a broker-dealer; and

(B) The price of Fund shares is based on Market Price, and because Exchange-Traded Fund shares trade at Market Prices rather than net asset value, shares may trade at a price greater than net asset value (premium) or less than net asset value (discount); and

(ii) If the Fund issues shares in creation units of not less than 25,000 shares each, the Fund may omit the information required by Items 6(a) and 6(b).

[(d) If the Fund uses swing pricing, explain the Fund's use of swing pricing; including what swing pricing is, the circumstances under which the Fund will use it, the effects of swing pricing on the Fund and investors, and provide the upper limit it has set on the swing factor. With respect to any portion of a Fund's assets that is invested in one or more open-end management investment companies that are registered under the Investment Company Act, the Fund shall include a statement 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, if applicable, state that the prospectuses for those companies explain the circumstances under which they will use swing pricing and the effects of using swing pricing. **amendment effective November 19, 2018**]

Item 7. Tax Information

State, as applicable, that the Fund intends to make distributions that may be taxed as ordinary income or capital gains or that the Fund intends to distribute tax-exempt income. For a Fund that holds itself out as investing in securities generating tax-exempt income, provide, as applicable, a general statement to the effect that a portion of the Fund's distributions may be subject to federal income tax.

Item 8. Financial Intermediary Compensation

Include the following statement. A Fund may modify the statement if the modified statement contains comparable information. A Fund may omit the statement if neither the Fund nor any of its related companies pay financial intermediaries for the sale of Fund shares or related services.

Payments to Broker-Dealers and Other Financial Intermediaries.

If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information.

Item 9. Investment Objectives, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings

(a) *Investment Objectives*. State the Fund's investment objectives and, if applicable, state that those objectives may be changed without shareholder approval.

(b) *Implementation of Investment Objectives.* Describe how the Fund intends to achieve its investment objectives. In the discussion:

(1) Describe the Fund's principal investment strategies, including the particular type or types of securities in which the Fund principally invests or will invest.

Instructions

1. A strategy includes any policy, practice, or technique used by the Fund to achieve its investment objectives.

2. Whether a particular strategy, including a strategy to invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the Fund's investment objectives, and how the strategy affects the Fund's potential risks and returns. In determining what is a principal investment strategy, consider, among other things, the amount of the Fund's assets expected to be committed to the strategy, the amount of the Fund's assets expected to be placed at risk by the strategy, and the likelihood of the Fund's losing some or all of those assets from implementing the strategy.

3. A negative strategy (e.g., a strategy not to invest in a particular type of security or not to borrow money) is not a principal investment strategy.

4. Disclose any policy to concentrate in securities of issuers in a particular industry or group of industries (i.e., investing more than 25% of a Fund's net assets in a particular industry or group of industries).

5. Disclose any other policy specified in Item 16(c)(1) that is a principal investment strategy of the Fund.

6. Disclose, if applicable, that the Fund may, from time to time, take temporary defensive positions that are inconsistent with the Fund's principal investment strategies in attempting to respond to adverse market, economic, political, or other conditions. /Also disclose the effect of taking such a temporary defensive position (e.g., that the Fund may not achieve its investment objective).

7. Disclose whether the Fund (if not a Money Market Fund) may engage in active and frequent trading of portfolio securities to achieve its principal investment strategies. If so, explain the tax consequences to shareholders of increased portfolio turnover, and how the tax consequences of, or trading costs associated with, a Fund's portfolio turnover may affect the Fund's performance.

(2) Explain in general terms how the Fund's adviser decides which securities to buy and sell (e.g., for an equity fund, discuss, if applicable, whether the Fund emphasizes value or growth or blends the two approaches).

(c) *Risks.* Disclose the principal risks of investing in the Fund, including the risks to which the Fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, or total return.

(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 10. Management, Organization, and Capital Structure

(a) *Management.*

(1) *Investment Adviser.*

(i) Provide the name and address of each investment adviser of the Fund, including sub advisers. Describe the investment adviser's experience as an investment adviser and the advisory services that it provides to the Fund.

(ii) Describe the compensation of each investment adviser of the Fund as follows:

(A) If the Fund has operated for a full fiscal year, state the aggregate fee paid to the adviser for the most recent fiscal year as a percentage of average net assets. If the Fund has not operated for a full fiscal year, state what the adviser's fee is as a percentage of average net assets, including any breakpoints.

(B) If the adviser's fee is not based on a percentage of average net assets (e.g., the adviser receives a performance-based fee), describe the basis of the adviser's compensation.

(iii) Include a statement, adjacent to the disclosure required by paragraph (a)(1)(ii) of this Item, that a discussion regarding the basis for the board of directors approving any investment advisory contract of the Fund is available in the Fund's annual or semi-annual report to shareholders, as applicable, and providing the period covered by the relevant annual or semi-annual report.

Instructions

1. If the Fund changed advisers during the fiscal year, describe the compensation and the dates of service for each adviser.

2. Explain any changes in the basis of computing the adviser's compensation during the fiscal year.

3. If a Fund has more than one investment adviser, disclose the aggregate fee paid to all of the advisers, rather than the fees paid to each adviser, in response to this Item.

(2) *Portfolio Manager*. For each Portfolio Manager identified in response to Item 5(b), state the Portfolio Manager's business experience during the past 5 years. Include a statement, adjacent to the foregoing disclosure, that the SAI provides additional information about the Portfolio Manager's(s') compensation, other accounts managed by the Portfolio Manager(s), and the Portfolio Manager's(s') ownership of securities in the Fund. If a Portfolio Manager is a member of a committee, team, or other group of persons associated with the Fund or an investment adviser of the Fund that is jointly and primarily responsible for the day-to-day management of the Fund's portfolio, provide a brief description of the person's role on the committee, team, or other group (e.g., lead member), including a description of any limitations on the person's role and the relationship between the person's role and the roles of other persons who have responsibility for the day-to-day management of the Fund's portfolio.

(3) *Legal Proceedings*. Describe any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Fund or the Fund's investment adviser or principal underwriter is a party. Include the name of the court in which the proceedings are pending, the date instituted, the principal parties involved, a description of the factual basis alleged to underlie the proceeding, and the relief sought. Include similar information as to any legal proceedings instituted, or known to be contemplated, by a governmental authority.

Instruction. For purposes of this requirement, legal proceedings are material only to the extent that they are likely to have a material adverse effect on the Fund or the ability of the investment adviser or principal underwriter to perform its contract with the Fund.

(b) *Capital Stock*. Disclose any unique or unusual restrictions on the right freely to retain or dispose of the Fund's shares or material obligations or potential liabilities associated with holding the Fund's shares (not including investment risks) that may expose investors to significant risks.

Item 11. Shareholder Information

(a) *Pricing of Fund Shares.* Describe the procedures for pricing the Fund's shares, including:

(1) An explanation that the price of Fund shares is based on the Fund's net asset value and the method used to value Fund shares (Market Price, fair value, or amortized cost); except that if the Fund is an Exchange-Traded Fund, an explanation that the price of Fund shares is based on Market Price.

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.

(2) A statement as to when calculations of net asset value are made and that the price at which a purchase or redemption is effected is based on the next calculation of net asset value after the order is placed.

(3) A statement identifying in a general manner any national holidays when shares will not be priced and specifying any additional local or regional holidays when the Fund shares will not be priced.

Instructions

1. In responding to this Item, a Fund may use a list of specific days or any other means that effectively communicates the information (e.g., explaining that shares will not be priced on the days on which the New York Stock Exchange is closed for trading).

2. If the Fund has portfolio securities that are primarily listed on foreign exchanges that trade on weekends or other days when the Fund does not price its shares, disclose that the net asset value of the Fund's shares may change on days when shareholders will not be able to purchase or redeem the Fund's shares.

(b) *Purchase of Fund Shares.* Describe the procedures for purchasing the Fund's shares.

(c) *Redemption of Fund Shares*. Describe the procedures for redeeming the Fund's shares, including:

(1) Any restrictions on redemptions.

(2) Any redemption charges, including how these charges will be collected and under what circumstances the charges will be waived.

(3) [If the Fund has reserved the right to redeem in kind.] **[This paragraph (c)(3) is to be removed and subsequent paragraphs renumbered accordingly, effective January 17, 2017, with a compliance date of June 1, 2017.]**

(3) Any procedure that a shareholder can use to sell the Fund's shares to the Fund or its underwriter through a broker-dealer, noting any charges that may be imposed for such service.

Instruction. The specific fees paid through the broker-dealer for such service need not be disclosed.

(4) The circumstances, if any, under which the Fund may redeem shares automatically without action by the shareholder in accounts below a certain number or value of shares.

(5) The circumstances, if any, under which the Fund may delay honoring a request for redemption for a certain time after a shareholder's investment (e.g., whether a Fund does not process redemptions until clearance of the check for the initial investment).

(6) Any restrictions on, or costs associated with, transferring shares held in street name accounts.

[The below paragraphs (c)(7) and (c)(8) are to be added effective January 17, 2017, with a compliance date of June 1, 2017.]

(7) The number of days following receipt of shareholder redemption requests in which the fund typically expects to pay out redemption proceeds to redeeming shareholders. If the number of days differs by method of payment (e.g., check, wire, automated clearing house), then disclose the typical number of days or estimated range of days that the fund expects it will take to pay out redemptions proceeds for each method used.

(8) The methods that the fund typically expects to use to meet redemption requests, and whether those methods are used regularly, or only in stressed market conditions (e.g., sales of portfolio assets, holdings of cash or cash equivalents, lines of credit, interfund lending, and/or ability to redeem in kind).

(d) *Dividends and Distributions*. Describe the Fund's policy with respect to dividends and distributions, including any options that shareholders may have as to the receipt of dividends and distributions.

(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.

(f) *Tax Consequences*.

(1) Describe the tax consequences to shareholders of buying, holding, exchanging and selling the Fund's shares, including, as applicable, that:

(i) The Fund intends to make distributions that may be taxed as ordinary income and capital gains (which may be taxable at different rates depending on the length of time the Fund holds its assets). If the Fund expects that its distributions, as a result of its investment objectives or strategies, will consist primarily of ordinary income or capital gains, provide disclosure to that effect.

(ii) The Fund's distributions, whether received in cash or reinvested in additional shares of the Fund, may be subject to federal income tax.

(iii) An exchange of the Fund's shares for shares of another fund will be treated as a sale of the Fund's shares and any gain on the transaction may be subject to federal income tax.

(2) For a Fund that holds itself out as investing in securities generating tax-exempt income:

(i) Modify the disclosure required by paragraph (f)(1) to reflect that the Fund intends to distribute tax-exempt income.

(ii) Also disclose, as applicable, that:

(A) The Fund may invest a portion of its assets in securities that generate income that is not exempt from federal or state income tax;

(B) Income exempt from federal tax may be subject to state and local income tax; and

(C) Any capital gains distributed by the Fund may be taxable.

(3) If the Fund does not expect to qualify as a regulated investment company under Subchapter M of the Internal Revenue Code [I.R.C. 851 et seq.], explain the tax consequences. If the Fund expects to pay an excise tax under the Internal Revenue Code [I.R.C. 4982] with respect to its distributions, explain the tax consequences.

(g) *Exchange-Traded Funds.* If the Fund is an Exchange-Traded Fund:

(1) The Fund may omit from the prospectus the information required by Items 11(a)(2), (b), and (c) if the Fund issues or redeems Fund shares in creation units of not less than 25,000 shares each; and

(2) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed calendar year, and the most recently completed calendar quarters since that year (or the life of the Fund, if shorter). The Fund may omit this table if the Fund provides an Internet address at the Fund's Web site, which is publicly accessible, free of charge, that investors can use to obtain the premium/discount information required in this Item.

Instructions.

1. Provide the information in tabular form.

2. Express the information as a percentage of the net asset value of the Fund, using separate columns for the number of days the Market Price was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value. Round all percentages to the nearest hundredth of one percent.

3. Adjacent to the table, provide a brief explanation that: shareholders may pay more than net asset value when they buy Fund shares and receive less than net asset value when they sell those shares, because shares are bought and sold at current market prices.

4. Include a statement that the data presented represents past performance and cannot be used to predict future results.

Item 12. Distribution Arrangements

(a) Sales Loads.

(1) Describe any sales loads, including deferred sales loads, applied to purchases of the Fund's shares. Include in a table any front-end sales load (and each breakpoint in the sales load, if any) as a percentage of both the offering price and the net amount invested.

Instructions

1. If the Fund's shares are sold subject to a front-end sales load, explain that the term "offering price" includes the front-end sales load.

2. Disclose, if applicable, that sales loads are imposed on shares, or amounts representing shares, that are purchased with reinvested dividends or other distributions.

3. Discuss, if applicable, how deferred sales loads are imposed and calculated, including:

   (a) Whether the specified percentage of the sales load is based on the offering price, or the lesser of the offering price or net asset value at the time the sales load is paid.

   (b) The amount of the sales load as a percentage of both the offering price and the net amount invested.

   (c) A description of how the sales load is calculated (e.g., in the case of a partial redemption, whether or not the sales load is calculated as if shares or amounts representing shares not subject to a sales load are redeemed first, and other shares or amounts representing shares are then redeemed in the order purchased).

   (d) If applicable, the method of paying an installment sales load (e.g., by withholding of dividend payments, involuntary redemptions, or separate billing of a shareholder's account).

(2) Unless disclosed in response to paragraph (a)(1), briefly describe any arrangements that result in breakpoints in, or elimination of, sales loads (e.g., letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, redemption reinvestment plans, and waivers for particular classes of investors). Identify each class of individuals or transactions to which the arrangements apply and state each different breakpoint as a percentage of both the offering price and the net amount invested. If applicable, state that additional information concerning sales load breakpoints is available in the Fund's SAI.

Instructions

1. The description, pursuant to paragraph (a)(1) or (a)(2) of this Item 12, of arrangements that result in breakpoints in, or elimination of, sales loads must include a brief summary of shareholder eligibility requirements, including a description or list of the types of accounts (e.g., retirement accounts, accounts held at other financial intermediaries), account holders (e.g., immediate family members, family trust accounts, solely-controlled business accounts), and fund holdings (e.g., funds held within the same fund complex) that may be aggregated for purposes of determining eligibility for sales load breakpoints.

2. The description pursuant to paragraph (a)(2) of this Item 12 need not contain any information required by Items 17(d) and 23(b).

(3) Describe, if applicable, the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints, including the circumstances in which and the classes of individuals to whom each method applies. Methods that should be described, if applicable, include historical cost, net amount invested, and offering price.

(4) (i) State, if applicable, that, in order to obtain a breakpoint discount, it may be necessary at the time of purchase for a shareholder to inform the Fund or his or her financial intermediary of the existence of other accounts in which there are holdings eligible to be aggregated to meet sales load breakpoints. Describe any information or records, such as account statements, that it may be necessary for a shareholder to provide to the Fund or his or her financial intermediary in order to verify his or her eligibility for a breakpoint discount. This description must include, if applicable:

(A) Information or records regarding shares of the Fund or other funds held in all accounts (e.g., retirement accounts) of the shareholder at the financial intermediary;

(B) Information or records regarding shares of the Fund or other funds held in any account of the shareholder at another financial intermediary; and

(C) Information or records regarding shares of the Fund or other funds held at any financial intermediary by related parties of the shareholder, such as members of the same family or household.

(ii) If the Fund permits eligibility for breakpoints to be determined based on historical cost, state that a shareholder should retain any records necessary to substantiate historical costs because the Fund, its transfer agent, and financial intermediaries may not maintain this information.

(5) State whether the Fund makes available free of charge, on or through the Fund's Web site at a specified Internet address, and in a clear and prominent format, the information required by paragraphs (a)(1) through (a)(4) and Item 23(a), including whether the Web site includes hyperlinks that facilitate access to the information. If the Fund does not make the information required by paragraphs (a)(1) through (a)(4) and Item 23(a) available in this manner, disclose the reasons why it does not do so (including, where applicable, that the Fund does not have an Internet Web site).

Instruction. All information required by paragraph (a) of this Item 12 must be adjacent to the table required by paragraph (a)(1) of this Item 12; **must** be presented in a clear, concise, and understandable manner; and must include tables, schedules, and charts as expressly required by paragraph (a)(1) of this Item 12 or where doing so would facilitate understanding.

(b) *Rule 12b-1 Fees*. If the Fund has adopted a plan under rule 12b-1, state the amount of the distribution fee payable under the plan and provide disclosure to the following effect:

(1) The Fund has adopted a plan under rule 12b-1 that allows the Fund to pay distribution fees for the sale and distribution of its shares; and

(2) Because these fees are paid out of the Fund's assets on an on-going basis, over time these fees will increase the cost of your investment and may cost you more than paying other types of sales charges.

Instruction. If the Fund pays service fees under its rule 12b-1 plan, modify this disclosure to reflect the payment of these fees (e.g., by indicating that the Fund pays distribution and other fees for the sale of its shares and for services pro-

vided to shareholders). For purposes of this paragraph, service fees have the same meaning given that term under rule 2830(b)(9) of the NASD Conduct Rules [NASD Manual (CCH) 4622].

(c) *Multiple Class and Master-Feeder Funds.*

(1) Describe the main features of the structure of the Multiple Class Fund or Master-Feeder Fund.

(2) If more than one Class of a Multiple Class Fund is offered in the prospectus, provide the information required by paragraphs (a) and (b) for each of those Classes.

(3) If a Multiple Class Fund offers in the prospectus shares that provide for mandatory or automatic conversions or exchanges from one Class to another Class, provide the information required by paragraphs (a) and (b) for both the shares offered and the Class into which the shares may be converted or exchanged.

(4) If a Feeder Fund has the ability to change the Master Fund in which it invests, describe briefly the circumstances under which the Feeder Fund can do so.

Instruction. A Feeder Fund that does not have the authority to change its Master Fund need not disclose the possibility and consequences of its no longer investing in the Master Fund.

Item 13. Financial Highlights Information

(a) Provide the following information for the Fund, or for the Fund and its subsidiaries, audited for at least the latest 5 years and consolidated as required in Regulation S-X [17 CFR 210].

Financial Highlights

The financial highlights table is intended to help you understand the Fund's financial performance for the past 5 years [or, if shorter, the period of the Fund's operations]. Certain information reflects financial results for a single Fund share. The total returns in the table represent the rate that an investor would have earned [or lost] on an investment in the Fund (assuming reinvestment of all dividends and distributions). This information has been audited by , whose report, along with the Fund's financial statements, are included in [the SAI or annual report], which is available upon request.

Net Asset Value, Beginning of Period
Income From Investment Operations
Net Investment Income
Net Gains or Losses on Securities (both realized and unrealized)
Total From Investment Operations
Less Distributions
Dividends (from net investment income)
Distributions (from capital gains)
Returns of Capital
Total Distributions
Capital Adjustments Due to Swing Pricing **[amendment effective November 19, 2018]**

Net Asset Value, End of Period

Net Asset Value, adjusted pursuant to swing pricing, End of Period **[amendment effective November 19, 2018]**

Total Return
- - - - - - - - - - - - - - - - - - - -
Ratios/Supplemental Data

Net Assets, End of Period
Ratio of Expenses to Average Net Assets
Ratio of Net Income to Average Net Assets
Portfolio Turnover Rate

Instructions

1. General.

(a) Present the information in comparative columnar form for each of the last 5 fiscal years of the Fund (or for such shorter period as the Fund has been in operation), but only for periods subsequent to the effective date of the Fund's registration statement. Also present the information for the period between the end of the latest fiscal year and the date of the latest balance sheet or statement of assets and liabilities. When a period in the table is for less than a full fiscal year, a Fund may annualize ratios in the table and disclose that the ratios are annualized in a note to the table.

(b) List per share amounts at least to the nearest cent. If the offering price is expressed in tenths of a cent or more, then state the amounts in the table in tenths of a cent. Present the information using a consistent number of decimal places.

(c) Include the narrative explanation before the financial information. A Fund may modify the explanation if the explanation contains comparable information to that shown.

2. *Per Share Operating Performance.*

(a) Derive net investment income data by adding (deducting) the increase (decrease) per share in undistributed net investment income for the period to (from) dividends from net investment income per share for the period. The increase (decrease) per share may be derived by comparing the per share figures obtained by dividing undistributed net investment income at the beginning and end of the period by the number of shares outstanding on those dates. Other methods of computing net investment income may be acceptable. Provide an explanation in a note to the table of any other method used to compute net investment income.

(b) The amount shown at the Net Gains or Losses on Securities caption is the balancing figure derived from the other amounts in the statement. The amount shown at this caption for a share outstanding throughout the year may not agree with the change in the aggregate gains and losses in the portfolio securities for the year because of the timing of sales and repurchases of the Fund's shares in relation to fluctuating market values for the portfolio.

(c) For any distributions made from sources other than net investment income and capital gains, state the per share amounts separately at the Returns of Capital caption and note the nature of the distributions.

(d) The amount shown at the Capital Adjustments Due to Swing Pricing caption should include the per share impact of any amounts retained by the Fund pursuant to its swing pricing policies and procedures, if applicable. [**amendment effective November 19, 2018**]

(e) The amounts shown at the Net Asset Value, as adjusted pursuant to swing pricing, End of Period caption should be the Fund's net asset value per share as adjusted pursuant to its swing pricing policies and procedures on the last day of the reporting period, if applicable. [**amendment effective November 19, 2018**]

3. *Total Return.*

(a) Assume an initial investment made at the net asset value calculated on the last business day before the first day of each period shown.

(b) Do not reflect sales loads or account fees in the initial investment, but, if sales loads or account fees are imposed, note that they are not reflected in total return.

(c) Reflect any sales load assessed upon reinvestment of dividends or distributions.

(d) Assume a redemption at the price calculated on the last business day of each period shown.

(e) For a period less than a full fiscal year, state the total return for the period and disclose that total return is not annualized in a note to the table.

4. *Ratios/Supplemental Data.*

(a) Calculate "average net assets" based on the value of the net assets determined no less frequently than the end of each month.

(b) Calculate the Ratio of Expenses to Average Net Assets using the amount of expenses shown in the Fund's statement of operations for the relevant fiscal period, including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X and reductions resulting from complying with paragraphs 2(a) and (f) of rule 6-07 regarding fee waivers and reimbursements. If a change in the methodology for determining the ratio of expenses to average net assets results from applying paragraph 2(g) of rule 6-07, explain in a note that the ratio reflects fees paid with brokerage commissions and fees reduced in connection with specific agreements only for periods ending after September 1, 1995.

(c) A Fund that is a Money Market Fund may omit the Portfolio Turnover Rate.

(d) Calculate the Portfolio Turnover Rate as follows:

(i) Divide the lesser of amounts of purchases or sales of portfolio securities for the fiscal year by the monthly average of the value of the portfolio securities owned by the Fund during the fiscal year. Calculate the monthly average by totaling the values of portfolio securities as of the beginning and end of the first

month of the fiscal year and as of the end of each of the succeeding 11 months and dividing the sum by 13.

(ii) Exclude from both the numerator and the denominator amounts relating to all securities, including options, whose maturities or expiration dates at the time of acquisition were one year or less. Include all long-term securities, including long-term U.S. Government securities. Purchases include any cash paid upon the conversion of one portfolio security into another and the cost of rights or warrants. Sales include net proceeds of the sale of rights and warrants and net proceeds of portfolio securities that have been called or for which payment has been made through redemption or maturity.

(iii) If the Fund acquired the assets of another investment company or of a personal holding company in exchange for its own shares during the fiscal year in a purchase-of-assets transaction, exclude the value of securities acquired from purchases and securities sold from sales to realign the Fund's portfolio. Adjust the denominator of the portfolio turnover computation to reflect these excluded purchases and sales and disclose them in a footnote.

(iv) Include in purchases and sales any short sales that the Fund intends to maintain for more than one year and put and call options with expiration dates more than one year from the date of acquisition. Include proceeds from a short sale in the value of the portfolio securities sold during the period; include the cost of covering a short sale in the value of portfolio securities purchased during the period. Include premiums paid to purchase options in the value of portfolio securities purchased during the reporting period; include premiums received from the sale of options in the value of the portfolio securities sold during the period.

(e) A Fund may incorporate by reference the Financial Highlights Information from a report to shareholders under rule 30e-1 into the prospectus in response to this Item if the Fund delivers the shareholder report with the prospectus or, if the report has been previously delivered (e.g., to a current shareholder), the Fund includes the statement required by Item 1(b)(1).

Part B—INFORMATION REQUIRED IN A STATEMENT OF ADDITIONAL INFORMATION

Item 14. Cover Page and Table of Contents

(a) *Front Cover Page.* Include the following information on the outside front cover page of the SAI:

(1) The Fund's name and the Class or Classes, if any, to which the SAI relates. If the Fund is a Series, also provide the Registrant's name.

(2) The exchange ticker symbol of the Fund's securities or, if the SAI relates to one or more Classes of the Fund's securities, adjacent to each such class, the exchange ticker symbol of such Class of the Fund's securities. If the Fund is an Exchange-Traded Fund, also identify the principal U. S. market or markets on which the Fund shares are traded.

(3) A statement or statements:

(i) That the SAI is not a prospectus;

(ii) How the prospectus may be obtained; and

(iii) Whether and from where information is incorporated by reference into the SAI, as permitted by General Instruction D.

Instruction. Any information incorporated by reference into the SAI must be delivered with the SAI unless the information has been previously delivered in a shareholder report (e.g., to a current shareholder), and the Fund states that the shareholder **report** is available, without charge, upon request. Provide a toll-free (or collect) telephone number to call to request the report.

(4) The date of the SAI and of the prospectus to which the SAI relates.

(b) *Table of Contents.* Include under appropriate captions (and subcaptions) a list of the contents of the SAI and, when useful, provide cross-references to related disclosure in the prospectus.

Item 15. Fund History

(a) Provide the date and form of organization of the Fund and the name of the state or other jurisdiction in which the Fund is organized.

(b) If the Fund has engaged in a business other than that of an investment company during the past 5 years, state the nature of the other business and give the approximate date on which the Fund commenced business as an investment company. If the Fund's name was changed during that period, state its former name and the approximate date on which it was changed. Briefly describe the nature and results of any change in the Fund's business or name that occurred in connection with any bankruptcy, receivership, or similar proceeding, or any other material reorganization, readjustment or succession.

Item 16. Description of the Fund and Its Investments and Risks

(a) *Classification.* State that the Fund is an open-end, management investment company and indicate, if applicable, that the Fund is diversified.

(b) *Investment Strategies and Risks.* Describe any investment strategies, including a strategy to invest in a particular type of security, used by an investment adviser of the Fund in managing the Fund that are not principal strategies and the risks of those strategies.

(c) *Fund Policies.*

(1) Describe the Fund's policy with respect to each of the following:

(i) Issuing senior securities;

(ii) Borrowing money, including the purpose for which the proceeds will be used;

(iii) Underwriting securities of other issuers;

(iv) Concentrating investments in a particular industry or group of industries;

(v) Purchasing or selling real estate or commodities;

(vi) Making loans; and

(vii) Any other policy that the Fund deems fundamental or that may not be changed without shareholder approval, including, if applicable, the Fund's investment objectives.

Instruction. If the Fund reserves freedom of action with respect to any practice specified in paragraph (c)(1), state the maximum percentage of assets to be devoted to the practice and disclose the risks of the practice.

(2) State whether shareholder approval is necessary to change any policy specified in paragraph (c)(1). If so, describe the vote required to obtain this approval.

(d) *Temporary Defensive Position.* Disclose, if applicable, the types of investments that a Fund may make while assuming a temporary defensive position described in response to Item 9(b).

(e) *Portfolio Turnover.* Explain any significant variation in the Fund's portfolio turnover rates over the two most recently completed fiscal years or any anticipated variation in the portfolio turnover rate from that reported for the last fiscal year in response to Item 13.

Instruction

This paragraph does not apply to a Money Market Fund.

(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 16(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 hyper link (or series of prominent hyperlinks) to the information will be available.

   *[**amendment effective January 17, 2017.** "N-Q" will be replaced by "N-PORT for the last month of the Fund's first or third fiscal quarters". **Note: Funds with assets of $1 billion or more will be required to file Form N-PORT by June 1, 2018. Funds with assets**

of less than $1 billion will be required to file Form N-PORT by June 1, 2019. Form N-Q will be rescinded on August 1, 2019.]

(g) *Money Market Fund Material Events.* If the Fund is a Money Market Fund (except any Money Market Fund that is not subject to the requirements of §§ 270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to § 270.2a-7(c)(2)(iii) of this chapter, and has not chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §§ 270.2a-7(c)(2)(i) and/or (ii)) disclose, as applicable, the following events:

(1) *Imposition of Liquidity Fees and Temporary Suspensions of Fund Redemptions.*

(i) During the last 10 years, any occasion on which the Fund has invested less than ten percent of its total assets in weekly liquid assets (as provided in § 270.2a-7(c)(2)(ii)), and with respect to each such occasion, whether the Fund's board of directors determined to impose a liquidity fee pursuant to § 270.2a-7(c)(2)(ii) and/or temporarily suspend the Fund's redemptions pursuant to § 270.2a-7(c)(2)(i).

(ii) During the last 10 years, any occasion on which the Fund has invested less than thirty percent, but more than ten percent, of its total assets in weekly liquid assets (as provided in § 270.2a-7(c)(2)(i)) and the Fund's board of directors has determined to impose a liquidity fee pursuant to § 270.2a-7(c)(2)(i) and/or temporarily suspend the Fund's redemptions pursuant to § 270.2a-7(c)(2)(i).

Instructions

1. With respect to each such occasion, disclose: the dates and length of time for which the Fund invested less than ten percent (or thirty percent, as applicable) of its total assets in weekly liquid assets; the dates and length of time for which the Fund's board of directors determined to impose a liquidity fee pursuant to § 270.2a-7(c)(2)(i) or § 270.2a-7(c)(2)(ii), and/or temporarily suspend the Fund's redemptions pursuant to § 270.2a-7(c)(2)(i); and the size of any liquidity fee imposed pursuant to § 270.2a-7(c)(2)(i) or § 270.2a-7(c)(2)(ii).

2. The disclosure required by Item 16(g)(1) should incorporate, as appropriate, any information that the Fund is required to report to the Commission on Items E.1, E.2, E.3, E.4, F.1, F.2, and G.1 of Form N-CR [17 CFR 274.222].

3. The disclosure required by Item 16(g)(1) should conclude with the following statement: "The Fund was required to disclose additional

information about this event [or "these events," as appropriate] on Form N-CR and to file this form with the Securities and Exchange Commission. Any Form N-CR filing submitted by the Fund is available on the EDGAR Database on the Securities and Exchange Commission's Internet site at http://www.sec.gov."

(2) *Financial Support Provided to Money Market Funds.* During the last 10 years, any occasion on which an affiliated person, promoter, or principal underwriter of the Fund, or an affiliated person of such a person, provided any form of financial support to the Fund, including a description of the nature of support, person providing support, brief description of the relationship between the person providing support and the Fund, date support provided, amount of support, security supported (if applicable), and the value of security supported on date support was initiated (if applicable).

Instructions

1. The term "financial support" includes any capital contribution, purchase of a security from the Fund in reliance on § 270.17a-9, purchase of any defaulted or devalued security at par, execution of letter of credit or letter of indemnity, capital support agreement (whether or not the Fund ultimately received support), performance guarantee, or any other similar action reasonably intended to increase or stabilize the value or liquidity of the Fund's portfolio; excluding, however, any routine waiver of fees or reimbursement of Fund expenses, routine inter-fund lending, routine inter-fund purchases of Fund shares, or any action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the Fund's portfolio.

2. If during the last 10 years, the Fund has participated in one or more mergers with another investment company (a "merging investment company"), provide the information required by Item 16(g)(2) with respect to any merging investment company as well as with respect to the Fund; for purposes of this Instruction, the term "merger" means a merger, consolidation, or purchase or sale of substantially all of the assets between the Fund and a merging investment company. If the person or entity that previously provided financial support to a merging investment company is not currently an affiliated person, promoter, or principal underwriter of the Fund, the Fund need not provide the information required by Item 16(g)(2) with respect to that merging investment company.

3. The disclosure required by Item 16(g)(2) should incorporate, as appropriate, any information that the Fund is required to report to the Commission on Items C.1, C.2, C.3, C.4, C.5, C.6, and C.7 of Form N-CR [17 CFR 274.222].

4. The disclosure required by Item 16(g)(2) should conclude with the following statement: "The Fund was required to disclose additional information about this event [or "these events," as appropriate] on Form N-CR and to file this form with the Securities and Exchange Commission. Any Form N-CR filing submitted by the Fund is available on the EDGAR Database on the Securities and Exchange Commission's Internet site at http://www.sec.gov."

Item 17. Management of the Fund

Instructions

1. For purposes of this Item 17, the terms below have the following meanings:

   (a) The term "family of investment companies" means any two or more registered investment companies that:

      (1) Share the same investment adviser or principal underwriter; and

      (2) Hold themselves out to investors as related companies for purposes of investment and investor services.

   (b) The term "fund complex" means two or more registered investment companies that:

      (1) Hold themselves out to investors as related companies for purposes of investment and investor services; or

      (2) Have a common investment adviser or have an investment adviser that is an affiliated person of the investment adviser of any of the other registered investment companies.

   (c) The term "immediate family member" means a person's spouse; child residing in the person's household (including step and adoptive children); and any dependent of the person, as defined in section 152 of the Internal Revenue Code (26 U.S.C. 152).

(d) The term "officer" means the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions.

2. When providing information about directors, furnish information for directors who are interested persons of the Fund separately from the information for directors who are not interested persons of the Fund. For example, when furnishing information in a table, you should provide separate tables (or separate sections of a single table) for directors who are interested persons and for directors who are not interested persons. When furnishing information in narrative form, indicate by heading or otherwise the directors who are interested persons and the directors who are not interested persons.

(a) *Management Information.*

(1) Provide the information required by the following table for each director and officer of the Fund, and, if the Fund has an advisory board, member of the board. Explain in a footnote to the table any family relationship between the persons listed.

(1)	(2)	(3)	(4)	(5)	(6)
Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director

Instructions

1. For purposes of this paragraph, the term "family relationship" means any relationship by blood, marriage, or adoption, not more remote than first cousin.

2. For each director who is an interested person of the Fund, describe, in a footnote or otherwise, the relationship, events, or transactions by reason of which the director is an interested person.

3. State the principal business of any company listed under column (4) unless the principal business is implicit in its name.

4. Indicate in column (6) directorships not included in column (5) that are held by a director in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Securities Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act, and name the companies in which

the directorships are held. Where the other directorships include directorships overseeing two or more portfolios in the same fund complex, identify the fund complex and provide the number of portfolios overseen as a director in the fund complex rather than listing each portfolio separately.

(2) For each individual listed in column (1) of the table required by paragraph (a)(1) of this Item 17, except for any director who is not an interested person of the Fund, describe any positions, including as an officer, employee, director, or general partner, held with affiliated persons or principal underwriters of the Fund.

Instruction

When an individual holds the same position(s) with two or more registered investment companies that are part of the same fund complex, identify the fund complex and provide the number of registered investment companies for which the position(s) are held rather than listing each registered investment company separately.

(3) Describe briefly any arrangement or understanding between any director or officer and any other person(s) (naming the person(s)) pursuant to which he was selected as a director or officer.

Instruction

Do not include arrangements or understandings with directors or officers acting solely in their capacities as such.

(b) *Leadership Structure and Board of Directors.*

(1) Briefly describe the leadership structure of the Fund's board, including the responsibilities of the board of directors with respect to the Fund's management and whether the chairman of the board is an interested person of the Fund. If the chairman of the board is an interested person of the Fund, disclose whether the Fund has a lead independent director and what specific role the lead independent director plays in the leadership of the Fund. This disclosure should indicate why the Fund has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Fund. In addition, disclose the extent of the board's role in the risk oversight of the Fund, such as how the board administers its oversight function and the effect that this has on the board's leadership structure.

(2) Identify the standing committees of the Fund's board of directors, and provide the following information about each committee:

(i) A concise statement of the functions of the committee;

(ii) The members of the committee;

(iii) The number of committee meetings held during the last fiscal year; and

(iv) If the committee is a nominating or similar committee, state whether the committee will consider nominees recommended by security holders and, if so, describe the procedures to be followed by security holders in submitting recommendations.

(3) (i) Unless disclosed in the table required by paragraph (a)(1) of this Item 17, describe any positions, including as an officer, employee, director, or general partner, held by any director who is not an interested person of the Fund, or immediate family member of the director, during the two most recently completed calendar years with:

(A) The Fund;

(B) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a-3(c)(1) and (c)(7)), having the same investment adviser or principal underwriter as the Fund or having an investment adviser or principal underwriter that directly or indirectly controls, is controlled by, or is under common control with an investment adviser or principal underwriter of the Fund;

(C) An investment adviser, principal underwriter, or affiliated person of the Fund; or

(D) Any person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund.

(ii) Unless disclosed in the table required by paragraph (a)(1) of this Item 17 or in response to paragraph (b)(3)(i) of this Item 17, indicate any directorships held dur-

ing the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Securities Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act, and name the companies in which the directorships were held.

Instruction. When an individual holds the same position(s) with two or more portfolios that are part of the same fund complex, identify the fund complex and provide the number of portfolios for which the position(s) are held rather than listing each portfolio separately.

(4) For each director, state the dollar range of equity securities beneficially owned by the director as required by the following table:

(i) In the Fund; and

(ii) On an aggregate basis, in any registered investment companies overseen by the director within the same family of investment companies as the Fund.

(1)	(2)	(3)
Name of Director	**Dollar Range of Equity Securities in the Fund**	**Aggregate Dollar Range of Equity Securities in All Registered Investment Companies Overseen by Director in Family of Investment Companies**

Instructions.

1. Information should be provided as of the end of the most recently completed calendar year. Specify the valuation date by footnote or otherwise.
2. Determine "beneficial ownership" in accordance with rule 16a-1(a)(2) under the Exchange Act (17 CFR 240.16a-1(a)(2)).
3. If the SAI covers more than one Fund or Series, disclose in column (2) the dollar range of equity securities beneficially owned by a director in each Fund or Series overseen by the director.
4. In disclosing the dollar range of equity securities beneficially owned by a director in columns (2) and (3), use the following ranges: none, $1-$10,000, $10,001-$50,000, $50,001-$100,000, or over $100,000.

(5) For each director who is not an interested person of the Fund, and his immediate family members, furnish the information required by the following table as to each class of securities owned beneficially or of record in:

(i) An investment adviser or principal underwriter of the Fund; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund:

(1)	(2)	(3)	(4)	(5)	(6)
Name of Director	**Name of Owners and Relationships to Director**	**Company**	**Title of Class**	**Value of Securities**	**Percent of Class**

Instructions

1. Information should be provided as of the end of the most recently completed calendar year. Specify the valuation date by footnote or otherwise.

2. An individual is a "beneficial owner" of a security if he is a "beneficial owner" under either rule 13d-3 or rule 16a-1(a)(2) under the Exchange Act (17 CFR 240.13d-3 or 240.16a-1(a)(2)).

3. Identify the company in which the director or immediate family member of the director owns securities in column (3). When the company is a person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter, describe the company's relationship with the investment adviser or principal underwriter.

4. Provide the information required by columns (5) and (6) on an aggregate basis for each director and his immediate family members.

(6) Unless disclosed in response to paragraph (b)(5) of this Item 17, describe any direct or indirect interest, the value of which exceeds $120,000, of each director who is not an interested person of the Fund, or immediate family member of the director, during the two most recently completed calendar years, in:

(i) An investment adviser or principal underwriter of the Fund; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund.

Instructions

1. A director or immediate family member has an interest in a company if he is a party to a contract, arrangement, or understanding with respect to any securities of, or interest in, the company.

2. The interest of the director and the interests of his immediate family members should be aggregated in determining whether the value exceeds $120,000.

(7) Describe briefly any material interest, direct or indirect, of any director who is not an interested person of the Fund, or immediate family member of the director, in any transaction, or series of similar transactions, during the two most recently completed calendar years, in which the amount involved exceeds $120,000 and to which any of the following persons was a party:

(i) The Fund;

(ii) An officer of the Fund;

(iii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c) (1) and 3(c)(7) (15 U.S.C. 80a-3(c)(1) and (c)(7)), having the same investment adviser or principal underwriter as the Fund or having an investment adviser or principal underwriter that directly or indirectly controls, is controlled by, or is under common control with an investment adviser or principal underwriter of the Fund;

(iv) An officer of an investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a-3(c)(1) and (c)(7)), having the same investment adviser or principal underwriter as the Fund or having an investment adviser or principal underwriter that directly or indirectly controls, is controlled by, or is under common control with an investment adviser or principal underwriter of the Fund;

(v) An investment adviser or principal underwriter of the Fund;

(vi) An officer of an investment adviser or principal underwriter of the Fund;

(vii) A person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund; or

(viii) An officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund.

Instructions

1. Include the name of each director or immediate family member whose interest in any transaction or series of similar transactions is described and the nature of the circumstances by reason of which the interest is required to be described.

2. State the nature of the interest, the approximate dollar amount involved in the transaction, and, where practicable, the approximate dollar amount of the interest.

3. In computing the amount involved in the transaction or series of similar transactions, include all periodic payments in the case of any lease or other agreement providing for periodic payments.

4. Compute the amount of the interest of any director or immediate family member of the director without regard to the amount of profit or loss involved in the transaction(s).

5. As to any transaction involving the purchase or sale of assets, state the cost of the assets to the purchaser and, if acquired by the seller within two years prior to the transaction, the cost to the seller. Describe the method used in determining the purchase or sale price and the name of the person making the determination.

6. Disclose indirect, as well as direct, material interests in transactions. A person who has a position or relationship with, or interest in, a company that engages in a transaction with one of the persons listed in paragraphs (b)(7)(i) through (b)(7) (viii) of this Item 17 may have an indirect interest in the transaction by reason of the position, relationship, or interest. The interest in the transaction, however, will not be deemed "material" within the meaning of paragraph (b)(7) of this Item 17 where the interest of the director or immediate family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that is a party to

the transaction with one of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17, and the transaction is not material to the company.

7. The materiality of any interest is to be determined on the basis of the significance of the information to investors in light of all the circumstances of the particular case. The importance of the interest to the person having the interest, the relationship of the parties to the transaction with each other, and the amount involved in the transaction are among the factors to be considered in determining the significance of the information to investors.

8. No information need be given as to any transaction where the interest of the director or immediate family member arises solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 and the director or immediate family member receives no extra or special benefit not shared on a pro rata basis by all holders of the Class of securities.

9. Transactions include loans, lines of credit, and other indebtedness. For indebtedness, indicate the largest aggregate amount of indebtedness outstanding at any time during the period, the nature of the indebtedness and the transaction in which it was incurred, the amount outstanding as of the end of the most recently completed calendar year, and the rate of interest paid or charged.

10. No information need be given as to any routine, retail transaction. For example, the Fund need not disclose that a director has a credit card, bank or brokerage account, residential mortgage, or insurance policy with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 unless the director is accorded special treatment.

(8) Describe briefly any direct or indirect relationship, in which the amount involved exceeds $120,000, of any director who is not an interested person of the Fund, or immediate family member of the director, that existed at any time during the two most recently completed calendar years with any of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17. Relationships include:

(i) Payments for property or services to or from any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17;

(ii) Provision of legal services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17;

(iii) Provision of investment banking services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17, other than as a participating underwriter in a syndicate; and

(iv) Any consulting or other relationship that is substantially similar in nature and scope to the relationships listed in paragraphs (b)(8)(i) through (b)(8)(iii) of this Item 17.

Instructions

1. Include the name of each director or immediate family member whose relationship is described and the nature of the circumstances by reason of which the relationship is required to be described.

2. State the nature of the relationship and the amount of business conducted between the director or immediate family member and the person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 as a result of the relationship during the two most recently completed calendar years.

3. In computing the amount involved in a relationship, include all periodic payments in the case of any agreement providing for periodic payments.

4. Disclose indirect, as well as direct, relationships. A person who has a position or relationship with, or interest in, a company that has a relationship with one of the persons listed in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 may have an indirect relationship by reason of the position, relationship, or interest.

5. In determining whether the amount involved in a relationship exceeds $120,000, amounts involved in a relationship of the director should be aggregated with those of his immediate family members.

6. In the case of an indirect interest, identify the company with which a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 has a relationship; the name of the director or immediate family member affiliated with the company and the nature of the affiliation; and the amount of business conducted between the company and the person specified in para-

graphs (b)(7)(i) through (b)(7)(viii) of this Item 17 during the two most recently completed calendar years.

7. In calculating payments for property and services for purposes of paragraph (b)(8)(i) of this Item 17, the following may be excluded:

   A. Payments where the transaction involves the rendering of services as a common contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority; or

   B. Payments that arise solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 and no extra or special benefit not shared on a pro rata basis by all holders of the class of securities is received.

8. No information need be given as to any routine, retail relationship. For example, the Fund need not disclose that a director has a credit card, bank or brokerage account, residential mortgage, or insurance policy with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 unless the director is accorded special treatment.

(9) If an officer of an investment adviser or principal underwriter of the Fund, or an officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund, served during the two most recently completed calendar years, on the board of directors of a company where a director of the Fund who is not an interested person of the Fund, or immediate family member of the director, was during the two most recently completed calendar years, an officer, identify:

   (i) The company;

   (ii) The individual who serves or has served as a director of the company and the period of service as director;

   (iii) The investment adviser or principal underwriter or person controlling, controlled by, or under common control with the investment adviser or principal underwriter where the individual named in paragraph (b)(9)(ii) of this Item 17 holds or held office and the office held; and

(iv) The director of the Fund or immediate family member who is or was an officer of the company; the office held; and the period of holding the office.

(10) For each director, briefly discuss the specific experience, qualifications, attributes, or skills that led to the conclusion that the person should serve as a director for the Fund at the time that the disclosure is made, in light of the Fund's business and structure. If material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications.

(c) *Compensation.* For all directors of the Fund and for all members of any advisory board who receive compensation from the Fund, and for each of the three highest paid officers or any affiliated person of the Fund who received aggregate compensation from the Fund for the most recently completed fiscal year exceeding $60,000 ("Compensated Persons"):

(1) Provide the information required by the following table:

COMPENSATION TABLE

(1)	(2)	(3)	(4)	(5)
Name of Person, Position	**Aggregate Compensation From Fund**	**Pension or Retirement Benefits Accrued As Part of Funds Expenses**	**Estimated Annual Benefits Upon Retirement**	**Total Compensation From Fund and Fund Complex Paid to Directors**

Instructions

1. For column (1), indicate, as necessary, the capacity in which the remuneration is received. For Compensated Persons who are directors of the Fund, compensation is amounts received for service as a director.

2. If the Registrant has not completed its first full year since its organization, furnish the information for the current fiscal year, estimating future payments that would be made pursuant to an existing agreement or understanding. Disclose in a footnote to the Compensation Table the period for which the information is furnished.

3. Include in column (2) amounts deferred at the election of the Compensated Person, whether pursuant to a plan established under Section 401(k) of the Internal Revenue Code [26 U.S.C. 401(k)] or otherwise for the fiscal year in which earned. Dis-

close in a footnote to the Compensation Table the total amount of deferred compensation (including interest) payable to or accrued for any Compensated Person.

4. Include in columns (3) and (4) all pension or retirement benefits proposed to be paid under any existing plan in the event of retirement at normal retirement date, directly or indirectly, by the Registrant, any of its subsidiaries, or other companies in the Fund Complex. Omit column (4) where retirement benefits are not determinable.

5. For any defined benefit or actuarial plan under which benefits are determined primarily by final compensation (or average final compensation) and years of service, provide the information required in column (4) in a separate table showing estimated annual benefits payable upon retirement (including amounts attributable to any defined benefit supplementary or excess pension award plans) in specified compensation and years of service classifications. Also provide the estimated credited years of service for each Compensated Person.

6. Include in column (5) only aggregate compensation paid to a director for service on the board and all other boards of investment companies in a Fund Complex specifying the number of such other investment companies.

(2) Describe briefly the material provisions of any pension, retirement, or other plan or any arrangement, other than fee arrangements disclosed in paragraph (c)(1), under which the Compensated Persons are or may be compensated for services provided, including amounts paid, if any, to the compensated Person under these arrangements during the most recently completed fiscal year. Specifically include the criteria used to determine amounts payable under the plan, the length of service or vesting period required by the plan, the retirement age or other event that gives rise to payment under the plan, and whether the payment of benefits is secured or funded by the Fund.

(d) *Sales Loads.* Disclose any arrangements that result in breakpoints in, or elimination of, sales loads for directors and other affiliated persons of the Fund. Identify each class of individuals and transactions to which the arrangements apply and state each different breakpoint as a percentage of both the offering price and the net amount invested of the Fund's shares. Explain, as applicable, the reasons for the difference in the price at which securities are offered generally to the public, and the prices at which securities are offered to directors and other affiliated persons of the Fund.

(e) *Codes of Ethics.* Provide a brief statement disclosing whether the Fund and its investment adviser and principal underwriter have adopted codes of ethics under rule 17j-1 of the Investment Company Act [17 CFR 270.17j-1] and whether these codes of ethics permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the Fund.

Instruction: A Fund that is not required to adopt a code of ethics under rule 17j-1 of the Investment Company Act is not required to respond to this item

(f) *Proxy Voting Policies.* Unless the Fund invests exclusively in non-voting securities, describe the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities, including the procedures that the Fund uses when a vote presents a conflict 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. 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, to determine how to vote proxies relating to portfolio securities. Also, state that information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available (1) without charge, upon request, by calling a specified toll-free (or collect) telephone number; or on or through the Fund's website at a specified Internet address; or both; and (2) on the Commission's website at http://www.sec.gov.

Instructions

1. A Fund may satisfy the requirement to provide a description of the policies and procedures that it uses to determine how to vote proxies relating to portfolio securities by including a copy of the policies and procedures themselves.

2. If a Fund discloses that the Fund's proxy voting record is available by calling a toll-free (or collect) telephone number, and the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for this information, the Fund (or financial intermediary) must send the information disclosed in the Fund's most recently filed report on Form N-PX, within three business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

3. If a Fund discloses that the Fund's proxy voting record is available on or through its website, the Fund must make available free of charge the information disclosed in the Fund's most re-

cently filed report on Form N-PX on or through its website as soon as reasonably practicable after filing the report with the Commission. The information disclosed in the Fund's most recently filed report on Form N-PX must remain available on or through the Fund's website for as long as the Fund remains subject to the requirements of Rule 30b1-4 (17 CFR 270.30b1-4) and discloses that the Fund's proxy voting record is available on or through its website.

Item 18. Control Persons and Principal Holders of Securities

Provide the following information as of a specified date no more than 30 days prior to the date of filing the registration statement or an amendment.

(a) *Control Persons.* State the name and address of each person who controls the Fund and explain the effect of that control on the voting rights of other security holders. For each control person, state the percentage of the Fund's voting securities owned or any other basis of control. If the control person is a company, give the jurisdiction under the laws of which it is organized. List all parents of the control person.

Instruction. For purposes of this paragraph, "control" means (i) the beneficial ownership, either directly or through one or more controlled companies, of more than 25% of the voting securities of a company; (ii) the acknowledgment or assertion by either the controlled or controlling party of the existence of control; or (iii) an adjudication under section 2(a)(9), which has become final, that control exists.

(b) *Principal Holders.* State the name, address, and percentage of ownership of each person who owns of record or is known by the Fund to own beneficially 5% or more of any Class of the Fund's outstanding equity securities.

Instructions

1. Calculate the percentages based on the amount of securities outstanding.
2. If securities are being registered under or in connection with a plan of acquisition, reorganization, readjustment or succession, indicate, as far as practicable, the ownership that would result from consummation of the plan based on present holdings and commitments.
3. Indicate whether the securities are owned of record, beneficially, or both. Show the respective percentage owned in each manner.

(c) *Management Ownership*. State the percentage of the Fund's equity securities owned by all officers, directors, and members of any advisory board of the Fund as a group. If the amount owned by directors and officers as a group is less than 1% of the Class, provide a statement to that effect.

Item 19. Investment Advisory and Other Services

(a) I*nvestment Advisers*. Disclose the following information with respect to each investment adviser:

(1) The name of any person who controls the adviser, the basis of the person's control, and the general nature of the person's business. Also disclose, if material, the business history of any organization that controls the adviser.

(2) The name of any affiliated person of the Fund who also is an affiliated person of the adviser, and a list of all capacities in which the person is affiliated with the Fund and with the adviser.

Instruction. If an **affiliated** person of the Fund alone or together with others controls the adviser, state that fact. It is not necessary to provide the amount or percentage of the outstanding voting securities owned by the controlling person.

(3) The method of calculating the advisory fee payable by the Fund including:

(i) The total dollar amounts that the Fund paid to the adviser (aggregated with amounts paid to affiliated advisers, if any), and any advisers who are not affiliated persons of the adviser, under the investment advisory contract for the last three fiscal years;

(ii) If applicable, any credits that reduced the advisory fee for any of the last three fiscal years; and

(iii) Any expense limitation provision.

Instructions

1. If the advisory fee payable by the Fund varies depending on the Fund's investment performance in relation to a standard, describe the standard along with a fee schedule in tabular form. The Fund may include examples showing the fees that the adviser would earn at various levels of performance as long as the examples include calculations showing the maximum and minimum fee percentages that could be earned under the contract.

2. State separately each type of credit or offset.

3. When a Fund is subject to more than one expense limitation provision, describe only the most restrictive provision.

4. For a Registrant with more than one Series, or a Multiple Class Fund, describe the methods of allocation and payment of advisory fees for each Series or Class.

(b) *Principal Underwriter.* State the name and principal business address of any principal underwriter for the Fund. Disclose, if applicable, that an affiliated person of the Fund is an affiliated person of the principal underwriter and identify the affiliated person.

(c) *Services Provided by Each Investment Adviser and Fund Expenses Paid by Third Parties.*

(1) Describe all services performed for or on behalf of the Fund supplied or paid for wholly or in substantial part by each investment adviser.

(2) Describe all fees, expenses, and costs of the Fund that are to be paid by persons other than an investment adviser or the Fund, and identify those persons.

(d) *Service Agreements.* Summarize the substantive provisions of any other management-related service contract that may be of interest to a purchaser of the Fund's shares, under which services are provided to the Fund, indicating the parties to the contract, and the total dollars paid and by whom for the past three years.

Instructions

1. The term "management-related service contract" includes any contract with the Fund to keep, prepare, or file accounts, books, records, or other documents required under federal or state law, or to provide any similar services with respect to the daily administration of the Fund, but does not include the following:

(a) Any contract with the Fund to provide investment advice;

(b) Any agreement with the Fund to perform as custodian, transfer agent, or dividend-paying agent for the Fund; and

(c) Any contract with the Fund for outside legal or auditing services, or contract for personal employment entered into with the Fund in the ordinary course of business.

2. No information need be given in response to this paragraph with respect to the service of mailing proxies or periodic reports to the Fund's shareholders.

3. In summarizing the substantive provisions of any management-related service contract, include the following:

(a) The name of the person providing the service;

(b) The direct or indirect relationships, if any, of the person with the Fund, an investment adviser of the Fund or the Fund's principal underwriter; and

(c) The nature of the services provided, and the basis of the compensation paid for the services for the last three fiscal years.

(e) *Other Investment Advice.* If any person (other than a director, officer, member of an advisory board, employee, or investment adviser of the Fund), through any understanding, whether formal or informal, regularly advises the Fund or the Fund's investment adviser with respect to the Fund's investing in, purchasing, or selling securities or other property, or has the authority to determine what securities or other property should be purchased or sold by the Fund, and receives direct or indirect remuneration, provide the following information:

(1) The person's name;

(2) A description of the nature of the arrangement, and the advice or information provided; and

(3) Any remuneration (including, for example, participation, directly or indirectly, in commissions or other compensation paid in connection with transactions in the Fund's portfolio securities) paid for the advice or information, and a statement as to how the remuneration was paid and by whom it was paid for the last three fiscal years.

Instruction. Do not include information for the following:

1. Persons who advised the investment adviser or the Fund solely through uniform publications distributed to subscribers;

2. Persons who provided the investment adviser or the Fund with only statistical and other factual information, advice about economic factors and trends, or advice as to occasional transactions in specific securities, but without generally advising about the purchase or sale of securities by the Fund;

3. A company that is excluded from the definition of "investment adviser" of an investment company under section 2(a)(20) (iii) [15 U.S.C. 80a-2(a)(20)(iii)];

4. Any person the character and amount of whose compensation for these services must be approved by a court; or

5. Other persons as the Commission has by rule or order determined not to be an "investment adviser" of an investment company.

(f) *Dealer Reallowances.* Disclose any front-end sales load reallowed to dealers as a percentage of the offering price of the Fund's shares.

(g) *Rule 12b-1 Plans.* If the Fund has adopted a plan under rule 12b-1, describe the material aspects of the plan, and any agreements relating to the implementation of the plan, including:

(1) A list of the principal types of activities for which payments are or will be made, including the dollar amount and the manner in which amounts paid by the Fund under the plan during the last fiscal year were spent on:

(i) Advertising;

(ii) Printing and mailing of prospectuses to other than current shareholders;

(iii) Compensation to underwriters;

(iv) Compensation to broker-dealers;

(v) Compensation to sales personnel;

(vi) Interest, carrying, or other financing charges; and

(vii) Other (specify).

(2) The relationship between amounts paid to the distributor and the expenses that it incurs (e.g., whether the plan reimburses the distributor only for expenses incurred or compensates the distributor regardless of its expenses).

(3) The amount of any unreimbursed expenses incurred under the plan in a previous year and carried over to future years, in dollars and as a percentage of the Fund's net assets on the last day of the previous year.

(4) Whether the Fund participates in any joint distribution activities with another Series or investment company. If so, disclose, if applicable, that fees paid under the Fund's rule 12b-1 plan may be used to finance the distribution of the shares of another Series or investment company, and state the method of allocat-

ing distribution costs (e.g., relative net asset size, number of shareholder accounts).

(5) Whether any of the following persons had a direct or indirect financial interest in the operation of the plan or related agreements:

(i) Any interested person of the Fund; or

(ii) Any director of the Fund who is not an interested person of the Fund.

(6) The anticipated benefits to the Fund that may result from the plan.

(h) Other Service Providers.

(1) Unless disclosed in response to paragraph (d), identify any person who provides significant administrative or business affairs management services for the Fund (e.g., an "administrator"), describe the services provided, and the compensation paid for the services.

(2) State the name and principal business address of the Fund's transfer agent and the dividend-paying agent.

(3) State the name and principal business address of the Fund's custodian and independent public accountant and describe generally the services performed by each. If the Fund's portfolio securities are held by a person other than a commercial bank, trust company, or depository registered with the Commission as custodian, state the nature of the business of that person or persons.

(4) If an affiliated person of the Fund, or an affiliated person of the affiliated person, acts as custodian, transfer agent, or dividend-paying agent for the Fund, describe the services that the person performs and the basis for remuneration.

[amendment effective January 17, 2017 with a compliance date of August 1, 2017:]

(i) *Securities Lending.*

(1) Provide the following dollar amounts of income and fees/compensation related to the securities lending activities of each Series during its most recent fiscal year:

(i) Gross income from securities lending activities, including income from cash collateral reinvestment;

(ii) All fees and/or compensation for each of the following securities lending activities and related services: any

share of revenue generated by the securities lending program paid to the securities lending agent(s) ("revenue split"); fees paid for cash collateral management services (including fees deducted from a pooled cash collateral reinvestment vehicle) that are not included in the revenue split; administrative fees that are not included in the revenue split; fees for indemnification that are not included in the revenue split; rebates paid to borrowers; and any other fees relating to the securities lending program that are not included in the revenue split, including a description of those other fees;

(iii) The aggregate fees/compensation disclosed pursuant to paragraph (ii); and

(iv) Net income from securities lending activities (i.e., the dollar amount in paragraph (i) minus the dollar amount in paragraph (iii)).

Instruction. If a fee for a service is included in the revenue split, state that the fee is "included in the revenue split."

(2) Describe the services provided to the Series by the securities lending agent in the Series' most recent fiscal year.

Item 20. Portfolio Managers

(a) *Other Accounts Managed.* If a Portfolio Manager required to be identified in response to Item 5(b) is primarily responsible for the day-to-day management of the portfolio of any other account, provide the following information:

(1) The Portfolio Manager's name;

(2) The number of other accounts managed within each of the following categories and the total assets in the accounts managed within each category:

(A) Registered investment companies;

(B) Other pooled investment vehicles; and

(C) Other accounts.

(3) For each of the categories in paragraph (a)(2) of this Item, the number of accounts and the total assets in the accounts with respect to which the advisory fee is based on the performance of the account; and

(4) A description of any material conflicts of interest that may arise in connection with the Portfolio Manager's management of the Fund's

investments, on the one hand, and the investments of the other accounts included in response to paragraph (a)(2) of this Item, on the other. This description would include, for example, material conflicts between the investment strategy of the Fund and the investment strategy of other accounts managed by the Portfolio Manager and material conflicts in allocation of investment opportunities between the Fund and other accounts managed by the Portfolio Manager.

Instructions

1. Provide the information required by this paragraph as of the end of the Fund's most recently completed fiscal year, except that, in the case of an initial registration statement or an update to the Fund's registration statement that discloses a new Portfolio Manager, information with respect to any newly identified Portfolio Manager must be provided as of the most recent practicable date. Disclose the date as of which the information is provided.

2. If a committee, team, or other group of persons that includes the Portfolio Manager is jointly and primarily responsible for the day-to-day management of the portfolio of an account, include the account in responding to paragraph (a) of this Item.

(b) *Compensation*. Describe the structure of, and the method used to determine, the compensation of each Portfolio Manager required to be identified in response to Item 5(b). For each type of compensation (e.g., salary, bonus, deferred compensation, retirement plans and arrangements), describe with specificity the criteria on which that type of compensation is based, for example, whether compensation is fixed, whether (and, if so, how) compensation is based on Fund pre- or after-tax performance over a certain time period, and whether (and, if so, how) compensation is based on the value of assets held in the Fund's portfolio. For example, if compensation is based solely or in part on performance, identify any benchmark used to measure performance and state the length of the period over which performance is measured.

Instructions

1. Provide the information required by this paragraph as of the end of the Fund's most recently completed fiscal year, except that, in the case of an initial registration statement or an update to the Fund's registration statement that discloses a new Portfolio Manager, information with respect to any newly identified Portfolio Manager must be provided as of the most recent practicable date. Disclose the date as of which the information is provided.

2. Compensation includes, without limitation, salary, bonus, deferred compensation, and pension and retirement plans and arrangements, whether the compensation is cash or non-cash. Group life, health, hospitalization, medical reimbursement, relocation, and pension and retirement plans and arrangements may be omitted, provided that they do not discriminate in scope, terms, or operation in favor of the Portfolio Manager or a group of employees that includes the Portfolio Manager and are available generally to all salaried employees. The value of compensation is not required to be disclosed under this Item.

3. Include a description of the structure of, and the method used to determine, any compensation received by the Portfolio Manager from the Fund, the Fund's investment adviser, or any other source with respect to management of the Fund and any other accounts included in the response to paragraph (a)(2) of this Item. This description must clearly disclose any differences between the method used to determine the Portfolio Manager's compensation with respect to the Fund and other accounts, e.g., if the Portfolio Manager receives part of an advisory fee that is based on performance with respect to some accounts but not the Fund, this must be disclosed.

(c) *Ownership of Securities.* For each Portfolio Manager required to be identified in response to Item 5(b), state the dollar range of equity securities in the Fund beneficially owned by the Portfolio Manager using the following ranges: none, $1-$10,000, $10,001-$50,000, $50,001-$100,000, $100,001-$500,000, $500,001-$1,000,000, or over $1,000,000.

Instructions

1. Provide the information required by this paragraph as of the end of the Fund's most recently completed fiscal year, except that, in the case of an initial registration statement or an update to the Fund's registration statement that discloses a new Portfolio Manager, information with respect to any newly identified Portfolio Manager must be provided as of the most recent practicable date. Specify the valuation date.

2. Determine "beneficial ownership" in accordance with rule 16a-1(a)(2) under the Exchange Act (17 CFR 240.16a-1(a)(2)).

Item 21. Brokerage Allocation and Other Practices

(a) *Brokerage Transactions.* Describe how transactions in portfolio securities are effected, including a general statement about brokerage commissions, markups,

and markdowns on principal transactions and the aggregate amount of any brokerage commissions paid by the Fund during its three most recent fiscal years. If, during either of the two years preceding the Fund's most recent fiscal year, the aggregate dollar amount of brokerage commissions paid by the Fund differed materially from the amount paid during the most recent fiscal year, state the reason(s) for the difference(s).

(b) *Commissions*.

(1) Identify, disclose the relationship, and state the aggregate dollar amount of brokerage commissions paid by the Fund during its three most recent fiscal years to any broker:

(i) That is an affiliated person of the Fund or an affiliated person of that person; or

(ii) An affiliated person of which is an affiliated person of the Fund, its investment adviser, or principal underwriter.

(2) For each broker identified in response to paragraph (b)(1), state:

(i) The percentage of the Fund's aggregate brokerage commissions paid to the broker during the most recent fiscal year; and

(ii) The percentage of the Fund's aggregate dollar amount of transactions involving the payment of commissions effected through the broker during the most recent fiscal year.

(3) State the reasons for any material difference in the percentage of brokerage commissions paid to, and the percentage of transactions effected through, a broker disclosed in response to paragraph (b)(1).

(c) *Brokerage* Selection. Describe how the Fund will select brokers to effect securities transactions for the Fund and how the Fund will evaluate the overall reasonableness of brokerage commissions paid, including the factors that the Fund will consider in making these determinations.

Instructions

1. If the Fund will consider the receipt of products or services other than brokerage or research services in selecting brokers, specify those products and services.

2. If the Fund will consider the receipt of research services in selecting brokers, identify the nature of those research services.

3. State whether persons acting on the Fund's behalf are authorized to pay a broker a higher brokerage commission than another broker might have charged for the same transaction in recognition of the value of (a) brokerage or (b) research services provided by the broker.

4. If applicable, explain that research services provided by brokers through which the Fund effects securities transactions may be used by the Fund's investment adviser in servicing all of its accounts and that not all of these services may be used by the adviser in connection with the Fund. If other policies or practices are applicable to the Fund with respect to the allocation of research services provided by brokers, explain those policies and practices.

(d) *Directed Brokerage*. If, during the last fiscal year, the Fund or its investment adviser, through an agreement or understanding with a broker, or otherwise through an internal allocation procedure, directed the Fund's brokerage transactions to a broker because of research services provided, state the amount of the transactions and related commissions.

(e) *Regular Broker-Dealers*. If the Fund has acquired during its most recent fiscal year or during the period of time since organization, whichever is shorter, securities of its regular brokers or dealers as defined in rule 10b-1 [17 CFR 270.10b-1] or of their parents, identify those brokers or dealers and state the value of the Fund's aggregate holdings of the securities of each issuer as of the close of the Fund's most recent fiscal year.

Instruction. The Fund need only disclose information about an issuer that derived more than 15% of its gross revenues from the business of a broker, a dealer, an underwriter, or an investment adviser during its most recent fiscal year.

Item 22. Capital Stock and Other Securities

(a) *Capital Stock*. For each Class of capital stock of the Fund, provide:

(1) The title of each Class; and

(2) A full discussion of the following provisions or characteristics of each Class, if applicable:

(i) Restrictions on the right freely to retain or dispose of the Fund's shares;

(ii) Material obligations or potential liabilities associated with owning the Fund's shares (not including investment risks);

(iii) Dividend rights;

(iv) Voting rights (including whether the rights of shareholders can be modified by other than a majority vote);

(v) Liquidation rights;

(vi) Preemptive rights;

(vii) Conversion rights;

(viii) Redemption provisions;

(ix) Sinking fund provisions; and

(x) Liability to further calls or to assessment by the Fund.

Instructions

1. If any Class described in response to this paragraph possesses cumulative voting rights, disclose the existence of those rights and explain the operation of cumulative voting.

2. If the rights evidenced by any Class described in response to this paragraph are materially limited or qualified by the rights of any other Class, explain those limitations or qualifications.

(b) *Other Securities*. Describe the rights of any authorized securities of the Fund other than capital stock. If the securities are subscription warrants or rights, state the title and amount of securities called for, and the period during which and the prices at which the warrants or rights are exercisable.

Item 23. Purchase, Redemption, and Pricing of Shares

(a) *Purchase of Shares*. To the extent that the prospectus does not do so, describe how the Fund's shares are offered to the public. Include any special purchase plans or methods not described in the prospectus or elsewhere in the SAI, including letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, redemption reinvestment plans, and waivers for particular classes of shareholders.

(b) *Fund Reorganizations*. Disclose any arrangements that result in breakpoints in, or elimination of, sales loads in connection with the terms of a merger, acquisition, or exchange offer made under a plan of reorganization. Identify each class of individuals to which the arrangements apply and state each different sales load available as a percentage of both the offering price and the net amount invested.

(c) *Offering Price*. Describe the method followed or to be followed by the Fund in determining the total offering price at which its shares may be offered to the public and the method(s) used to value the Fund's assets.

Instructions

1. Describe the valuation procedure(s) that the Fund uses in determining the net asset value and public offering price of its shares.

2. Explain how the excess of the offering price over the net amount invested is distributed among the Fund's principal underwriters or others and the basis for determining the total offering price.

3. Explain the reasons for any difference in the price at which securities are offered generally to the public, and the prices at which securities are offered for any class of transactions or to any class of individuals.

4. Unless provided as a continuation of the balance sheet in response to Item 27, include a specimen price-make-up sheet showing how the Fund calculates the total offering price per unit. Base the calculation on the value of the Fund's portfolio securities and other assets and its outstanding securities as of the date of the balance sheet filed by the Fund.

(d) *Redemption in Kind*. If the Fund has received an order of exemption from section 18(f) or has filed a notice of election under rule 18f-1 that has not been withdrawn, describe the nature, extent, and effect of the exemptive relief or notice.

(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 23(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.

Item 24. Taxation of the Fund

(a) If applicable, state that the Fund is qualified or intends to qualify under Subchapter M of the Internal Revenue Code. Disclose the consequences to the Fund if it does not qualify under Subchapter M.

(b) Disclose any special or unusual tax aspects of the Fund, such as taxation resulting from foreign investment or from status as a personal holding company, or any tax loss carry-forward to which the Fund may be entitled.

Item 25. Underwriters

(a) *Distribution of Securities*. For each principal underwriter distributing securities of the Fund, state:

(1) The nature of the obligation to distribute the Fund's securities;

(2) Whether the offering is continuous; and

(3) The aggregate dollar amount of underwriting commissions and the amount retained by the principal underwriter for each of the Fund's last three fiscal years.

(b) *Compensation*. Provide the information required by the following table with respect to all commissions and other compensation received by each principal underwriter, who is an affiliated person of the Fund or an affiliated person of that affiliated person, directly or indirectly, from the Fund during the Fund's most recent fiscal year:

(1)	(2)	(3)	(4)	(5)
Name of Principal Underwriter	Net Underwriting Discounts and Commissions	Compensation on Redemptions and Repurchases	Brokerage Commissions	Other Compensation

Instruction

Disclose in a footnote to the table the type of services rendered in consideration for the compensation listed under column (5).

(c) *Other Payments*. With respect to any payments made by the Fund to an underwriter or dealer in the Fund's shares during the Fund's last fiscal year, disclose the name and address of the underwriter or dealer, the amount paid and basis for determining that amount, the circumstances surrounding the payments, and the consideration received by the Fund. Do not include information about:

(1) Payments made through deduction from the offering price at the time of sale of securities issued by the Fund;

(2) Payments representing the purchase price of portfolio securities acquired by the Fund;

(3) Commissions on any purchase or sale of portfolio securities by the Fund; or

(4) Payments for investment advisory services under an investment advisory contract.

Instructions

1. Do not include in response to this paragraph information provided in response to paragraph (b) or with respect to service fees under the Instruction to Item 12(b)(2). Do not include any payment for a service excluded by Instructions 1 and 2 to Item 19(d) or by Instruction 2 to Item 34.

2. If the payments were made under an arrangement or policy applicable to dealers generally, describe only the arrangement or policy.

Item 26. Calculation of Performance Data

(a) *Money Market Funds*. Yield quotation(s) for a Money Market Fund included in the prospectus should be calculated according to paragraphs (a)(1)—(4).

(1) *Yield Quotation*. Based on the 7 days ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's yield by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one share at the beginning of the period, subtracting a hypothetical charge reflecting deductions from shareholder accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then multiplying the base period return by (365/7) with the resulting yield figure carried to at least the nearest hundredth of one percent.

(2) *Effective Yield Quotation*. Based on the 7 days ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's effective yield, carried to at least the nearest hundredth of one percent, by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one share at the beginning of the period, subtracting a hypothetical charge reflecting deductions from shareholder accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then compounding the base period return by adding 1, raising the sum to a power equal to 365 divided by 7, and subtracting 1 from the result, according to the following formula:

EFFECTIVE YIELD = $[(\text{BASE PERIOD RETURN} + 1)^{365/7}] - 1$.

(3) *Tax Equivalent Current Yield Quotation*. Calculate the Fund's tax equivalent current yield by dividing that portion of the Fund's yield (as

calculated under paragraph (a)(1)) that is tax-exempt by 1 minus a stated income tax rate and adding the quotient to that portion, if any, of the Fund's yield that is not tax-exempt.

(4) *Tax Equivalent Effective Yield Quotation*. Calculate the Fund's tax equivalent effective yield by dividing that portion of the Fund's effective yield (as calculated under paragraph (a)(2)) that is tax-exempt by 1 minus a stated income tax rate and adding the quotient to that portion, if any, of the Fund's effective yield that is not tax-exempt.

Instructions

1. When calculating yield or effective yield quotations, the calculation of net change in account value must include:

   (a) The value of additional shares purchased with dividends from the original share and dividends declared on both the original shares and additional shares; and

   (b) All fees, other than non-recurring account or sales charges, that are imposed on all shareholder accounts in proportion to the length of the base period. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size.

2. Exclude realized gains and losses from the sale of securities and unrealized appreciation and depreciation from the calculation of yield and effective yield. Exclude income other than investment income.

3. Disclose the amount or specific rate of any nonrecurring account or sales charges not included in the calculation of the yield.

4. If the Fund holds itself out as distributing income that is exempt from federal, state, or local income taxation, in calculating yield and effective yield (but not tax equivalent yield or tax equivalent effective yield), reduce the yield quoted by the effect of any income taxes on the shareholder receiving dividends, using the maximum rate for individual income taxation. For example, if the Fund holds itself out as distributing income exempt from federal taxation and the income taxes of State A, but invests in some securities of State B, it must reduce its yield by the effect of state income taxes that must be paid by the residents of State A on that portion of the income attributable to the securities of State B.

(b) *Other Funds*. Performance information included in the prospectus should be calculated according to paragraphs (b)(1)—(6).

(1) *Average Annual Total Return Quotation*. For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet included in the registration statement (or for the periods the Fund has been in operation), calculate the Fund's average annual total return by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods (or for the periods of the Fund's operations) that would equate the initial amount invested to the ending redeemable value, according to the following formula:

$$P(1+T)^n = ERV$$

Where:

p	=	a hypothetical initial payment of $1,000.
t	=	average annual total return.
n	=	number of years.
ERV	=	ending redeemable value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion).

Instructions

1. Assume the maximum sales load (or other charges deducted from payments) is deducted from the initial $1,000 payment.

2. Assume all distributions by the Fund are reinvested at the price stated in the prospectus (including any sales load imposed upon reinvestment of dividends) on the reinvestment dates during the period.

3. Include all recurring fees that are charged to all shareholder accounts. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size. Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

4. Determine the ending redeemable value by assuming a complete redemption at the end of the 1-, 5-, or 10-year periods and the deduction of all nonrecurring charges deducted at the end of each period. If shareholders are assessed a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus.

5. State the average annual total return quotation to the nearest hundredth of one percent.

6. Total return information in the prospectus need only be current to the end of the Fund's most recent fiscal year.

(2) *Average Annual Total Return (After Taxes on Distributions) Quotation.* For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet included in the registration statement (or for the periods the Fund has been in operation), calculate the Fund's average annual total return (after taxes on distributions) by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods (or for the periods of the Fund's operations) that would equate the initial amount invested to the ending value, according to the following formula:

$$P(1+T)n = ATV_D$$

Where:

P	=	a hypothetical initial payment of $1,000.
T	=	average annual total return (after taxes on distributions).
n	=	number of years.
ATV_D	=	ending value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion), after taxes on fund distributions but not after taxes on redemption.

Instructions

1. Assume the maximum sales load (or other charges deducted from payments) is deducted from the initial $1,000 payment.

2. Assume all distributions by the Fund, less the taxes due on such distributions, are reinvested at the price stated in the prospectus (including any sales load imposed upon reinvestment of dividends) on the reinvestment dates during the period.

3. Calculate the taxes due on any distributions by the Fund by applying the tax rates specified in Instruction 4 to each component of the distributions on the reinvestment date (e.g., ordinary income, short-term capital gain, long-term capital gain). The taxable amount and tax character of each distribution should be as specified by the Fund on the dividend declaration date, but may be adjusted to reflect subsequent recharacterizations of distributions. Distributions should be adjusted to re-

flect the federal tax impact the distribution would have on an individual taxpayer on the reinvestment date. For example, assume no taxes are due on the portion of any distribution that would not result in federal income tax on an individual, e.g., tax-exempt interest or non-taxable returns of capital. The effect of applicable tax credits, such as the foreign tax credit, should be taken into account in accordance with federal tax law.

4. Calculate the taxes due using the highest individual marginal federal income tax rates in effect on the reinvestment date. The rates used should correspond to the tax character of each component of the distributions (e.g., ordinary income rate for ordinary income distributions, short-term capital gain rate for short-term capital gain distributions, long-term capital gain rate for long-term capital gain distributions). Note that the required tax rates may vary over the measurement period. Disregard any potential tax liabilities other than federal tax liabilities (e.g., state and local taxes); the effect of phaseouts of certain exemptions, deductions, and credits at various income levels; and the impact of the federal alternative minimum tax.

5. Include all recurring fees that are charged to all shareholder accounts. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size. Assume that no additional taxes or tax credits result from any redemption of shares required to pay such fees. Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

6. Determine the ending value by assuming a complete redemption at the end of the 1-, 5-, or 10-year periods and the deduction of all nonrecurring charges deducted at the end of each period. If shareholders are assessed a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus. Assume that the redemption has no tax consequences.

7. State the average annual total return (after taxes on distributions) quotation to the nearest hundredth of one percent.

(3) *Average Annual Total Return (After Taxes on Distributions and Redemption) Quotation.* For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet included in the registration statement (or for the periods the Fund has been in operation), calculate

the Fund's average annual total return (after taxes on distributions and redemption) by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods (or for the periods of the Fund's operations) that would equate the initial amount invested to the ending value, according to the following formula:

$$P(1 + T)n = ATV_{DR}$$

Where:

P	=	a hypothetical initial payment of $1,000.
T	=	average annual total return (after taxes on distributions and redemption).
n	=	number of years.
ATV_{DR}	=	ending value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion), after taxes on fund distributions and redemption.

Instructions

1. Assume the maximum sales load (or other charges deducted from payments) is deducted from the initial $1,000 payment.

2. Assume all distributions by the Fund, less the taxes due on such distributions, are reinvested at the price stated in the prospectus (including any sales load imposed upon reinvestment of dividends) on the reinvestment dates during the period.

3. Calculate the taxes due on any distributions by the Fund by applying the tax rates specified in Instruction 4 to each component of the distributions on the reinvestment date (e.g., ordinary income, short-term capital gain, long-term capital gain). The taxable amount and tax character of each distribution should be as specified by the Fund on the dividend declaration date, but may be adjusted to reflect subsequent recharacterizations of distributions. Distributions should be adjusted to reflect the federal tax impact the distribution would have on an individual taxpayer on the reinvestment date. For example, assume no taxes are due on the portion of any distribution that would not result in federal income tax on an individual, e.g., tax-exempt interest or non-taxable returns of capital. The effect of applicable tax credits, such as the foreign tax credit, should be taken into account in accordance with federal tax law.

4. Calculate the taxes due using the highest individual marginal federal income tax rates in effect on the reinvestment date. The rates used should correspond to the tax character of each com-

ponent of the distributions (e.g., ordinary income rate for ordinary income distributions, short-term capital gain rate for short-term capital gain distributions, long-term capital gain rate for long-term capital gain distributions). Note that the required tax rates may vary over the measurement period. Disregard any potential tax liabilities other than federal tax liabilities (e.g., state and local taxes); the effect of phaseouts of certain exemptions, deductions, and credits at various income levels; and the impact of the federal alternative minimum tax.

5. Include all recurring fees that are charged to all shareholder accounts. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size. Assume that no additional taxes or tax credits result from any redemption of shares required to pay such fees. Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

6. Determine the ending value by assuming a complete redemption at the end of the 1-, 5-, or 10-year periods and the deduction of all nonrecurring charges deducted at the end of each period. If shareholders are assessed a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus.

7. Determine the ending value by subtracting capital gains taxes resulting from the redemption and adding the tax benefit from capital losses resulting from the redemption.

   (a) Calculate the capital gain or loss upon redemption by subtracting the tax basis from the redemption proceeds (after deducting any nonrecurring charges as specified by Instruction 6).

   (b) The Fund should separately track the basis of shares acquired through the $1,000 initial investment and each subsequent purchase through reinvested distributions. In determining the basis for a reinvested distribution, include the distribution net of taxes assumed paid from the distribution, but not net of any sales loads imposed upon reinvestment. Tax basis should be adjusted for any distributions representing returns of capital and any other tax basis adjustments that would apply to an individual taxpayer, as permitted by applicable federal tax law.

(c) The amount and character (e.g., short-term or long-term) of capital gain or loss upon redemption should be separately determined for shares acquired through the $1,000 initial investment and each subsequent purchase through reinvested distributions. The Fund should not assume that shares acquired through reinvestment of distributions have the same holding period as the initial $1,000 investment. The tax character should be determined by the length of the measurement period in the case of the initial $1,000 investment and the length of the period between reinvestment and the end of the measurement period in the case of reinvested distributions.

(d) Calculate the capital gains taxes (or the benefit resulting from tax losses) using the highest federal individual capital gains tax rate for gains of the appropriate character in effect on the redemption date and in accordance with federal tax law applicable on the redemption date. For example, applicable federal tax law should be used to determine whether and how gains and losses from the sale of shares with different holding periods should be netted, as well as the tax character (e.g., short-term or long-term) of any resulting gains or losses. Assume that a shareholder has sufficient capital gains of the same character from other investments to offset any capital losses from the redemption so that the taxpayer may deduct the capital losses in full.

8. State the average annual total return (after taxes on distributions and redemption) quotation to the nearest hundredth of one percent.

(4) *Yield Quotation.* Based on a 30-day (or one month) period ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's yield by dividing the net investment income per share earned during the period by the maximum offering price per share on the last day of the period, according to the following formula:

$$YIELD = 2\left[\left(\frac{a - b}{cd} + 1\right)^6 - 1\right]$$

Where:

a = dividends and interest earned during the period.
b = expenses accrued for the period (net of reimbursements).
c = the average daily number of shares outstanding during the period that were entitled to receive dividends.
d = the maximum offering price per share on the last day of the period.

Instructions

1. To calculate interest earned on debt obligations for purposes of "a" above:

   (a) Calculate the yield to maturity of each obligation held by the Fund based on the market value of the obligation (including actual accrued interest) at the close of business on the last business day of each month or, with respect to obligations purchased during the month, the purchase price (plus actual accrued interest). The maturity of an obligation with a call provision(s) is the next call date on which the obligation reasonably may be expected to be called, or if none, the maturity date.

   (b) Divide the yield to maturity by 360 and multiply the quotient by the market value of the obligation (including actual accrued interest) to determine the interest income on the obligation for each day of the subsequent month that the obligation is in the portfolio. Assume that each month has 30 days.

   (c) Total the interest earned on all debt obligations and all dividends accrued on all equity securities during the 30-day (or one month) period. Although the period for calculating interest earned is based on calendar months, a 30-day yield may be calculated by aggregating the daily interest on the portfolio from portions of 2 months. In addition, a Fund may recalculate daily interest income on the portfolio more than once a month.

   (d) For a tax-exempt obligation issued without original issue discount and having a current market discount, use the coupon rate of interest in lieu of the yield to maturity. For a tax-exempt obligation with original issue discount in which the discount is based on the

current market value and exceeds the then-remaining portion of original issue discount (market discount), base the yield to maturity on the imputed rate of the original issue discount calculation. For a tax-exempt obligation with original issue discount, where the discount based on the current market value is less than the then-remaining portion of original issue discount (market premium), base the yield to maturity on the market value.

2. For discount and premium on mortgage or other receivables-backed obligations that are expected to be subject to monthly payments of principal and interest ("paydowns"):

   (a) Account for gain or loss attributable to actual monthly paydowns as an increase or decrease to interest income during the period; and

   (b) The Fund may elect:

      (i) To amortize the discount and premium on the remaining securities, based on the cost of the securities, to the weighted average maturity date, if the information is available, or to the remaining term of the securities, if the weighted average maturity date is not available; or

      (ii) Not to amortize the discount or premium on the remaining securities.

3. Solely for the purpose of calculating yield, recognize dividend income by accruing 1/360 of the stated dividend rate of the security each day that the security is in the portfolio.

4. Do not use equalization accounting in calculating yield.

5. Include expenses accrued under a plan adopted under rule 12b-1 in the expenses accrued for the period. Reimbursement accrued under the plan may reduce the accrued expenses, but only to the extent the reimbursement does not exceed expenses accrued for the period.

6. Include in the expenses accrued for the period all recurring fees that are charged to all shareholder accounts in proportion to the length of the base period. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size.

7. If a broker-dealer or an affiliate of the broker-dealer (as defined in rule 1-02(b) of Regulation S-X [17 CFR 210.1-02(b)]) has, in connection with directing the Fund's brokerage transactions to the broker-dealer, provided, agreed to provide, paid for, or agreed to pay for, in whole or in part, services provided to the Fund (other than brokerage and research services as those terms are used in section 28(e) of the Securities Exchange Act [15 U.S.C. 78bb(e)]), add to expenses accrued for the period an estimate of additional amounts that would have been accrued for the period if the Fund had paid for the services directly in an arm's length transaction.

8. Undeclared earned income, calculated in accordance with generally accepted accounting principles, may be subtracted from the maximum offering price. Undeclared earned income is the net investment income that, at the end of the base period, has not been declared as a dividend, but is reasonably expected to be and is declared as a dividend shortly thereafter.

9. Disclose the amount or specific rate of any nonrecurring account or sales charges.

10. If, in connection with the sale of the Fund's shares, a deferred sales load payable in installments is imposed, the "maximum public offering price" includes the aggregate amount of the installments ("installment load amount").

(5) *Tax Equivalent Yield Quotation.* Based on a 30-day (or one month) period ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's tax equivalent yield by dividing that portion of the Fund's yield (as calculated under paragraph (b)(2)) that is tax-exempt by 1 minus a stated income tax rate and adding the quotient to that portion, if any, of the Fund's yield that is not tax-exempt.

(6) *Non-Standardized Performance Quotation*. A Fund may calculate performance using any other historical measure of performance (not subject to any prescribed method of computation) if the measurement reflects all elements of return.

Item 27. Financial Statements

(a) *Registration Statement*. Include, in a separate section following the responses to the preceding Items, the financial statements and schedules required by Regulation S-X. The specimen price-make-up sheet required by Instruction 4 to Item 23(c) may be provided as a continuation of the balance sheet specified by Regulation S-X.

Instructions

1. The statements of any subsidiary that is not a majority-owned subsidiary required by Regulation S-X may be omitted from Part B and included in Part C.

2. In addition to the requirements of rule 3-18 of Regulation S-X [17 CFR 210.3-18], any Fund registered under the Investment Company Act that has not previously had an effective registration statement under the Securities Act must include in its initial registration statement under the Securities Act any additional financial statements and condensed financial information (which need not be audited) necessary to make the financial statements and condensed financial information included in the registration statement current as of a date within 90 days prior to the date of filing.

(b) *Annual Report*. Every annual report to shareholders required by rule 30e-1 must contain the following:

(1) *Financial Statements*. The audited financial statements required, and for the periods specified, by Regulation S-X.

Instructions

1. Schedule VI—Summary schedule of investments in securities of unaffiliated issuers [17 CFR 210.12-12C] [**amendment effective January 17, 2017, with a compliance date of August 1, 2017:** "Schedule VI—Summary schedule of investments in securities of unaffiliated issuers [17 CFR 210.12-12C]" will be amended to state "Schedule IX—Summary schedule of investments in securities of unaffiliated issuers [17 CFR 210.12-12B]"] may be included in the financial statements in lieu of Schedule I—Investments in securities of unaffiliated issuers [17 CFR 210.12-12] if:

(a) the Fund states in the report that the Fund's complete schedule of investments in securities of unaffiliated issuers is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; (ii) on the Fund's website, if applicable; and (iii) on the Commission's website at http://www.sec.gov; and (b) whenever the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for the Fund's schedule of investments in securities of unaffiliated issuers, the Fund (or financial intermediary) sends a copy of Schedule I—

Investments in securities of unaffiliated issuers within 3 business days of receipt by first-class mail or other means designed to ensure equally prompt delivery.

2. In the case of a Money Market Fund, Schedule I—Investments in securities of unaffiliated issuers [17 CFR 210.12-12C] [**amendment effective January 17, 2017, with a compliance date of August 1, 2017:** "[17 CFR 210.12-12C]" will be amended to state "[17 CFR 210.12-12B]"] may be omitted from its financial statements, provided that: (a) the Fund states in the report that the Fund's complete schedule of investments in securities of unaffiliated issuers is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; (ii) on the Fund's website, if applicable; and (iii) on the Commission's website at http://www.sec.gov; and (b) whenever the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for the Fund's schedule of investments in securities of unaffiliated issuers, the Fund (or financial intermediary) sends a copy of Schedule I—Investments in securities of unaffiliated issuers within 3 business days of receipt by first-class mail or other means designed to ensure equally prompt delivery.

(2) *Condensed Financial Information.* The condensed financial information required by Item 13(a) with at least the most recent fiscal year audited.

(3) *Remuneration Paid to Directors, Officers, and Others.* Unless shown elsewhere in the report as part of the financial statements required by paragraph (b)(1), the aggregate remuneration paid by the Fund during the period covered by the report to:

(i) All directors and all members of any advisory board for regular compensation;

(ii) Each director and each member of an advisory board for special compensation;

(iii) All officers; and

(iv) Each person of whom any officer or director of the Fund is an affiliated person.

(4) *Changes in and Disagreements with Accountants.* The information concerning changes in and disagreements with accountants and on accounting and financial disclosure required by Item 304 of Regulation S-K [17 CFR 229.304].

(5) *Management Information.* The management information required by Item 17(a)(1).

(6) *Availability of Additional Information about Fund Directors.* A statement that the SAI includes additional information about Fund directors and is available, without charge, upon request, and a toll-free (or collect) telephone number for shareholders to call to request the SAI.

(7) *Management's Discussion of Fund Performance.* Disclose the following information unless the Fund is a Money Market Fund:

(i) Discuss the factors that materially affected the Fund's performance during the most recently completed fiscal year, including the relevant market conditions and the investment strategies and techniques used by the Fund's investment adviser.

(ii) (A) Provide a line graph comparing the initial and subsequent account values at the end of each of the most recently completed 10 fiscal years of the Fund (or for the life of the Fund, if shorter), but only for periods subsequent to the effective date of the Fund's registration statement. Assume a $10,000 initial investment at the beginning of the first fiscal year in an appropriate broad-based securities market index for the same period.

(B) In a table placed within or next to the graph, provide the Fund's average annual total returns for the 1-, 5-, and 10-year periods as of the end of the last day of the most recent fiscal year (or for the life of the Fund, if shorter), but only for periods subsequent to the effective date of the Fund's registration statement. Average annual total returns should be computed in accordance with Item 26(b)(1). Include a statement accompanying the graph and table to the effect that past performance does not predict future performance and that the graph and table do not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares.

Instructions

1. *Line Graph Computation.*

(a) Assume that the initial investment was made at the offering price last calculated on the business day before the first day of the first fiscal year.

(b) Base subsequent account values on the net asset value of the Fund last calculated on the last business day of the first and each subsequent fiscal year.

(c) Calculate the final account value by assuming the account was closed and redemption was at the price last calculated on the last business day of the most recent fiscal year.

(d) Base the line graph on the Fund's required minimum initial investment if that amount exceeds $10,000.

2. *Sales Load.* Reflect any sales load (or any other fees charged at the time of purchasing shares or opening an account) by beginning the line graph at the amount that actually would be invested (i.e., assume that the maximum sales load, and other charges deducted from payments, is deducted from the initial $10,000 investment). For a Fund whose shares are subject to a contingent deferred sales load, assume the deduction of the maximum deferred sales load (or other charges) that would apply for a complete redemption that received the price last calculated on the last business day of the most recent fiscal year. For any other deferred sales load, assume that the deduction is in the amount(s) and at the time(s) that the sales load actually would have been deducted.

3. *Dividends and Distributions.* Assume reinvestment of all of the Fund's dividends and distributions on the reinvestment dates during the period, and reflect any sales load imposed upon reinvestment of dividends or distributions or both.

4. *Account Fees.* Reflect recurring fees that are charged to all accounts.

(a) For any account fees that vary with the size of the account, assume a $10,000 account size.

(b) Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

(c) Reflect an annual account fee that applies to more than one Fund by allocating the fee in the following manner: divide the total amount of account fees collected during the year by the Funds' total average net assets, multiply the resulting percentage by the average account value for each Fund and reduce the value of each hypothetical account at the end of each fiscal year during which the fee was charged.

5. *Appropriate Index.* For purposes of this Item, an "appropriate broad-based securities market index" is one that

is administered by an organization that is not an affiliated person of the Fund, its investment adviser, or principal underwriter, unless the index is widely recognized and used. Adjust the index to reflect the reinvestment of dividends on securities in the index, but do not reflect the expenses of the Fund.

6. *Additional Indexes.* A Fund is encouraged to compare its performance not only to the required broad-based index, but also to other more narrowly based indexes that reflect the market sectors in which the Fund invests. A Fund also may compare its performance to an additional broad-based index, or to a non-securities index (e.g., the Consumer Price Index), so long as the comparison is not misleading.

7. *Change in Index.* If the Fund uses an index that is different from the one used for the immediately preceding fiscal year, explain the reason(s) for the change and compare the Fund's annual change in the value of an investment in the hypothetical account with the new and former indexes.

8. *Other Periods.* The line graph may cover earlier fiscal years and may compare the ending values of interim periods (e.g., monthly or quarterly ending values), so long as those periods are after the effective date of the Fund's registration statement.

9. *Scale.* The axis of the graph measuring dollar amounts may use either a linear or a logarithmic scale.

10. *New Funds.* A New Fund (as defined in Instruction 6 to Item 3) is not required to include the information specified by this Item in its prospectus (or annual report), unless Form N-1A (or the annual report) contains audited financial statements covering a period of at least 6 months.

11. *Change in Investment Adviser.* If the Fund has not had the same investment adviser for the previous 10 fiscal years, the Fund may begin the line graph on the date that the current adviser began to provide advisory services to the Fund so long as:

    (a) Neither the current adviser nor any affiliate is or has been in "control" of the previous adviser under section 2(a) (9) [15 U.S.C. 80a-2(a)(9)];

    (b) The current adviser employs no officer(s) of the previous adviser or employees of the previous adviser who were responsible for providing investment advisory or portfolio management services to the Fund; and

(c) The graph is accompanied by a statement explaining that previous periods during which the Fund was advised by another investment adviser are not shown.

(iii) Discuss the effect of any policy or practice of maintaining a specified level of distributions to shareholders on the Fund's investment strategies and per share net asset value during the last fiscal year. Also discuss the extent to which the Fund's distribution policy resulted in distributions of capital.

(iv) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed five fiscal years (or the life of the Fund, if shorter). The Fund may omit this table from the annual report if the Fund provides an Internet address at the Fund's Web site, which is publicly accessible, free of charge, that investors can use to obtain the premium/discount information required in Item 11(g)(2).

Instructions

1. Provide the information in tabular form.

2. Express the information as a percentage of the net asset value of the Exchange-Traded Fund, using separate columns for the number of days the Market Price was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value. Round all percentages to the nearest hundredth of one percent.

3. Adjacent to the table, provide a brief explanation that: shareholders may pay more than net asset value when they buy Fund shares and receive less than net asset value when they sell those shares, because shares are bought and sold at current market prices.

4. Include a statement that the data presented represents past performance and cannot be used to predict future results.

(c) *Semi-Annual Report.* Every semi-annual report to shareholders required by rule 30e-1 must contain the following, which need not be audited:

(1) *Financial Statements.* The financial statements required by Regulation S-X for the period commencing either with:

(i) The beginning of the Fund's fiscal year (or date of organization, if newly organized); or

(ii) A date not later than the date after the close of the period included in the last report under rule 30e-1 and the most recent preceding fiscal year.

Instruction

Instructions 1 and 2 to Item 27(b)(1) also apply to this Item 27(c)(1).

(2) *Condensed Financial Information.* The condensed financial information required by Item 13(a), for the period of the report as specified by paragraph (c)(1), and the most recent preceding fiscal year.

(3) *Remuneration Paid to Directors, Officers, and Others.* Unless shown elsewhere in the report as part of the financial statements required by paragraph (c)(1), the aggregate remuneration paid by the Fund during the period covered by the report to the persons specified under paragraph (b)(3).

(4) *Changes in and Disagreements with Accountants.* The information concerning changes in and disagreements with accountants and on accounting and financial disclosure required by Item 304 of Regulation S-K [17 CFR 229.304].

(d) *Annual and Semi-Annual Reports.* Every annual and semi-annual report to shareholders required by rule 30e-1 must contain the following:

(1) Expense Example. The following information regarding expenses for the period:

Example

As a shareholder of the Fund, you incur two types of costs: (1) transaction costs, including sales charges (loads) on purchase payments, reinvested dividends, or other distributions; redemption fees; and exchange fees; and (2) ongoing costs, including management fees; distribution [and/or service] (12b-1) fees; and other Fund expenses. This Example is intended to help you understand your ongoing costs (in dollars) of investing in the Fund and to compare these costs with the ongoing costs of investing in other mutual funds.

The Example is based on an investment of $1,000 invested at the beginning of the period and held for the entire period [insert dates].

Actual Expenses

The first line of the table below provides information about actual account values and actual expenses. You may use the information in this line, together with the amount you invested, to estimate the expenses that you paid over the period. Simply divide your account value by $1,000 (e.g., an $8,600 account value divided by $1,000 = 8.6), then multiply the result by the number in the first line under the heading entitled "Expenses Paid During Period" to estimate the expenses you paid on your account during this period. [If the Fund charges any account fees or other recurring fees that are not included in the expenses shown in the table, for example, because they are not charged to all investors, disclose the amounts of these fees, describe the accounts that are charged these fees, and explain how an investor would use this information to estimate the total ongoing expenses paid over the period and the impact of these fees on ending account value.]

Hypothetical Example for Comparison Purposes

The second line of the table below provides information about hypothetical account values and hypothetical expenses based on the Fund's actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Fund's actual return. The hypothetical account values and expenses may not be used to estimate the actual ending account balance or expenses you paid for the period. You may use this information to compare the ongoing costs of investing in the Fund and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds. [If the Fund charges any account fees or other recurring fees that are not included in the expenses shown in the table, for example, because they are not charged to all investors, disclose the amounts of these fees, describe the accounts that are charged these fees, and explain how an investor would use this information in making the foregoing comparison.]

Please note that the expenses shown in the table are meant to highlight your ongoing costs only and do not reflect any transactional costs, such as sales charges (loads), redemption fees, or exchange fees. Therefore, the second line of the table is useful in comparing ongoing costs only, and will not help you determine the relative total costs of owning different funds. In addition, if these transactional costs were included, your costs would have been higher.

	Beginning Account Value [Date]	Ending Account Value [Date]	Expenses Paid During Period* [Dates]
Actual	**$1,000**		
Hypothetical (5% return before expenses)	**$1,000**		

*** Expenses are equal to the Fund's annualized expense ratio of [%], multiplied by the average account value over the period, multiplied by [number of days in most recent fiscal half-year/365 [or 366]] (to reflect the one-half year period).**

Instructions

1. *General.*

(a) Round all figures in the table to the nearest cent.

(b) Include the narrative explanations in the order indicated. A Fund may modify the narrative explanations if the explanation contains comparable information to that shown, and is required to make any modifications necessary to reflect accurately the Fund's circumstances. A Fund may eliminate any parts of the narrative explanations that are inapplicable. For example, a Fund that does not charge loads need not include the statement that the Example does not reflect loads or that costs would be higher if loads were included.

(c) The Fund's expense ratio shown in the footnote to the table should be calculated in the manner required by Instruction 4(b) to Item 13(a) using the expenses for the Fund's most recent fiscal half-year (the Fund's second fiscal half-year in the case of an annual report). Express the expense ratio on an annualized basis.

(d) (i) If the Fund is a Feeder Fund, reflect the aggregate expenses of the Feeder Fund and the Master Fund. In a footnote to the Example, state that the Example reflects the expenses of both the Feeder and Master Funds.

(ii) If the report covers more than one Class of a Multiple Class Fund or more than one Feeder Fund that invests in the same Master Fund, provide a separate Example for each Class or Feeder Fund.

(e) If the Fund is an Exchange-Traded Fund:

(i) Modify the narrative explanation to state that investors may pay brokerage commissions on their purchases and sales of Exchange-Traded Fund shares, which are not reflected in the example; and

(ii) If the Fund issues or redeems shares in creation units of not less than 25,000 shares each, exclude any fees charged for the purchase and redemption of the Fund's creation units.

2. *Computation*.

(a) (i) In determining the Fund's "actual expenses" for purposes of this example, include all expenses that are deducted from the Fund's assets or charged to all shareholder accounts, including "Management Fees," "Distribution [and/or Service] (12b-1) Fees," and "Other Expenses" as those terms are defined in Instruction 3 to Item 3 of this form as modified by Instructions 2(a)(ii) and (c)(i) to this Item. Reflect recurring and non-recurring fees charged to all investors other than any exchange fees, sales charges (loads), or fees charged upon redemption of the Fund's shares. The amount of expenses deducted from the Fund's assets are the amounts shown as expenses in the Fund's statement of operations (including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X [17 CFR 210.6-07]).

(ii) For purposes of this Item 27(d)(1), "Other Expenses" include extraordinary expenses as determined under generally accepted accounting principles (see FASB ASC Subtopic 225-20, Income Statement—Extraordinary and Unusual Items). If extraordinary expenses were incurred that materially affected the Fund's "Other Expenses," the Fund may disclose in a footnote to the Example what "actual expenses" would have been had the extraordinary expenses not been included.

(b) Assume reinvestment of all dividends and distributions.

(c) (i) Base the percentages of "actual expenses" on amounts incurred during the Fund's most recent fiscal half-year (the Fund's second fiscal half-year in the case of an annual report). "Actual expenses" should reflect actual expenses after expense reimbursement or fee waiver arrangements that reduced expenses during the most recent fiscal half-year.

(ii) If there have been any increases or decreases in Fund expenses that occurred during the Fund's most recent fiscal half-year (or that have occurred or are expected to occur during the current fiscal year) that would have materially affected the information in the Example had those changes been in place throughout the most recent fiscal half-year, restate in a footnote to the Example the expense information using the current fees as if they had been in effect throughout the entire most recent fiscal half-year. A change in Fund expenses does not include a decrease in expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in the Fund's assets.

(d) Reflect any shareholder account fees collected by more than one Fund by allocating the total amount of the fees collected during the Fund's most recent fiscal half-year (the Fund's second fiscal half-year in the case of an annual report) for all such Funds to each Fund in proportion to the relative average net assets of the Fund. A Fund that charges account fees based on a minimum account requirement exceeding $1,000 may adjust its account fees based on the amount of the fee in relation to the Fund's minimum account requirement.

3. *Graphical Representation of Holdings*. One or more tables, charts, or graphs depicting the portfolio holdings of the Fund by reasonably identifiable categories (e.g., type of security, industry sector, geographic regions, credit quality, or maturity) showing the percentage of net asset value or total investments attributable to each. The categories and the basis of the presentation should be formatted, in a manner reasonably designed to depict clearly the types of investments made by the Fund, given its investment objectives. If the Fund depicts portfolio holdings according to the credit quality, it should include a description of how the credit quality of the holdings were determined, and if credit ratings, as defined in section 3(a)(60) of the Securities Exchange Act [15 U.S.C. 78(c)(a)(60)], assigned by a credit rating agency, as defined in section 3(a)(61) of the Securities Exchange Act [15 U.S.C. 78(c)(a)(61)], are used, explain how they were identified and selected. This description should be included near, or as part of, the graphical representation.

4. *Statement Regarding Availability of Quarterly Portfolio Schedule*. A statement that: (i) the Fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year on Form N-Q; (ii) the Fund's Forms N-Q are available on the Commission's website at http://www.sec.gov; (iii) the Fund's Forms N-Q may be reviewed and copied at the *Commission's* Public Reference Room in Washington, DC, and that information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330; and (iv) if the Fund makes the information on Form N-Q available to shareholders on its website or upon request, a description of how the information may be obtained from the Fund.

[effective January 17, 2017 Instruction 4 above will be amended to state the following:

4. *Statement Regarding Availability of Quarterly Portfolio Schedule*. A statement that: (i) the Fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year as an exhibit to its reports on Form N-PORT; (ii) the Fund's Form N-PORT reports are available on the Commission's website at http://www.sec.gov; and (iii) if the Fund makes the information on Form N-PORT available to shareholders on its website or upon request, a description of how the information may be obtained from the Fund.]

[Note Regarding Replacement of Form N-Q by Form N-PORT: Funds with assets of $1 billion or more will be required to file Form N-PORT by June 1, 2018. Funds with assets of less than $1 billion will be required to file Form N-PORT by June 1, 2019. Form N-Q will be rescinded on August 1, 2019.]

5. *Statement Regarding Availability of Proxy Voting Policies and Procedures*. A statement that a description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; (ii) on the Fund's website, if applicable; and (iii) on the Commission's website at http://www.sec.gov.

Instruction

When a Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for a description of the policies and procedures that the Fund uses to determine how to vote proxies, the Fund (or

financial intermediary) must send the information disclosed in response to Item 17(f) of this Form, within three business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

6. *Statement Regarding Availability of Proxy Voting Record.* A statement that information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; or on or through the Fund's website at a specified Internet address; or both; and (ii) on the Commission's website at http://www.sec.gov.

Instructions

1. If a Fund discloses that the Fund's proxy voting record is available by calling a toll-free (or collect) telephone number, and the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for this information, the Fund (or financial intermediary) must send the information disclosed in the Fund's most recently filed report on Form N-PX, within three business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

2. If a Fund discloses that the Fund's proxy voting record is available on or through its website, the Fund must make available free of charge the information disclosed in the Fund's most recently filed report on Form N-PX on or through its website as soon as reasonably practicable after filing the report with the Commission. The information disclosed in the Fund's most recently filed report on Form N-PX must remain available on or through the Fund's website for as long as the Fund remains subject to the requirements of rule 30b1-4 (17 CFR 270.30b1-4) and discloses that the Fund's proxy voting record is available on or through its website.

7. *Statement Regarding Basis for Approval of Investment Advisory Contract.* If the board of directors approved any investment advisory contract during the Fund's most recent fiscal half-year, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board's approval. Include the following in the discussion:

   (i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to,

a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. Also indicate in the discussion whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (e.g., pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

Instructions

1. Board approvals covered by this Item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by this Item include subadvisory contracts.

2. Conclusory statements or a list of factors will not be considered sufficient disclosure. Relate the factors to the specific circumstances of the Fund and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

3. If any factor enumerated in paragraph (d)(6)(i) of this Item is not relevant to the board's evaluation of an investment advisory contract, note this and explain the reasons why that factor is not relevant.

Part C—OTHER INFORMATION

Item 28. Exhibits

Subject to General Instruction D regarding incorporation by reference and rule 483 under the Securities Act [17 CFR 230.483], file the exhibits listed below as part of the registration statement. Letter or number the exhibits in the sequence indicated and file copies rather than originals, unless otherwise required by rule 483. Reflect any exhibit incorporated by reference in the list below and identify the previously filed document containing the incorporated material.

(a) *Articles of Incorporation*. The Fund's current articles of incorporation, charter, declaration of trust or corresponding instruments and any related amendment.

(b) *By-laws*. The Fund's current by-laws or corresponding instruments and any related amendment.

(c) *Instruments Defining Rights of Security Holders*. Instruments defining the rights of holders of the securities being registered, including the relevant portion of the Fund's articles of incorporation or by-laws.

(d) *Investment Advisory Contracts*. Investment advisory contracts relating to the management of the Fund's assets.

(e) *Underwriting Contracts*. Underwriting or distribution contracts between the Fund and a principal underwriter, and agreements between principal underwriters and dealers.

(f) *Bonus or Profit Sharing Contracts*. Bonus, profit sharing, pension, or similar contracts or arrangements in whole or in part for the benefit of the Fund's directors or officers in their official capacity. Describe in detail any plan not included in a formal document.

(g) *Custodian Agreements*. Custodian agreements and depository contracts under section 17(f) [15 U.S.C. 80a-17(f)] concerning the Fund's securities and similar investments, including the schedule of remuneration.

(h) *Other Material Contracts*. Other material contracts not made in the ordinary course of business to be performed in whole or in part on or after the filing date of the registration statement.

(i) *Legal Opinion*. An opinion and consent of counsel regarding the legality of the securities being registered, stating whether the securities will, when sold, be legally issued, fully paid, and nonassessable.

(j) *Other Opinions*. Any other opinions, appraisals, or rulings, and related consents relied on in preparing the registration statement and required by section 7 of the Securities Act [15 U.S.C. 77g].

(k) *Omitted Financial Statements*. Financial statements omitted from Item 27.

(l) *Initial Capital Agreements*. Any agreements or understandings made in consideration for providing the initial capital between or among the Fund, the underwriter, adviser, promoter or initial shareholders and written assurances from promoters or initial shareholders that purchases were made for investment purposes and not with the intention of redeeming or reselling.

(m) *Rule 12b-1 Plan*. Any plan entered into by the Fund under rule 12b-1 and any agreements with any person relating to the plan's implementation.

(n) *Rule 18f-3 Plan*. Any plan entered into by the Fund under rule 18f-3, any agreement with any person relating to the plan's implementation, and any amendment to the plan or an agreement.

(o) *Reserved*.

(p) *Codes of Ethics*. Any codes of ethics adopted under rule 17j-1 of the Investment Company Act [17 CFR 270.17j-1] and currently applicable to the Fund (i.e., the codes of the Fund and its investment advisers and principal underwriters). If there are no codes of ethics applicable to the Fund, state the reason (e.g., that the Fund is a Money Market Fund).

Instruction

A Fund that is a Feeder Fund also must file a copy of all codes of ethics applicable to the Master Fund.

Item 29. Persons Controlled by or Under Common Control with the Fund

Provide a list or diagram of all persons directly or indirectly controlled by or under common control with the Fund. For any person controlled by another person, disclose the percentage of voting securities owned by the immediately controlling person or other basis of that person's control. For each company, also provide the state or other sovereign power under the laws of which the company is organized.

Instructions

1. Include the Fund in the list or diagram and show the relationship of each company to the Fund and to the other companies named, using cross-references if a company is controlled through direct ownership of its securities by two or more persons.

2. Indicate with appropriate symbols subsidiaries that file separate financial statements, subsidiaries included in consolidated financial statements, or unconsolidated subsidiaries included in group financial statements. Indicate for other subsidiaries why financial statements are not filed.

Item 30. Indemnification

State the general effect of any contract, arrangements or statute under which any director, officer, underwriter or affiliated person of the Fund is insured or indemnified against any liability incurred in their official capacity, other than insurance provided by any director, officer, affiliated person, or underwriter for their own protection.

Item 31. Business and Other Connections of Investment Adviser

Describe any other business, profession, vocation or employment of a substantial nature that each investment adviser, and each director, officer or partner of the adviser, is or has been engaged within the last two fiscal years for his or her own account or in the capacity of director, officer, employee, partner, or trustee.

Instructions

1. Disclose the name and principal business address of any company for which a person listed above serves in the capacity of director, officer, employee, partner, or trustee, and the nature of the relationship.
2. The names of investment advisory clients need not be given in answering this Item.

Item 32. Principal Underwriters

(a) State the name of each investment company (other than the Fund) for which each principal underwriter currently distributing the Fund's securities also acts as a principal underwriter, depositor, or investment adviser.

(b) Provide the information required by the following table for each director, officer, or partner of each principal underwriter named in the response to Item 25:

(1) Name and Principal Business Address	(2) Positions and Offices with Underwriter	(3) Positions and Offices with Fund

(c) Provide the information required by the following table for all commissions and other compensation received, directly or indirectly, from the Fund during the last fiscal year by each principal underwriter who is not an affiliated person of the Fund or any affiliated person of an affiliated person:

(1) Name of Principal Underwriter	(2) Net Underwriting Discounts and Commissions	(3) Compensation on Redemption and Repurchases	(4) Brokerage Commissions	(5) Other Compensation

Instructions

1. Disclose the type of services rendered in consideration for the compensation listed under column (5).

2. Instruction 1 to Item 25(c) also applies to this Item.

Item 33. Location of Accounts and Records

State the name and address of each person maintaining physical possession of each account, book, or other document required to be maintained by section 31(a) [15 U.S.C. 80a-30(a)] and the rules under that section.

Instructions

1. The instructions to Item 20.4 also apply to this item.

2. Exclude information about any service provided for payments totaling less than $5,000 during each of the last three fiscal years.

[amendment effective January 17, 2017, with a compliance date of August 1, 2017:

3. A Fund may omit this information to the extent it is provided in its most recent report on Form N-CEN [17 CFR 274.101].

Item 34. Management Services

Provide a summary of the substantive provisions of any management-related service contract not discussed in Part A or B, disclosing the parties to the contract and the total amount paid and by whom for the Fund's last three fiscal years.

Instructions

1. The instructions to Item 19 also apply to this Item.

2. Exclude information about any service provided for payments totaling less than $5,000 during each of the last three fiscal years.

Item 35. Undertakings

In initial registration statements filed under the Securities Act, provide an undertaking to file an amendment to the registration statement with certified financial statements showing the initial capital received before accepting subscriptions from more than 25 persons if the Fund intends to raise its initial capital under section 14(a)(3) [15 U.S.C. 80a-14(a)(3)].

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933 and the Investment Company Act of 1940, the Fund (certifies that it meets all of the requirement for effectiveness of this registration statement under rule 485(b) under the Securities Act and) has duly caused this registration statement to be signed on its behalf by the undersigned, duly authorized, in the city of _____, and State of _____, on the __ day of _____, _____.

_____
Fund

By _____ _____
Signature Title

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed below by the following persons in the capacities and on the dates indicated.

_____	_____	_____
Signature	Title	Date

FORM N-1A
(Annotated)
See page 17 for Unannotated Form N-1A

You may not send a completed printout of this form to the SEC to satisfy a filing obligation. You can only satisfy an SEC filing obligation by submitting the information required by this form to the SEC in electronic format online at https://www.edgarfiling.sec.gov.

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

FORM N-1A

OMB APPROVAL
OMB Number: 3235-0307 Expires: February 28, 2018 Estimated average burden hours per response 263

Check appropriate box or boxes

❒ REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

❒ Pre-Effective Amendment No. _____

❒ Post-Effective Amendment No. _____

and/or

❒ REGISTRATION STATEMENT UNDER THE INVESTMENT COMPANY ACT OF 1940

❒ Amendment No. _____

_____

Registrant Exact Name as Specified in Charter

_____

Address of Principal Executive Offices (Number, Street, City, State, Zip Code)

Registrant's Telephone Number, including Area Code _____

_____

Name and Address (Number, Street, City, State, Zip Code) of Agent for Service

Approximate Date of Proposed Public Offering _____

It is proposed that this filing will become effective (check appropriate box)

❒ immediately upon filing pursuant to paragraph (b)
❒ on (date) pursuant to paragraph (b)
❒ 60 days after filing pursuant to paragraph (a)
❒ on (date) pursuant to paragraph (a)
❒ 75 days after filing pursuant to paragraph (a)(2)
❒ on (date) pursuant to paragraph (a)(2) of rule 485.

If appropriate, check the following box:

❒ This post-effective amendment designates a new effective date for a previously filed post-effective amendment.

Omit from the facing sheet reference to the other Act if the Registration Statement or amendment is filed under only one of the Acts. Include the "Approximate Date of Proposed Public Offering" and ["Title of Securities Being Registered"] only where securities are being registered under the Securities Act of 1933. [Editor's note: while the line for Approximate Date of Proposed Public Offering is listed above, there appears to be no comparable line for Title of Securities Being Registered]

Form N-1A is to be used by open-end management investment companies, except insurance company separate accounts and small business investment companies licensed under the United States Small Business Administration, to register under the Investment Company Act of 1940 and to offer their shares under the Securities Act of 1933. The Commission has designed Form N-1A to provide investors with information that will assist them in making a decision about investing in an investment company eligible to use the Form. The Commission also may use the information provided on Form N-1A in its regulatory, disclosure review, inspection, and policy making roles.

A Registrant is required to disclose the information specified by Form N-1A, and the Commission will make this information public. A Registrant is not required to respond to the collection of information contained in Form N-1A unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

ENHANCED DISCLOSURE AND NEW PROSPECTUS DELIVERY OPTION FOR REGISTERED OPEN-END MANAGEMENT INVESTMENT COMPANIES
(Release Nos. 33-8998; IC-28584; January 13, 2009)

3. Information Required in Summary Section

We are adopting the required content of the summary section substantially as proposed, except that, having considered commenters' concerns and the views of investors expressed in focus groups, we have determined not to require disclosure of a fund's portfolio holdings. The summary section of a mutual fund statutory prospectus will consist of the following information: (1) investment objectives; (2) costs; (3) principal investment strategies, risks, and performance; (4) investment advisers and portfolio managers; (5) brief purchase and sale and tax information; and (6) financial intermediary compensation. These items will appear in the same order that we proposed. We have modified the requirements for some items to address comments and views expressed in the focus groups.

* * *

b. Order of Information

We are adopting the order of the information required in the summary section, as proposed. This includes moving the fee table forward from its current location, which follows information about investment strategies, risks, and past performance. We continue to believe that the change to the location of the fee table will enhance the prominence of this information, which is important to address continuing concerns about investor understanding of mutual fund costs.[1] Several commenters agreed that relocation of the fee table will place fee information in a more prominent location and encourage investors to give greater attention to costs and cost comparisons.[2] While several commenters suggested alternative orders for the information in the summary section, there was no consensus by commenters regarding any alternative.[3]

A number of commenters, largely from the fund industry, opposed relocating the fee table. These commenters argued that moving the fee table forward inappropriately overemphasizes costs over other more important information and that the fee table should not come between investment objectives and principal investment strategies and risks.[4] Some of these commenters argued that the fee table should not be moved forward, because it is important for investors to first and foremost understand a fund and its risks, and that a fund's objectives, strategies, and risks provide necessary context for fees. Some commenters also argued that moving the fee table forward is unnecessary because the short length of the summary section will make the fee table sufficiently prominent.

We are not persuaded by these commenters. We continue to believe, along with a number of commenters, that placement of the fee table in a more prominent location will encourage investors to give greater attention to costs. The fee table and example are designed to help investors understand the costs of investing in a fund and compare those costs with the costs of

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[1]*See Barbara Roper, Director of Investor Protection, Consumer Federation of America, June 12 Roundtable Transcript, supra note 18, at 21; James J. Choi, David Laibson, & Brigitte C. Madrian, National Bureau of Economic Research, Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds, at 6 (May 2006), available at http://www.nber.org/papers/w12261.pdf.; Focus Group Transcripts, supra note 32, at 6 ("[The hypothetical summary prospectus] shows the fee right up there, what they charge, so that would appeal to me.").*

[2]*See, e.g., Letter of Roy J. Biegel (Feb. 14, 2008) ("Biegel Letter"); CFA Institute Letter, supra note 37; Foreside Letter, supra note 74; Letter of Fund Democracy and Consumer Federation of America (Apr. 17, 2008); NAPFA Letter, supra note 44; Letter of Charles Sikorovsky (Feb. 29, 2008) ("Sikorovsky Letter"). See also Focus Group Transcripts, supra note 32, at 10 (investors expressed view that fund costs are important); Letter of Investment Company Institute (Mar. 14, 2008) ("ICI Survey") (finding that 95% of respondents believed that fees are important).*

[3]*See, e.g., Letter of Ward C. Bourn (Feb. 27, 2008); Capital Research Letter, supra note 34; Evergreen Letter, supra note 41; Financial Services Institute Letter, supra note 41; Vanguard Letter, supra note 42.*

[4]*See, e.g., AIM Letter, supra note 47; Evergreen Letter, supra note 41; Letter of Fidelity Investments (Feb. 28, 2008) ("Fidelity Letter"); ICI Letter, supra note 34; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48; T. Rowe Letter, supra note 49.*

other funds. Placing the fee table and example at the front of the summary section reflects the importance of costs to an investment decision.[5] Moving the fee table forward also eliminates the possibility that the fee table could be obscured by other information.[6]

* * *

4. Exchange-Traded Funds

In March of this year, the Commission proposed several amendments to Form N-1A to accommodate the use of the form by ETFs.[7] Most ETFs are organized and registered as open-end funds. Unlike traditional mutual funds, however, they sell and redeem individual shares ("ETF shares") only in large aggregations called "creation units" to certain financial institutions. ETFs register offerings and sales of ETF shares under the Securities Act and list their shares for trading under the Securities Exchange Act of 1934 ("Exchange Act").[8] As with any listed security, investors trade ETF shares at market prices.

The proposed amendments for ETF prospectuses were designed to meet the needs of investors (including retail investors) who purchase ETF shares in secondary market transactions rather than financial institutions that purchase creation units directly from the ETF. The proposed amendments for ETF prospectuses also addressed the need to modify the summary section of ETF prospectuses to include the amended ETF disclosures. Today, we are adopting the proposed amendments for ETF prospectuses with changes to respond to issues raised by commenters on the summary prospectus proposing release and the ETF proposing release.[9]

a. Purchasing and Redeeming Shares

We are amending Form N-1A to eliminate the requirement that ETF prospectuses disclose information on how to buy and redeem shares directly from the ETF because it is not relevant to investors who are secondary market purchasers of ETF shares.[10] We proposed to

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[5]*For example, a 1% increase in annual fees reduces an investor's return by approximately 18% over 20 years.*

[6]*See Sikorovsky Letter, supra note 84 (stating that if an investment manager can in any way "hide" fees from an investor, the document has failed to fulfill its function).*

[7]*See ETF Proposing Release, supra note 14, 73 FR at 14618.*

[8]*For a description of how ETFs operate, see id. at 14620-21. ETFs currently operate pursuant to exemptive orders granted by the Commission. The final amendments define an ETF as a fund or class of a fund, the shares of which are traded on a national securities exchange, and that has formed and operates pursuant to an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission. General Instruction A of Form N-1A. The final ETF definition in Form N-1A eliminates from the proposed definition the cross-reference to proposed rule 6c-11, which, if adopted, would codify many of the exemptive orders granted to ETFs. See ETF Proposing Release, supra note 14, 73 FR at 14621-30. We have made this technical change to the ETF definition because the Commission has not adopted proposed rule 6c-11.*

[9] *The amendments we proposed in the ETF Proposing Release incorporated most of the comments from Barclays Global Fund Advisors ("BGFA") in response to the Proposing Release. See Letter of BGFA (Feb. 28, 2008) ("BGFA Letter"). BGFA also requested guidance on how disclosure requirements in future exemptive orders will be integrated into the summary section of the prospectus. We are unable to provide guidance in this release because we do not know what additional disclosure requirements, if any, would be required for ETFs that form and operate pursuant to future exemptive orders. Additional disclosure requirements, if any, will be included in those exemptive orders.*

[10]*Item 6(c)(ii) of Form N-1A.*

require ETF prospectuses to state the number of shares contained in a creation unit (*i.e.*, the aggregate number of shares an ETF will issue or that is necessary to redeem from the ETF), that individual shares can only be bought and sold on the secondary market through a broker-dealer, and that shareholders may pay more than net asset value ("NAV") when they buy ETF shares and receive less than NAV when they sell shares because shares are bought and sold at current market prices.[11] We also proposed to amend the fee table disclosure in Form N-1A to exclude fees and expenses for purchases or redemptions of creation units and instead to modify the narrative explanation preceding the example in the fee table to state that investors in ETF shares may pay brokerage commissions that are not reflected in the example.[12] Commenters who addressed the proposed amendments generally supported this approach.[13] We are adopting the amendments largely as proposed, with minor changes to conform to the final amendments to the summary section.[14] ETFs still will be required to include disclosure on how creation units are offered to the public in the SAI.[15]

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[11] *See proposed Item 6(h)(3) and (4) of current Form N-1A; proposed Instruction 3 to Item 6(h) of current Form N-1A.*

[12] *Proposed Instruction 1(e)(i) to current Item 3 of Form N-1A. One commenter to the ETF Proposing Release requested that we require ETFs to include spread costs in the fee table. See Letter of BGFA (May 16, 2008) (File No. S7-07-08) ("BGFA Letter on ETF Proposing Release"). This information is required to be disclosed pursuant to rule 11Ac1-5(b) of the Exchange Act [17 CFR 240.11Ac1-5(b)] and is publicly available to investors and the market, which considers the effect of spreads. We did not follow the commenter's suggestion because we believe that disclosure regarding additional spreads in an ETF prospectus, particularly in the summary section, would not be meaningful to most investors and may be confusing.*

[13] *See, e.g., BGFA Letter on ETF Proposing Release, supra note 166, Letter of Investment Company Institute (May 19, 2008) (File No. S7-07-08) ("ICI Letter on ETF Proposing Release").*

[14] *Item 6(c)(i) of Form N-1A; Instruction 1(e)(i) to Item 3 of Form N-1A. Item 6(c)(i)(B) requires disclosure that ETF shares may trade at a price greater than NAV (premium) or less than NAV (discount). The final amendments, like the proposed amendments, also will require each ETF to identify the exchange ticker symbol(s) and principal U.S. market(s) on which the shares are traded. Item 1(a)(2) of Form N-1A; rule 498(b)(1)(ii) 17 CFR 230.498(b)(1)(ii). We also are adopting a conforming amendment to the expense example in ETF annual and semi-annual reports. Instruction 1(e)(i) to Item 27(d) of Form N-1A.*

[15] *Item 23(a) of Form N-1A. Consistent with our proposal, we are not amending this disclosure to include information on creation unit redemption, which Item 11 requires and which we are eliminating for ETFs. See Item 11(g) of Form N-1A.*

Consistent with our proposal, the alternative disclosures in Items 3 and 6 of Form N-1A will not be available to ETFs with creation units of less than 25,000 shares.[16] Although only certain financial institutions purchase and redeem creation units directly from an ETF, individual or retail investors may be more likely to transact in creation units through one of these financial institutions if the creation unit size is less than 25,000 shares.[17] Because there is greater potential for retail investors to transact (indirectly) in creation units as they decrease in size, we are requiring any ETF that sells and redeems its shares in creation units of 25,000 or less to include in its prospectus information on how to purchase and redeem creation units and the costs associated with those transactions.[18]

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[16]*Instruction (1)(e)(ii) to Item 3 of Form N-1A; Item 6(c)(ii) of Form N-1A. We also are adopting a conforming amendment to the expense example in ETF annual and semiannual reports. Instruction 1(e)(ii) to Item 27(d) of Form N-1A.*

[17]*ETFs directly sell and redeem creation units only to investors ("authorized participants"), usually brokerage houses, with which the ETF has a contractual agreement. See, e.g., Investment Company Act Release No. 27963 (Aug. 31, 2007) [72 FR 51475 (Sept. 7, 2007)]. The authorized participant may act as a principal in the transaction or as agent for another, typically an institutional investor.*

[18]*We have not, as one commenter to the ETF Proposing Release suggested, used a dollar value of a creation unit as the threshold for disclosure. See ICI Letter on ETF Proposing Release, supra note 167. We do not want to establish a threshold that may change (and as a consequence require amended disclosure) as a result of fluctuations in portfolio value rather than direct action by the ETF. We also disagree with one commenter who opined that the proposed threshold would create a de facto minimum of 25,000 shares for creation units and suggested that the threshold for exemptions from disclosure be set at 1,000 shares. See Letter of James J. Angel (May 16, 2008) (File No. S7-07-08). Other commenters, including ETF sponsors, explained they supported the proposed exemption from disclosure on the purchase and redemption of creation units because the information would confuse retail investors rather than because the disclosures were particularly costly or burdensome. See BGFA Letter on ETF Proposing Release, supra note 166; ICI Letter on ETF Proposing Release, supra note 167; Letter of Xshares Advisors LLC (May 20, 2008) (File No. S7-07-08) ("Xshares Letter"). Thus, it seems unlikely that an exemption from these disclosures would outweigh the other factors an ETF considers in determining the appropriate size of a creation unit, and we have not reduced the threshold for the exemption. See ICI Letter on ETF Proposing Release, supra note 167 ("[T]he appropriate size of a creation unit may vary depending on a number of factors, such as the type and availability of component securities, the expected uses of the product, and the likely Authorized Participants.").*

New Form N-1A Adopting Release; Investment Company Act Release No. 23064 (March 13, 1998)

Disclosure Principles

The Commission believes that, in revising Form N-1A and in providing for the use of profiles, it has laid the foundation for the development of fund disclosure documents of a significantly higher quality than those often used today, which have drawn the consistent criticism of fund investors and others. If the initiatives are to have their intended effect, however, all those who participate in the preparation and review of those documents funds, their legal counsels and other advisors, the Commission and its staff, and other regulators and their staffs—should act consistently with the basic disclosure principles that serve as the cornerstones of the initiatives. These principles, which are referred to throughout this release, include the following:

- Funds should design disclosure documents, particularly their prospectuses, first and foremost, to communicate information to investors effectively. Funds should present information in prospectuses following the principles of plain English, using language that is concise, straightforward, and easy to understand.
- A fund's prospectus principally should include essential information about the fundamental characteristics of, and risks of investing in, the fund. Whenever possible, a fund should present this information in a manner that:
  - ♦ assists investors in comparing and contrasting the fund with other funds;
  - ♦ avoids simply restating legal or regulatory requirements to which funds generally are subject; and
  - ♦ avoids a disproportionate emphasis on possible investments or activities of the fund that are not a significant part of the fund's investment operations.
- Funds should limit disclosure in prospectuses generally to information that is necessary for an average or typical investor to make an investment decision. Detailed or highly technical discussions, as well as information that may be helpful to more sophisticated investors, dilute the effect of necessary prospectus disclosure and should be placed in the SAI.
- Prospectus disclosure requirements should not lead to lengthy disclosure that discourages investors from reading the prospectus or obscures essential information about an investment in a fund.

The Commission has instructed its staff to use these principles consistently in administering the requirements of both amended Form N-1A and new rule 498 and strongly encourages all other participants in the development of fund disclosure documents to apply these principles in preparing their prospectuses and profiles.

A. General Instructions

* * *

2. Plain English Disclosure

The Commission is adopting amendments to General Instruction C clarifying that funds must comply with rule 421 under the Securities Act, which sets out the Commission's recently adopted plain English requirements.[19] Rule 421(b) sets out general requirements that the entire prospectus be clear, concise, and understandable and provides guidance on how to draft prospectuses that meet this standard.

Under Form N-1A, as amended, a fund would need to draft the front and back cover pages and the risk/return summary of a fund prospectus in accordance with the provisions of rule 421(d).[20] In meeting these requirements, a fund will need to use plain English principles in the organization, language, and design of these sections of their prospectuses. Funds also will comply substantially with the following six principles of clear writing:

- short sentences;
- definite, concrete, everyday language;
- active voice;
- tabular presentation or bullet lists for complex material, wherever possible;
- no legal jargon or highly technical business terms; and
- no multiple negatives.

The compliance dates for rule 421(d) and Form N-1A, as amended, will be the same. Therefore, when a fund files a new or amended registration statement in order to comply with Form N-1A, as amended, it must also comply with the plain English rule.[21]

3. Disclosure Guidelines

The Commission has revised General Instruction C to reflect clearly the basic disclosure principles underlying the Commission's initiatives being adopted today. The Commission believes that applying these principles consistently in developing fund disclosure documents will result in high quality documents that effectively communicate information to investors.

[19] *General Instruction C.1(e).*

[20] *Items 1(a) (Front Cover Page), 1(b) (Back Cover Page), 2 (Risk/Return Summary: Investments, Risks, and Performance), and 3 (Risk/Return Summary: Fee Table).*

[21] *See* infra *Section II.H for a discussion of the effective and compliance dates for Form N-1A, as amended. The compliance date for investment companies other than funds is October 1, 1998. See Plain English Release,* supra *note 20, at 6370. Unit investment trusts and closed-end investment companies must comply with the plain English rule only for new registration statements. Variable annuity issuers filing on Forms N-3 and N4, and variable life insurance issuers filing on Forms N-8B-2 and S-6 must comply with rule 421(d) for new and updated registration statements. The Commission also has proposed new Form N-6 for variable life insurance issuers that incorporates the Commission's plain English requirements. Investment Company Act Release No. 23066 (Mar. 13, 1998).*

General Instruction C, as amended, includes a set of drafting guidelines that are designed to improve prospectus disclosure. The Instruction encourages funds to avoid cross-references in their prospectuses to their SAIs or shareholder reports. Repeated cross-references to the SAI and shareholder reports can add unnecessary length and complexity to fund prospectuses and often preclude prospectuses from disclosing information effectively to investors.

General Instruction C provides guidance on the use of Form N-1A by more than one fund and by a multiple class fund. Fund prospectuses frequently contain information for multiple series and classes that offer investors different investment alternatives and distribution arrangements. When information in them is presented clearly, prospectuses offering more than one fund may make it easier for investors to compare funds and may be more efficient for funds and investors by eliminating the need to provide investors with multiple prospectuses containing repetitive information. Instruction C generally enables a fund to organize information about multiple funds and classes in a format of its choice that is consistent with the goal of communicating information to investors effectively.[22]

4. Modified Prospectuses for Certain Funds

Proposed Instruction C would permit a fund that is offered as an investment alternative in a participant-directed defined contribution plan to modify its prospectus for use by participants in the plan. Under the Proposed Amendments, a prospectus used to offer fund shares to plan participants could omit certain information required by proposed Items 7 (shareholder information) and 8 (distribution arrangements). This prospectus disclosure would largely be irrelevant to plan participants; investments that can be made by participants, and the distributions participants receive (including the tax consequences of distributions), are governed by statutory requirements and by the terms of individual plans.[23] Commenters generally supported permitting prospectuses to be modified for plan participants, asserting that it would allow funds to provide meaningful disclosure specifically designed for plan participants who invest in funds. The Commission is adopting the provisions in Instruction C relating to prospectuses for plan participants with modifications to reflect suggestions of commenters.

Instruction C, as proposed, would permit funds to tailor disclosure for prospectuses to be used for investments in defined contribution plans qualified under the Internal Revenue Code. One commenter suggested that the Commission permit funds that serve as investment options for variable insurance contracts to use modified prospectuses that set out purchase and sale

[22] *General Instruction C.3(c). A fund, for example, may decide that using a horizontal rather than vertical presentation for the fee table would present the required fee information most effectively. A fund may find that using different formats in its prospectus risk/return summary would communicate the required information effectively. Depending on the number and type of funds offered in the prospectus, for example, a fund may find it useful to group the required information for all funds together under each caption or to present the information sequentially for each fund. See John Hancock Funds, Inc. (pub. avail. June 28, 1996) (using a two-page disclosure format for each of 7 funds offered in a single prospectus).*

[23] *In addition to plans under rule 401(k) of the Internal Revenue Code, these plans include those under section 403(b) (available to employees of certain tax-exempt organizations and public educational systems) and section 457 (available to employees of state and local governments and other tax-exempt employers).*

procedures, distributions, and tax consequences applicable to these funds. In response to the commenter's suggestions, the Commission is permitting prospectuses to be tailored for funds offered through variable insurance contracts in furthering its goal of providing investors with more useful disclosure documents.[24]

5. Incorporation By Reference

Proposed General Instruction D would replace an existing instruction to Form N-1A that addresses incorporation by reference in a fund's prospectus of information in the fund's SAI. When the Commission adopted the two-part disclosure format for Form N-1A, the Commission intended that Part A of the registration statement provide investors with a simplified prospectus that, standing alone, would meet the requirements of section 10(a) of the Securities Act.[25] Part B, the SAI (which is available to investors upon request), includes additional information that the Commission has determined may be useful to some investors and should be available to all investors, but is not necessary in the public interest or for the protection of investors to be in the prospectus.[26] Form N-1A currently permits, but does not require, a fund to incorporate the SAI by reference into the prospectus. The two-part disclosure format has been widely used by funds, and the Commission has found that the current approach to incorporation by reference is consistent with the intended purpose of Form N-1A and should be retained.[27] Proposed Instruction D would continue to permit, but not require, a fund to incorporate the SAI by reference into the prospectus. Commenters supported this approach to incorporation by reference, and the Commission is adopting Instruction D substantially as proposed.[28] The revised Instruction clarifies that incorporating information by reference from the SAI is not permitted as a response to an item of Form N-1A requiring information to be included in the prospectus. Permitting the SAI to be incorporated by reference into the prospectus was meant to allow funds to add material that the Commission determined not to require in the prospectus, not to permit funds to delete required information from the prospectus and place it in the SAI. Form N-1A, as amended, provides funds with clearer directions for allocating disclosure between the prospectus and the SAI. Funds can discuss items of information required to appear in the prospectus in greater detail in the SAI, which may be incorporated by reference into the prospectus.

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[24] *General Instruction C.3(d).*

[25] *1983 Form N-1A Adopting Release,* supra *note 12, at 37930.*

[26] *Id. See White v. Melton, 757 F. Supp. 267 (S.D.N.Y. 1991) (citing the 1983 Form N-1A Adopting Release,* supra *note 12, as authority for the principle that certain matters are required to appear in the prospectus and that others may be appropriately disclosed in the SAI, which may be incorporated by reference into the prospectus).*

[27] *See Form N-1A Proposing Release,* supra *note 8, at 10920 (citing the 1982 Form N-1A Proposing Release as suggesting that prohibiting incorporation by reference of the SAI into the prospectus or, alternatively, requiring delivery of the SAI with the prospectus, would "vitiate the Commission's attempt to provide shorter, simpler prospectuses").*

[28] *General Instruction D, as adopted, includes technical revisions to simplify its requirements. The specific instruction regarding incorporation by reference of condensed financial information from reports to shareholders in existing General Instruction E has been incorporated in Item 9 of Form N-1A, as amended (financial highlights table). The existing instruction allowing incorporation of financial information in response to Item 23 of Form N-1A from reports to shareholders has been deleted as unnecessary because the Form does not limit incorporation of information into the SAI. The requirement that a shareholder report incorporated by reference into the SAI be delivered with the SAI has been added in Item 10(a)(iv).*

The Commission notes that section 19(a) of the Securities Act[29] and section 38(c) of the Investment Company Act[30] protect a fund from liability under these Acts for actions taken in good faith in conformity with any rule of the Commission. The amendments to Form N-1A are designed to provide better guidance to funds as to what information should be in the prospectus and the SAI to assist funds seeking to act in good faith in conformity with Form N-1A.[31]

6. Form N-1A Guidelines and Related Staff Positions

The Guidelines to current Form N-1A (the "Guides") were prepared by the Division and published by the Commission when it adopted the Form in 1983.[32] The Guides, which generally restate Division positions that may affect fund disclosure, were intended to assist funds in preparing and filing their registration statements. Additional Division positions on disclosure matters have been included from time to time in Generic Comment Letters prepared by the Division ("GCLs").[33] Although certain Guides have been revised and new ones added in connection with the adoption of various rules, the Guides collectively have not been reviewed since 1983. Certain Division positions in the Guides and GCLs have become outdated.[34] Other Guides and GCLs explain or restate legal requirements and may encourage generic disclosure about fund operations that does not appear to help investors evaluate and compare funds.[35] In addition, the presentation of information in 35 Guides and 7 GCLs is not organized in the most useful or effective manner.

To address these issues, Form N-1A, as amended, incorporates certain disclosure requirements from the Guides and GCLs. Other disclosure requirements in the Guides and the GCLs have not been incorporated in Form N-1A because, among other things, they are outdated or result in disclosure about technical, legal, and operational matters generally common to all funds. In addition, Form N-1A does not incorporate certain requirements calling for specific disclosure about certain types of fund investments because these requirements have tended to standardize disclosure about certain securities without regard to how a particular fund intends

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[29] *1415 U.S.C. 77q(a).*

[30] *15 U.S.C. 80a-38(c).*

[31] *See 1983 Form N-1A Adopting Release,* supra *note 12, at 37930.*

[32] *1983 Form N-1A Adopting Release,* supra *note 12, at 37938 (stating that publication of the Guides was not intended to elevate their status beyond that of staff guidance). The Commission initially adopted guidelines in 1972 to assist funds in preparing and filing registration statements. Investment Company Act Release Nos. 7220, 7221 (June 9, 1972) [37 FR 12790] ("Guides Releases").*

[33] *See 1993 GCL and 1994 GCL,* supra *note 25.*

[34] *See, e.g., Guide 9 (Short Sales) (a new interpretive position of the Commission's staff as to limits under the Investment Company Act on short sales entered into by funds was set out in Robertson Stephens Investment Trust (pub. avail. Aug. 24, 1995)); Guide 30 (Tax Consequences) (each series is now treated as a separate entity for tax purposes and may not, as suggested by the Guide, offset gains of one series against losses of another); 1990 GCL,* supra *note 25, at I.B (undertakings); 1991 GCL,* supra *note 25, at II.A.2 (country, international, and global funds); and 1992 GCL,* supra *note 25, at II.F (segregated accounts).*

[35] *See, e.g., Guides 8 (Senior Securities, Reverse Repurchase Agreements, Firm Commitment Agreements and Standby Commitment Agreements), 9 (Short Sales), 15 (Qualification for Treatment Under Subchapter M of the Intermal Revenue Code), and 28 (Valuation of Securities Being Offered); 1994 GCL,* supra *note 25, at III.C (redemption fees); and 1995 GCL,* supra *note 25, at II.A (MDFP disclosure).*

to use the securities in achieving its investment objectives. Generalized disclosure of this sort is inconsistent with the goal of the amendments to prospectus disclosure being adopted today to provide investors with information about how a particular fund's portfolio will be managed and elicit disclosure tailored to a fund's particular investment objectives and strategies.[36]

Information in the Guides and GCLs about legal requirements (including information about fund organization and operations), interpretive positions, and descriptions of filing procedures will be updated and reorganized in a new Investment Company Registration Guide ("Registration Guide").[37] The Commission has instructed the Division to make the Registration Guide available as soon as practicable. While the Commission believes that the Registration Guide will be a useful tool for funds in preparing their filings, Form N-1A, as amended, includes all of the requirements necessary for funds to prepare new or amend existing registration statements.[38]

B. Administration of Form N-1A

While generally praising the Proposed Amendments and their goals, some commenters voiced concern that, unless administered appropriately, Form N-1A, as amended, would not lead to more useful and understandable disclosure documents for fund investors. Some commenters argued that, over time, the Commission's staff has interpreted Form N-1A's existing requirements so narrowly as to prevent funds from adopting formats in which information could be effectively communicated to investors. Other commenters asserted that the Commission's staff, in interpreting the provisions of existing Form N-1A, has consistently required lengthy and complex disclosure that may discourage investors from reading fund prospectuses.[39]

The Commission acknowledges that so me interpretations relating to Form N-1A disclosure taken by the staff in the past have contributed to fund prospectuses becoming dense and less inviting to read by shareholders.[40] The Commission believes, however, that funds, their counsels and other advisors also have contributed to this result. In seeking to minimize

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[36] *See* supra *Section II.A.3.*

[37] *The Guides have not been republished with Form N-1A, as amended. Neither the Guides nor the GCLs will apply to registration statements prepared on the amended Form. The Commission also is rescinding the Guides Releases,* supra *note 209.*

[38] *The Registration Guide will address topics discussed in the GCLs relating to closed-end investment companies and unit investment trusts, and other matters not relevant to Form N-1A (e.g. proxy disclosure). Information traditionally addressed in the GCLs will be considered when the Registration Guide is updated, unless the nature of the information warrants immediate dissemination. The Registration guide will serve as a "small entity compliance guide," which the Commission is required to publish under the Small Business Regulatory Enforcement Fairness Act (5 U.S.C.S. 601 note (Supp. July 1996)).*

[39] *Several commenters referred to this aspect of staff disclosure interpretations as resulting in "disclosure creep." According to these commenters, the disclosure that proved problematic typically related to complex instruments in which some funds invested such as options, futures, and junk bonds. The commenters said that, in response to difficulties experienced by funds investing in these instruments, the staff often required all funds holding these instruments to amend their prospectuses to add lengthy and overly technical discussions of the instruments.*

[40] *See Levitt Article,* supra *note 5, at 37 ("We recognize that we share responsibility for the state of the modern prospectus. Our passion for full disclosure has resulted in fact-bloated reports, and prospectuses that are more redundant than revealing").*

potential liabilities under the federal securities laws, many funds appear to have made the use of clear formats and concise and understandable language in fund prospectuses only a secondary concern, at best. Funds also appear to have added material to their prospectuses not otherwise required by Form N-1A to facilitate marketing or other business objectives. The Commission firmly believes that achieving the goals underlying the amendments to Form N-1A being adopted today necessitates discipline on the part of the Commission and its staff, as well as on the part of funds and their advisors. In exercising discipline, all parties involved in the disclosure process should look not only to the Form N-1A disclosure requirements, as amended, but also to the disclosure principles reflected in the Form. The Commission has instructed its staff to adhere to those principles closely when providing comments on registration statements filed on Form N-1A and in interpreting provisions of the Form.[41] The Commission strongly encourages funds and their advisors to follow closely the principles in drafting language and designing formats for use in fund prospectuses.

Throughout the period during which the Form N-1A and profile initiatives were developed, the Commission staff worked with numerous fund groups to create innovative disclosure materials and new and improved prospectuses.[42] The results of these efforts have been commended by many as achieving a significant improvement over existing disclosure documents.[43] Many of the efforts were furthered by the willingness of the staff to interpret Commission disclosure requirements in a manner consistent with the goal of enabling funds to communicate more effectively to investors information essential in considering an investment in a fund.[44] The Commission's staff will continue to exercise this approach in interpreting the provisions of Form N-1A, as amended, and in reviewing fund filings under the revised disclosure requirements.[45]

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[41]*The Commission has also generally instructed the staff to avoid as much as possible using disclosure requirements as a means of regulating the conduct of funds, which are subject to extensive substantive regulation under the Investment Company Act.*

[42]*See, e.g., Levitt Article,* supra *note 5 (discussing various Commission initiatives to work with mutual funds and other corporate issuers to improve prospectus disclosure); Connors, Mutual Fund Prospectus Simplification: The Time Has Come, THE INVESTMENT LAWYER, Vol. 3, No. 8, Aug. 1997, at 14 (describing the Commission's role in the development of the simplified John Hancock prospectus).*

[43]*See, e.g., Dow Jones Newswires, State Street Rewrites Prospectuses to Help Ease Investors' Task, THE WALL STREET JOURNAL, Nov. 14, 1997, at 1B (commenting on State Street's new plain English prospectus); Kelley, John Hancock Builds a Better Mousetrap, MORNINGSTAR MUTUAL FUNDS, Sept. 13, 1996, at 52 (commenting on the improvements in John Hancock's new prospectus); McTague, Simply Beautiful: Shorn of Legalese, Even Prospectuses Make Sense, BARRON'S Oct. 7, 1996, at F10 (concerning the recent efforts of the John Hancock funds and other fund groups to simplify their prospectuses); Morcau, Prospectuses are Getting Easier to Read, INVESTOR'S BUSINESS DAILY, Dec. 15, 1997, at B1 (noting improvements in the prospectuses from Vanguard, State Street, Dreyfus, and other fund groups); Williamson, State Street Launches Redesigned Prospectus, PENSIONS & INVESTMENTS, Dec. 8, 1997,at 36 (commenting on State Street's simplified and redesigned prospectus); Zweig, Our 1997 Mutual Fund Awards: Picks, Pans and Some Tips Too, MONEY, Vol. 26, No. 13, 1997, at 35 (commending USAA and State Street for producing prospectuses in clear, simple English).*

[44]*See John Hancock Funds, Inc.,* supra *note 199; see also 1997 Profile Letter, 1996 Profile Letter, and 1995 Profile Letter,* supra *note 16; National Association for Variable Annuities (pub. avail. June 4, 1996); Fidelity Institutional Retirement Services Company, Inc. (pub. avail. Apr. 5, 1995).*

[45]*The Commission recognizes that, in interpreting these provisions, the staff will have to balance the goal of furthering the effective communication of information to investors with the goal of presenting prospectuses in formats designed to permit investors to compare the operations of one fund to those of other funds.*

C. Coordination with the NASD

As discussed in the Form N-1A Proposing Release, some rules of the NASD restrict the ability of NASD members to engage in various activities relating to funds unless certain disclosures are made in fund prospectuses.[46] NASD Conduct Rule 2830, for example, generally does not allow underwriters to pay compensation to broker-dealers for selling shares of a fund, unless the compensation arrangements are disclosed in the fund's prospectus.[47] Certain commenters expressed concern that these and other NASD prospectus disclosure requirements appear to be inconsistent with the Commission's broad initiatives to improve fund disclosure, and encouraged the Commission to coordinate its regulatory efforts with the NASD.

The Commission believes that it is of the utmost importance that all disclosure contained in fund prospectuses conforms to the principles of effective communication reflected in Form N-1A, as amended. The Commission has discussed these principles with the NASD staff, which has agreed to evaluate all of the NASD's existing requirements for consistency with these principles and to propose to the Commission that those rules be changed as necessary to achieve greater consistency. In addition, to the extent that it imposes prospectus disclosure requirements in the future, the NASD will seek to do so in accordance with the Commission's disclosure principles.[48]

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[46]*See Form N-1A Proposing Release,* supra *note 8, at 10916-17.*

[47]*See, e.g., rule 2830(l)(1)(C) of the NASD Conduct rules,* supra *note 37, at 4627 (prohibiting the offer, payment, or arrangement of "concessions" in connection with retail sales of investment company securities unless the arrangement is disclosed in the investment company's prospectus). The NASD has proposed to eliminate the provision in Conduct Rule 2830 that necessitates prospectus disclosure concerning these non-cash arrangements. See Securities Exchange Act Release No. 38993 (Sept. 5, 1997). Moreover, the NASD staff has assured the Commission's staff that the NASD staff will reconsider the appropriateness of requiring prospectus disclosure concerning cash compensation, in light of the Commission's Form N-1A initiatives. Id. at 47086. In addition, the NASD has proposed to eliminate certain prospectus disclosure concerning the effects of asset-based sales charges. See* supra *note 169.*

[48]*The Commission also encourages the NASD to follow as much as possible the disclosure principles underlying the Form N-1A in considering and proposing disclosure requirements under NASD rules that apply to fund advertisements.*

Relevant Portion of SEC Generic Comment Letters

1996 Comment IV.A—Filing Procedures

3. Cover Letters

Where appropriate, cover letters relating to a filing should be included as part of the electronic submission of the relevant filing. Cover letters provide information helpful to the review of the filing, including requests for selective review.[49] Cover letters always should include a typed letterhead, since letters that are "EDGARized" will not include the letterhead printed on firm or company stationery. Also, if they are not included in the letterhead, the name, address, and telephone number of the registrant's contact person(s) should be provided in the text of the letter. See Comment I.A. of the February 22, 1993 Letter to Registrants for other types of information that may be appropriately included in cover letters.

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6. Facing Sheets

Registrants are reminded to check the appropriate box(es) on the facing sheet of amendments filed under Rule 485 and to make sure that all submission and document header tags corresponding to those boxes are prepared correctly.

1994 Comment I.D—Information Provided in Transmittal Letter

The staff reminds registrants of its request made in the February 22, 1993 generic comment letter for certain information to facilitate the review of filings (viz., the 1940 Act and 1933 Act file numbers, the number and name of new series, which of the new series are money market funds, and of those, which are taxable and non-taxable). In addition to the information set forth in that letter, we request that the cover letter state if (1) the filing concerns a master/feeder arrangement, (2) the registrant or any series will be marketed through banks, savings and loan associations, or credit unions, and/or (3) the registrant's operations raise novel or complex issues of law or policy.

1993 Comment I.A—Information Provided in Transmittal Letters

Registrants shall include the following information in transmittal letters accompanying filings:

(i) for all filings: the Investment Company Act of 1940 file number assigned to the registered investment company making the filing (this will be a number with an 811-, 813-, or 814- prefix) and the Securities Act of 1933 file number (a number with a 2- or 33- prefix);

(ii) for filings introducing or adding new series: the number of new series included in the filing and the name of each;

[49] *Registrants should note that cover letters submitted under document type "COVER" and correspondence submitted under submission and/or document type "CORRESP" are treated as non-public and are not disseminated. See the EDGAR Filer Manual, Section E, paragraph 4.12 ("Non-Public and Confidential Information").*

(iii) for UIT pricing amendments filed under Rule 487: the number and name of each series included;

(iv) for open-end management investment companies: which of the new series are money market funds, and of those, which are taxable and non-taxable.

Provision of this information is voluntary. Registrants currently provide some of this information in transmittal letters. Providing this information on a standard basis will assist the staff significantly in reviewing filings and keeping track of investment company and series registrants.

Excerpt from IM Guidance Update No. 2016-06 (December 2016)—Mutual Fund Fee Structures

Selective Review

We encourage registrants to request a selective review of a filing that contains disclosure that is not substantially different from the disclosure contained in one or more prior filings by the Fund or other Funds in the complex. In particular, a request for selective review may be appropriate for the rule 485(a) filing of a Fund that first reflects a new share class or sales load variation that is expected to be introduced for other Funds in the complex. Any such request should be made in the cover letter accompanying the filing and should include: (i) a statement as to whether the disclosure in the filing has been reviewed by the staff in another context; (ii) a statement identifying prior filings that the registrant considers similar to, or intends as precedent for, the current filing; (iii) a summary of the material changes made in the current filing from the previous filings; and (iv) any specific areas that the registrant believes warrant particular attention. [Footnotes Omitted]

Securities Act Release No. 6510 (February 15, 1984). This Release sets forth new procedures for the selective review of investment company registration statements and post-effective amendments and new processing procedures for preliminary proxy solicitation materials filed by registered investment companies.

Under the new procedures, any registration statement filed by a fund in a complex for an offering that: (1) employs investment objectives, policies and techniques that are similar to a recent prior offering by another fund in that complex and (2) contains disclosure that is not substantially different than the disclosure contained in one or more prior filings by funds in the complex, generally, will be subject only to a cursory review by the staff to determine that the registration statement contains no other information that should be reviewed.

To facilitate this process, registrants should describe in their transmittal letters to the Commission: (1) any material changes from the most recent filing of the same kind by that fund complex, (2) any problem areas that in the registrant's view warrant particular attention, (3) any new investment techniques, products or methods of distribution covered by the filings, and (4) the identity of any prior filings, or portions thereof, that the registrant considers similar to, or intends as precedent for the current filing.

Each reviewing branch will designate one or more senior staff members to perform a cursory review of every filing subject to this procedure.

CONTENTS OF [ANNOTATED] FORM N-1A

GENERAL INSTRUCTIONS

A. Definitions

References to sections and rules in this Form N-1A are to the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq*.] (the "Investment Company Act"), unless otherwise indicated. Terms used in this Form N-1A have the same meaning as in the Investment Company Act or the related rules, unless otherwise indicated. As used in this Form N-1A, the terms set out below have the following meanings:

"Class" means a class of shares issued by a Multiple Class Fund that represents interests in the same portfolio of securities under rule 18f-3 [17 CFR 270.18f-3] or under an order exempting the Multiple Class Fund from sections 18(f), 18(g), and 18(i) [15 U.S.C. 80a-18(f), 18(g), and 18(i)].

"Exchange-Traded Fund" means a Fund or Class, the shares of which are listed and traded on a national securities exchange, and that has formed and operates under an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission.

"Fund" means the Registrant or a separate Series of the Registrant. When an item of Form N-1A specifically applies to a Registrant or a Series, those terms will be used.

"Market Price" refers to the last reported sale price at which Exchange-Traded Fund shares trade on the principal U.S. market on which the Fund's shares are traded during a regular trading session or, if it more accurately reflects the current market value of the Fund's shares at the time the Fund uses to calculate its net asset value, a price within the range of the highest bid and lowest offer on the principal U.S. market on which the Fund's shares are traded during a regular trading session.

"Master-Feeder Fund" means a two-tiered arrangement in which one or more Funds (each a "Feeder Fund") holds shares of a single Fund (the "Master Fund") in accordance with section 12(d)(1)(E) [15 U.S.C. 80a-12(d)(1)(E)].

"Money Market Fund" means a registered open-end management investment company, or series thereof, that is regulated as a money market fund pursuant to rule 2a-7 [17 CFR 270.2a-7] under the Investment Company Act of 1940.

"Multiple Class Fund" means a Fund that has more than one Class.

"Registrant" means an open-end management investment company registered under the Investment Company Act.

"SAI" means the Statement of Additional Information required by Part B of this Form.

"Securities Act" means the Securities Act of 1933 [15 U.S.C. 77a *et seq*.].

"Securities Exchange Act" means the Securities Exchange Act of 1934 [15 U.S.C. 78a *et seq*.].

"Series" means shares offered by a Registrant that represent undivided interests in a portfolio of investments and that are preferred over all other series of shares for assets specifically allocated to that series in accordance with rule 18f-2(a) [17 CFR 270.18f-2(a)].

B. Filing and Use of Form N-1A

1. What is Form N-1A used for?

Form N-1A is used by Funds, except insurance company separate accounts and small business investment companies licensed under the United States Small Business Administration, to file:

(a) An initial registration statement under the Investment Company Act and amendments to the registration statement, including amendments required by rule 8b-16 [17 CFR 270.8b-16];

(b) An initial registration statement under the Securities Act and amendments to the registration statement, including amendments required by section 10(a)(3) of the Securities Act [15 U.S.C. 77j(a)(3)]; or

(c) Any combination of the filings in paragraph (a) or (b).

2. What is included in the registration statement?

(a) For registration statements or amendments filed under both the Investment Company Act and the Securities Act or only under the Securities Act, include the facing sheet of the Form, Parts A, B, and C, and the required signatures.

(b) For registration statements or amendments filed only under the Investment Company Act, include the facing sheet of the Form, responses to all Items of Parts A (except Items 1, 2, 3, 4 and 13), B, and C (except Items 28(e) and (i)-(k)), and the required signatures.

3. What are the fees for Form N-1A?

No registration fees are required with the filing of Form N-1A to register as an investment company under the Investment Company Act or to register securities under the Securities Act. See section 24(f) [15 U.S.C. 80a-24(f)] and related rule 24f-2 [17 CFR 270.24f-2].

4. What rules apply to the filing of a registration statement on Form N-1A?

(a) For registration statements and amendments filed under both the Investment Company Act and the Securities Act or only under the Securities Act, the general rules regarding the filing of registration statements in Regulation C under the Securities Act [17 CFR 230.400 - 230.497] apply to the filing of Form N-1A. Specific requirements concerning Funds appear in rules 480-485 and 495-497 of Regulation C.

(b) For registration statements and amendments filed only under the Investment Company Act, the general provisions in rules 8b-1-8b-33 [17 CFR 270.8b-1 - 270.8b-33] apply to the filing of Form N-1A.

(c) The plain English requirements of rule 421 under the Securities Act [17 CFR 230.421] apply to prospectus disclosure in Part A of Form N-lA. The information required by Items 2 through 8 must be provided in plain English under rule 421(d) under the Securities Act.

(d) Regulation S-T [17 CFR 232.10 – 232.903] applies to all filings on the Commission's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR").

C. Preparation of the Registration Statement

1. Administration of the Form N-1A requirements:

(a) The requirements of Form N-1A are intended to promote effective communication between the Fund and prospective investors. A Fund's prospectus should clearly disclose the fundamental characteristics and investment risks of the Fund, using concise, straightforward, and easy to understand language. A Fund should use document design techniques that promote effective communication. The prospectus should emphasize the Fund's overall investment approach and strategy.

(b) The prospectus disclosure requirements in Form N-1A are intended to elicit information for an average or typical investor who may not be sophisticated in legal or financial matters. The prospectus should help investors to evaluate the risks of an investment and to decide whether to invest in a Fund by providing a balanced disclosure of positive and negative factors. Disclosure in the prospectus should be designed to assist an investor in comparing and contrasting the Fund with other funds.

(c) Responses to the Items in Form N-1A should be as simple and direct as reasonably possible and should include only as much information as is necessary to enable an average or typical investor to understand the particular characteristics of the Fund. The prospectus should avoid: including lengthy legal and technical discussions; simply restating legal or regulatory requirements to which Funds generally are subject; and disproportionately emphasizing possible investments or activities of the Fund that are not a significant part of the Fund's investment operations. Brevity is especially important in describing the practices or aspects of the Fund's operations that do not differ materially from those of other investment companies. Avoid excessive detail, technical or legal terminology, and complex language. Also avoid lengthy sentences and paragraphs that may make the prospectus difficult for many investors to understand and detract from its usefulness.

(d) The requirements for prospectuses included in Form N-1A will be administered by the Commission in a way that will allow variances in disclosure or presentation if appropriate for the circumstances involved while remaining consistent with the objectives of Form N-1A.

2. Form N-1A is divided into three parts:

(a) *Part A*. Part A includes the information required in a Fund's prospectus under section 10(a) of the Securities Act. The purpose of the prospectus is to provide essential information about the Fund in a way that will help investors to make informed decisions about whether to

purchase the Fund's shares described in the prospectus. In responding to the Items in Part A, avoid cross-references to the SAI or shareholder reports. Cross-references within the prospectus are most useful when their use assists investors in understanding the information presented and does not add complexity to the prospectus.

(b) *Part B.* Part B includes the information required in a Fund's SAI. The purpose of the SAI is to provide additional information about the Fund that the Commission has concluded is not necessary or appropriate in the public interest or for the protection of investors to be in the prospectus, but that some investors may find useful. Part B affords the Fund an opportunity to expand discussions of the matters described in the prospectus by including additional information that the Fund believes may be of interest to some investors. The Fund should not duplicate in the SAI information that is provided in the prospectus, unless necessary to make the SAI comprehensible as a document independent of the prospectus.

(c) *Part C.* Part C includes other information required in a Fund's registration statement.

3. Additional Matters:

(a) *Organization of Information.* Organize the information in the prospectus and SAI to make it easy for investors to understand. Notwithstanding rule 421(a) under the Securities Act regarding the order of information required in a prospectus, disclose the information required by Items 2 through 8 in numerical order at the front of the prospectus. Do not precede these Items with any other Item except the Cover Page (Item 1) or a table of contents meeting the requirements of rule 481(c) under the Securities Act. Information that is included in response to Items 2 through 8 need not be repeated elsewhere in the prospectus. Disclose the information required by Item 12 (Distribution Arrangements) in one place in the prospectus.

(b) *Other Information.* A Fund may include, except in response to Items 2 through 8, information in the prospectus or the SAI that is not otherwise required. For example, a Fund may include charts, graphs, or tables so long as the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of the information that is required to be included. Items 2 through 8 may not include disclosure other than that required or permitted by those Items.

(c) *Use of Form N-1A by More Than One Registrant Series, or Class.* Form N-l A may be used by one or more Registrants, Series, or Classes.

(i) When disclosure is provided for more than one Fund or Class, the disclosure should be presented in a format designed to communicate the information effectively. Except as required by paragraph (c)(ii) for Items 2 through 8, Funds may order or group the response to any Item in any manner that organizes the information into readable and comprehensible segments and is consistent with the intent of the prospectus to provide clear and concise information about the Funds or Classes. Funds are encouraged to use, as appropriate, tables, side-by-side comparisons, captions, bullet points, or other organizational techniques when presenting disclosure for multiple Funds or Classes.

(ii) Paragraph (a) requires Funds to disclose the information required by Items 2 through 8 in numerical order at the front of the prospectus and not to precede Items 2 through 8 with other information. Except as permitted by paragraph (c)(iii), a prospectus that contains information about more than one Fund must present all of the information required by Items 2 through 8 for each Fund sequentially and may not integrate the information for more than one Fund together. That is, a prospectus must present all of the information for a particular Fund that is required by Items 2 through 8 together, followed by all of the information for each additional Fund, and may not, for example, present all of the Item 2 (Risk/Return Summary: Investment Objectives/Goals) information for several Funds followed by all of the Item 3 (Risk/Return Summary: Fee Table) information for several Funds. If a prospectus contains information about multiple Funds, clearly identify the name of the relevant Fund at the beginning of the information for the Fund that is required by Items 2 through 8. A Multiple Class Fund may present the information required by Items 2 through 8 separately for each Class or may integrate the information for multiple Classes, although the order of the information must be as prescribed in Items 2 through 8. For example, the prospectus may present all of the Item 2 (Risk/Return Summary: Investment Objectives/Goals) information for several Classes followed by all of the Item 3 (Risk/Return Summary: Fee Table) information for the Classes, or may present Items 2 and 3 for each of several Classes sequentially. Other presentations of multiple Class information also would be acceptable if they are consistent with the Form's intent to disclose the information required by Items 2 through 8 in a standard order at the beginning of the prospectus. For a Multiple Class Fund, clearly identify the relevant Classes at the beginning of the Items 2 through 8 information for those Classes.

(iii) A prospectus that contains information about more than one Fund may integrate the information required by any of Items 6 through 8 for all of the Funds together, provided that the information contained in any Item that is integrated is identical for all Funds covered in the prospectus. If the information required by any of Items 6 through 8 is integrated pursuant to this paragraph, the integrated information should be presented immediately following the separate presentations of Item 2 through 8 information for individual Funds. In addition, include a statement containing the following information in each Fund's separate presentation of Item 2 through 8 information, in the location where the integrated information is omitted: "For important information about [purchase and sale of fund shares,] [tax information,] and [financial intermediary compensation], please turn to [identify section heading and page number of prospectus]."

(d) *Modified Prospectuses for Certain Funds.*

(i) A Fund may modify or omit, if inapplicable, the information required by Items 6, 11(b)-(d), and 12(a)(2)-(5) for funds used as investment options for:

(A) 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));

(B) a tax-deferred arrangement under sections 403(b) or 457 of the Internal Revenue Code (26 U.S.C. 403(b) and 457); and

(C) a variable contract as defined in section 817(d) of the Internal Revenue Code (26 U.S.C. 817(d)), if covered in a separate account prospectus.

(ii) A Fund that uses a modified prospectus under Instruction (d)(i) may:

(A) alter the legend required on the back cover page by Item 1(b)(1) to state, as applicable, that the prospectus is intended for use in connection with a defined contribution plan, tax-deferred arrangement, or variable contract; and

(B) modify other disclosure in the prospectus consistent with offering the Fund as a specific investment option for a defined contribution plan, tax-deferred arrangement, or variable contract.

(iii) A Fund may omit the information required by Items 4(b)(2)(iii)(B) and (C) and 4(b)(2)(iv) if the Fund's prospectus will be used exclusively to offer Fund shares as investment options for one or more of the following:

(A) 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)), a tax-deferred arrangement under section 403(b) or 457 of the Internal Revenue Code (26 U.S.C. 403(b) or 457), a variable contract as defined in section 817(d) of the Internal Revenue Code (26 U.S.C. 817(d)), or a similar plan or arrangement pursuant to which an investor is not taxed on his or her investment in the Fund until the investment is sold; or

(B) persons that are not subject to the federal income tax imposed under section 1 of the Internal Revenue Code (26 U.S.C. 1), or any successor to that section.

(iv) A Fund that omits information under Instruction (d)(iii) may alter the legend required on the back cover page by Item 1(b)(1) to state, as applicable, that the prospectus is intended for use in connection with a defined contribution plan, tax-deferred arrangement, variable contract, or similar plan or arrangement, or persons described in Instruction (d)(iii)(B).

(e) *Dates*. Rule 423 under the Securities Act [17 CFR 230.423] applies to the dates of the prospectus and the SAI. The SAI should be made available at the same time that the prospectus becomes available for purposes of rules 430 and 460 under the Securities Act [17 CFR 230.430 and 230.460].

(f) *Sales Literature*. A Fund may include sales literature in the prospectus so long as the amount of this information does not add substantial length to the prospectus and its placement does not obscure essential disclosure.

(g) *Interactive Data File*.

(i) An Interactive Data File (§ 232.11 of this chapter) is required to be submitted to the Commission and posted on the Fund's Web site, if any, in the manner provided by Rule 405 of Regulation S-T (§ 232.405 of this chapter) for any registration statement or post-effective amendment thereto on Form N-1A that includes or amends information provided in response to Items 2, 3, or 4. The Interactive Data File must be submitted as an amendment to the registration statement to which the Interactive Data File relates. The amendment must

be submitted after the registration statement or post-effective amendment that contains the related information becomes effective but not later than 15 business days after the effective date of that registration statement or post-effective amendment.

(ii) An Interactive Data File is required to be submitted to the Commission and posted on the Fund's Web site, if any, in the manner provided by Rule 405 of Regulation S-T for any form of prospectus filed pursuant to rule 497(c) or (e) under the Securities Act [17 CFR 230.497(c) or (e)] that includes information provided in response to Items 2, 3, or 4 that varies from the registration statement. The Interactive Data File may be submitted with or up to 15 business days subsequent to the filing made pursuant to rule 497.

(iii) An Interactive Data File is required to be posted on the Fund's Web site for as long as the registration statement or post-effective amendment to which the Interactive Data File relates remains current.

(iv) An Interactive Data File must be submitted as an exhibit to Form N-1A, under paragraph (i) of this Instruction, or as an exhibit to the filing made pursuant to rule 497, under paragraph (ii) of this Instruction. The Interactive Data File must be submitted in such a manner that will permit the information for each Series and, for any information that does not relate to all of the Classes in a filing, each Class of the Fund to be separately identified.

D. Incorporation by Reference

1. Specific rules for incorporation by reference in Form N-1A:

(a) A Fund may not incorporate by reference into a prospectus information that Part A of this Form requires to be included in a prospectus, except as specifically permitted by Part A of the Form.

(b) A Fund may incorporate by reference any or all of the SAI into the prospectus (but not to provide any information required by Part A to be included in the prospectus) without delivering the SAI with the prospectus.

(c) A Fund may incorporate by reference into the SAI or its response to Part C, information that Parts B and C require to be included in the Fund's registration statement.

2. General Requirements:

All incorporation by reference must comply with the requirements of this Form and the following rules on incorporation by reference: rule 10(d) of Regulation S-K under the Securities Act [17 CFR 229.10(d)] (general rules on incorporation by reference, which, among other things, prohibit, unless specifically required by this Form, incorporating by reference a document that includes incorporation by reference to another document, and limits incorporation to documents filed within the last 5 years, with certain exceptions); rule 411 under the Securities Act [17 CFR 230.411] (general rules on incorporation by reference in a prospectus); rule 303 of Regulation S-T [17 CFR 232.303] (specific requirements for electronically filed documents); and rules 0-4, 8b-23 and 8b-32 [17 CFR 270.0-4, 270.8b-23 and 270.8b-32] (additional rules on incorporation by reference for Funds).

ENHANCED DISCLOSURE AND NEW PROSPECTUS DELIVERY OPTION FOR REGISTERED OPEN-END MANAGEMENT INVESTMENT COMPANIES
(Release Nos. 33-8998; IC-28584; January 13, 2009)

1. General Instructions to Form N-1A

We are adopting, substantially as proposed, amendments to the General Instructions to Form N-1A to address the new summary section of the statutory prospectus. These amendments address plain English and organizational requirements.

Plain English

We are amending, as proposed, the General Instructions to state that the summary section of the prospectus must be provided in plain English under rule 421(d) under the Securities Act.[50] Rule 421(d) requires an issuer to use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors sections of its prospectus.[51] The amended instruction will serve as a reminder that the new prospectus summary section is subject to rule 421(d). The use of plain English principles in the new summary section will further our goal of encouraging its entirety, also will remain subject to the requirement that the information be presented in a clear, concise, and understandable manner.[52]

Organizational Requirements

We are also adopting amendments to the organizational requirements of the General Instructions, with one modification to address commenters' suggestions. The amendments will require mutual funds to disclose the summary information in numerical order at the front of the prospectus and not to precede this information with any information other than the cover page or table of contents.[53] Commenters generally supported standardizing the order and content of the summary section, agreeing that a standardized summary section will enhance investor understanding and the ability to compare funds.[54] Information included in the sum-

[50] *General Instruction B.4.(c) of Form N-1A; rule 421(d) [17 CFR 230.421(d)].*

Commenters generally supported the use of plain English in the summary section. See, e.g., AARP Letter, supra note 34; Letter of CFA Institute (Feb. 28, 2008) ("CFA Institute Letter"); Letter of Committee on Federal Regulation of Securities of the American Bar Association's Section of Business Law (Mar. 17, 2008) ("ABA Letter"); Letter of Investment Company Institute and Securities Industry and Financial Markets Association (Feb. 28, 2008) ("ICI and SIFMA Letter").

[51] *Rule 421(d) lists the following plain English principles: (1) short sentences; (2) definite, concrete, everyday words; (3) active voice; (4) tabular presentation or bullet lists for complex material, wherever possible; (5) no legal jargon or highly technical business terms; and (6) no multiple negatives.*

[52] *Pursuant to rule 421(b) [17 CFR 230.421(b)], the following standards must be used when preparing prospectuses: (1) present information in clear, concise sections, paragraphs, and sentences; (2) use descriptive headings and subheadings; (3) avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus; and (4) avoid legal and highly technical business terminology. We note that these standards provide funds with flexibility, for example, in determining whether or not to use headings in a question-and-answer format.*

[53] *General Instruction C.3.(a) to Form N-1A.*

[54] *See, e.g., Letter of Evergreen Investments (Feb. 28, 2008) ("Evergreen Letter"); Letter of Financial Services Institute (Feb. 28, 2008) ("Financial Services Institute Letter").*

mary section need not be repeated elsewhere in the prospectus. While a fund may continue to include information in the prospectus that is not required, a fund may not include any such additional information in the summary section of the prospectus.[55]

As noted above, we are, with one exception, requiring as proposed that a multiple fund prospectus present the summary information for each fund sequentially and not integrate the information for more than one fund.[56] That is, a multiple fund prospectus will be required to present all of the summary information for a particular fund together, followed by all of the summary information for each additional fund. For example, a multiple fund prospectus will not be permitted to present the investment objectives for several funds followed by the fee tables for several funds. A multiple fund prospectus will also be required to identify clearly the name of the particular fund at the beginning of the summary information for that fund.

Many commenters agreed that multiple fund prospectuses should present the summary information for each fund separately.[57] Some commenters stated that requiring a separate summary for each fund will better achieve the Commission's goal of keeping summaries short which should help facilitate comparisons across funds.[58] Commenters also stated that multiple fund prospectuses often confuse investors and make reviewing key information for a single fund more difficult.[59]

A number of commenters, however, expressed reservations about the Commission's proposal to prohibit multiple fund summary sections, requesting that the Commission permit integrated summaries for multiple funds in at least some circumstances.[60] Some commenters suggested that integrated summary information would allow investors to better compare all funds within a fund family, or at least certain categories of funds within a fund family.[61] Categories of funds cited included international funds, asset allocation funds, and U.S. Treasury Funds.[62] In addition, some commenters argued that prohibiting multiple fund summaries

[55] *General Instruction C.3.(b) of Form N-1A. See, e.g., CFA Institute Letter, supra note 37; Letter of Great-West Retirement Services (Feb. 28, 2008) ("Great-West Letter"); ICI Letter, supra note 34; Letter of The Vanguard Group, Inc. (Feb. 28, 2008) ("Vanguard Letter") (supporting prohibition on including information in the summary section that is not required).*

[56] *General Instruction C.3.(c)(ii) of Form N-1A. See supra note 36 and accompanying text.*

[57] *See, e.g., CFA Institute Letter, supra note 37; Letter of Coalition of Mutual Fund Investors (Feb. 13, 2008) ("CMFI Letter"); Fund Democracy et al. Letter, supra note 34; Evergreen Letter, supra note 41; MFDF Letter, supra note 34; Letter of the National Association of Personal Financial Advisors (Feb. 28, 2008) ("NAPFA Letter"); Letter of Oppenheimer Funds (Feb. 28, 2008) ("Oppenheimer Letter").*

[58] *See, e.g., Fund Democracy et al. Letter, supra note 34; Data Communiqué Letter, supra note 35. See also ICI Letter, supra note 34 (stating that some of its members believe that requiring a separate summary for each fund will better facilitate the Commission's goals of keeping documents short and facilitating comparisons across funds).*

[59] *See, e.g., Data Communiqué Letter, supra note 35; CMFI Letter, supra note 44; Oppenheimer Letter, supra note 44.*

[60] *See, e.g., Letter of AIM Investments (Feb. 27, 2008) ("AIM Letter") (favoring integrated summaries for target date, asset allocation or lifestyle funds, and variable annuity funds); Capital Research Letter, supra note 34 (favoring integrated summaries for target date and variable annuity funds).*

[61] *See, e.g., AIM Letter, supra note 47; Letter of American Century Investments (Feb. 28, 2008) ("American Century Letter"); Clarke Letter, supra note 35; ICI Letter, supra note 34; Letter of Putnam Investments (Feb. 28, 2008) ("Putnam Letter"); Letter of Russell Investments (Feb. 28, 2008) ("Russell Letter").*

[62] *See, e.g., Letter of T. Rowe Price Associates, Inc. (Feb. 28, 2008) ("T. Rowe Letter") (favoring integrated summaries for certain categories of funds and citing focus group research conducted by T. Rowe Price concerning integrated versus single-fund summaries).*

would lead to unnecessary duplication of information and longer statutory prospectuses.[63] A number of investors in our focus groups expressed the view that multiple fund presentations of mutual fund information could be helpful in facilitating useful comparisons among funds.[64] Some of these investors stated that multiple fund presentations could be used as a screening tool to determine which funds to research in more detail.[65] Some investors in our focus groups, however, indicated that combining too many funds within a single summary can result in confusing complexity.[66] The investors in our focus groups did not express a consensus on a specific limit on the number of funds or page length that would be appropriate in multiple fund presentations.

While we believe that multiple fund presentations can, in limited circumstances, be useful in helping investors to compare funds, we have determined that prohibiting multiple fund summary sections is more consistent with the goal of achieving concise, readable summaries for investors. The requirement that summary information be separately presented for each fund in a multiple fund prospectus is intended to address the problem of lengthy and complex multiple fund prospectuses in the least intrusive manner possible. Multiple fund prospectuses contribute substantially to prospectus length and complexity, which act as barriers to investor understanding. We have concluded that permitting information for multiple funds to be integrated in the summary section would undermine our goal of providing mutual fund investors with concise and readable key information.

We note, however, that our rules do not restrict in any way the use of multiple fund presentations in advertising and sales materials, whether those materials are provided along with the Summary Prospectus or separately.[67] Funds have complete flexibility to prepare and present comparative information to investors regarding any grouping of multiple funds that they believe is useful, and also to provide automated tools on their Web sites permitting investors to choose which funds to compare. As a result, we do not believe that the prohibition on multiple fund summaries in the statutory prospectus will impair in any significant manner funds' ability to provide useful, comparative information to investors.

We are adopting one exception to the requirement that multiple fund prospectuses not integrate the summary information for more than one fund in order to eliminate duplicative information and reduce prospectus length. Two commenters recommended that the Commission permit summary information that is identical for multiple funds to be presented once, at

[63] *See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; Letter of Dechert LLP (Mar. 3, 2008) ("Dechert Letter"); Putnam Letter, supra note 48; Russell Letter, supra note 48. See also ICI Letter, supra note 34 (members split, with some noting that an integrated summary may be more useful to investors in certain circumstances, in particular for groups of funds an investor may wish to compare, and others believing that a separate document for each fund would better accomplish goals of keeping the document short and facilitating comparisons across funds).*

[64] *See Focus Group Report, supra note 32, at 9.*

[65] *See Focus Group Transcripts, supra note 32, at 20.*

[66] *Id. at 19 ("I thought there were too many in the [multiple fund prospectus]. It just really makes your head spin when you have to read all that."), 22, 46.*

[67] *See rule 482 under the Securities Act [17 CFR 230.482] and rule 34b-1 under the Investment Company Act [17 CFR 270.34b-1] (investment company advertising rules).*

the end of all the individual summaries within a multiple fund statutory prospectus.[68] We agree with these commenters that permitting integration of information that is likely to be uniform for multiple funds will further our goal of concise, user-friendly summary sections. Therefore, a multiple fund prospectus will be permitted to integrate the information required by any of new Item 6 (purchase and sale of fund shares), Item 7 (tax information), and Item 8 (financial intermediary compensation) if it is identical for all funds covered in the prospectus.[69] This information is often uniform across multiple funds unlike, for example, information about investment objectives, costs, performance, or portfolio managers. If the information required by any of Items 6 through 8 is integrated, the integrated information will be required to immediately follow the separate individual fund summaries containing the other non-integrated information. In addition, a statement containing the following information will be required in each individual fund summary section in the location where the information that is integrated, and presented later, would have appeared.

> "For important information about [purchase and sale of fund shares,] [tax information,] and [financial intermediary compensation], please turn to [identify section heading and page number of prospectus]."

As proposed, the instructions will permit a fund with multiple share classes, each with its own cost structure, to present the summary information separately for each class, to integrate the information for multiple classes, or to use another presentation that is consistent with disclosing the summary information in a standard order at the beginning of the prospectus.[70] Commenters generally supported, or did not express a view with respect to, allowing multiple class summary sections; and some commenters noted that such sections would assist investors in choosing the class most appropriate for their circumstances.[71] We are not requiring the integration of information for multiple classes of a fund, which two commenters argued was important to facilitate cost comparisons.[72] We are retaining flexibility in this area because we believe that whether a multiple class presentation is helpful or overwhelming depends on the particular circumstances. We note, however, that our ongoing interactive data initiative is intended, among other things, to facilitate cost comparisons by investors across multiple classes of a single fund, as well as across different funds.[73]

Page Limits

As proposed, we are not imposing page limits on the summary section. We emphasize, however, that it is our intent that funds prepare a concise summary (on the order of three or four pages) that will provide key information. Commenters differed regarding whether the Commission should impose page limits on the summary.

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[68] *See Capital Research Letter, supra note 34; ICI Letter, supra note 34.*

[69] *General Instruction C.3.(c)(iii) of Form N-1A. This exception will not be available to Summary Prospectuses delivered pursuant to new rule 498 because a Summary Prospectus may describe only one fund. See discussion infra Part III.B.2.a.*

[70] *General Instruction C.3.(c)(ii) of Form N-1A.*

[71] *See, e.g., Clarke Letter, supra note 35; Data Communiqué Letter, supra note 35; Great-West Letter, supra note 42; Oppenheimer Letter, supra note 44.*

[72] *See, e.g., Fund Democracy et al. Letter, supra note 34; Letter of Brock Hastie (Jan. 8, 2008) ("Hastie Letter").*

[73] *See supra note 28 and accompanying text.*

Several commenters supported page limits. One commenter expressed concern that, in the absence of a page limit, the summary section would tend to expand over time, which would un dermine its usefulness.[74] Another commenter noted that, absent page limits, lengths of summary sections would vary widely, hindering investors' ability to compare funds.[75]

While we share these commenters' concerns, especially with respect to the possibility of summary sections getting longer over time, we believe that these concerns are outweighed by the concerns of other commenters that page limits could constrain appropriate disclosure and lead funds to omit material information.[76] We also agree with a commenter who noted that the prohibition of multiple fund summary sections should help to limit their length.[77]

Elimination of Separate Purchase and Redemption Document

As proposed, we are eliminating the provisions of Form N-1A that permit a fund to omit detailed information about purchase and redemption procedures from the prospectus and to provide this information in a separate document that is incorporated into and delivered with the prospectus, as well as a similar provision in the requirements for the statement of additional information ("SAI").[78] We have concluded that this option is unnecessary in light of the new Summary Prospectus which could be used, at a fund's option, along with any additional sales materials, including a document describing purchase and redemption procedures.[79] The elimination of these provisions does not otherwise alter the information about purchase and redemption procedures that must appear in the fund's prospectus and SAI, and this information will continue to be required in those documents.

Variable Contract and Retirement Plan Funds

Finally, we are modifying the proposal to permit funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit certain information required in the new summary section. This modification addresses commenters' concerns that certain information is not relevant to those funds.[80] Specifically, we are amending the General Instructions to Form N-1A to permit funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit the information required by new summary section Item 6 (purchase and sale of fund shares).[81]

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[74] *See Letter of Independent Directors Council (Feb. 15, 2008) ("IDC Letter").*

[75] *See Firehouse Letter, supra note 35. See also Letter of Jeffrey C. Keil (Jan. 9, 2008) ("Keil Letter") (suggesting that summaries might garner more investor attention if limited to two or three pages).*

[76] *See, e.g., Letter of Janus Capital Group (Feb. 28, 2008) ("Janus Letter"); CMFI Letter, supra note 44.*

[77] *See Data Communiqué Letter, supra note 35.*

[78] *Instruction 6 to current Item 1(b) of Form N-1A; current Item 6(g) of Form N-1A; Instruction to current Item 18(a) of Form N-1A.*

[79] *See discussion infra Part III.B.1. Most commenters did not address this proposed change. But see Clarke Letter, supra note 35 (supporting change); Schnase Letter, supra note 35 (opposing change).*

[80] *See Letter of EQ Advisors Trust/AXA Premier VIP Trust (Feb. 28, 2008) ("EQ/AXA Letter"); Letter of Committee of Annuity Insurers (Feb. 28, 2008) ("CAI Letter").*

[81] *General Instruction C.3.(d)(i) of Form N-1A.*

Existing Form N-1A permits funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit certain information regarding the purchase and sale of fund shares that is not relevant in these contexts.[82] The amendment we are making extends the same treatment to the purchase and sale information in the new summary section.

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4. Exchange-Traded Funds

c. Premium/Discount Information

For purposes of calculating premium/discount information, we are adopting, with a modification, the proposed definition of "market price." Commenters objected to our proposed definition of market price as the closing price because of stale pricing concerns. These commenters suggested that ETFs instead be permitted to use the mid-point between the highest bid and the lowest offer at the time the fund's NAV is calculated. To address these concerns, the final amendments define the term "market price" to mean the closing price on the principal market on which ETF shares trade or within the range between the highest offer and the lowest bid if that price more accurately reflects the current market value of the fund's shares at the time the Fund calculates its NAV.

Summary of Relevant Release

Investment Company Act Release-28617 (February 11, 2009)—Interactive Data for Mutual Fund Risk /Return Summary

Mutual funds must submit to the Commission a new exhibit with their risk/return summary information in interactive data format, beginning with initial registration statements, and post-effective amendments that are annual updates to effective registration statements that become effective after January 1, 2011. An interactive data file submitted with a registration statement must be filed as a post-effective amendment under rule 485(b) under the Securities Act and must be filed after effectiveness of the related filing, but no later than 15 business days after the effective date of the related filing. An interactive data file required to be submitted with a form of prospectus filed pursuant to rule 497(c) or (e) under the Securities Act may be submitted with the filing or subsequent thereto, but no later than 15 business days after the filing made pursuant to rule 497. A mutual fund required to provide risk/return summary information in interactive data format to the SEC also is required to post that information in interactive data format on its Web site not later than the end of the calendar day it submitted or was required to submit the interactive data exhibit to the Commission, whichever is earlier.

[82] *General Instruction C.3.(d)(i) of existing Form N-1A. We note that Item 7 of the summary section, which requires tax information that may not be relevant in the context of retirement plans and variable insurance contracts, expressly states that the disclosures are only required to be made, as applicable.*

If a mutual fund does not submit or post interactive data as required, the fund's ability to file post-effective amendments to its registration statement under rule 485(b) under the Securities Act will be automatically suspended until the fund submits and posts the interactive data as required. Mutual funds providing risk/return summary information in interactive data format are required to use the most recent list of tags released by XBRL U.S. as required by Regulation S-T and the EDGAR Filer Manual. Mutual funds are also required to tag a limited number of document and entity identifier elements such as the form type and the fund's name.

Relevant Portions of SEC Generic Comment Letters

1994 Comment I.C—Calculation of Automatic Effectiveness under Rules 485 and 488

Rule 485 provides for the automatic effectiveness of certain post-effective amendments on the "sixtieth day after the filing thereof" or on a later date designated by the registrant not later than "eighty days after the date on which the amendment is filed." Similarly, Rule 488 provides for automatic effectiveness of a registration statement filed on Form N-14 on the "thirtieth day after the date on which it is filed" or on a later date designated by the registrant not later than "fifty days after the date on which the registration statement is filed." The staff has observed some inconsistency in the manner of calculating the range of available dates for automatic effectiveness.

It is the staff's position that the first day after filing is the day following the day of filing, not the day of filing. Thus, for a post-effective amendment filed on November 1, sixty days after filing is December 31 (not December 30), and eighty days after the date of filing is January 20 (not January 19).

Similarly, for a Form N-14 filed on November 1, thirty days after filing is December 1 (not November 30) and fifty days after filing is December 21 (not December 20).

For any filings made after the date of this letter, registrants should not expect an automatic effective date earlier than that which is calculated in accordance with the position stated in this letter.

1993 Comment IV.C—Gun Jumping

Registrants, investment advisers, underwriters, and their respective directors, officers, employees, agents, and affiliates should exercise caution when discussing pending registration statements with representatives of the news media. The discussion of a new fund in interviews, in press conferences, or in speeches which are then reprinted, excerpted, quoted, or used in articles or broadcasts before the effective date of the fund's registration statement may constitute a "prospectus" under Section 2(10) of the 1933 Act that does not meet the requirements of Section 10 of the Act and thereby violates Section 5(b)(1). Such a violation is commonly referred to as "gun jumping". In such a case, acceleration of the effectiveness of the registration statement may be delayed and a "cooling off" period with a re-circulation of any preliminary prospectus may be required.

1993 Comment II.K—Experts

A company that provides general information about issuers, including investment companies, to the public and whose services are not procured by a particular fund to assign the fund a rating is not considered by the staff to be an "expert" under Section 7 of the 1933 Act. Accordingly, filings that refer to rankings provided by a company such as Morningstar, Inc. do not have to be accompanied by a written consent from the company.

When a ranking is used in the prospectus, Statement of Additional Information, or an advertisement, it should be accompanied by a statement that past performance is no guarantee of future results as well as a simple, brief explanation of the manner in which the ranking is calculated. The fund should disclose whether the ranking takes into account sales loads and other fees and charges. A ranking from whatever source should be current.

1990 Comment I.A—Updating the Registration Statement

Section 10(a)(3) of the 1933 Act provides for the annual updating of prospectuses. Rule 485 under the 1933 Act prescribes an updating process for open-end management companies and unit investment trusts. When a prospectus is used more than nine months after the effective date of the registration statement, the information contained in it must be as of a date not more than 16 months prior to use. If financial statements in a filing are as of a date 245 days or more prior to the date the filing is expected to become effective, updated financial statements must be furnished. (See Rule 3-18 of Regulation S-X.)

* * *

The staff will make every effort to provide timely comments on post-effective amendments filed under Rule 485(a). To assist the staff in its review of amendments, the registrant, in addition to providing a red-lined copy to highlight disclosure changes made from the most recently filed amendment, should enumerate in the transmittal letter the material changes which require the amendment to be filed under Rule 485(a).

The staff seeks to give comments within forty-five days after receipt of a post-effective amendment by the Commission. If the registrant has not received comments within forty-five days, it would be appropriate to contact the staff to ascertain the status of the filing.

To expedite the processing of post-effective amendments filed under Rule 485(a), the staff urges the registrant to use selective review procedures.[83] Based on the information available to the staff, the branch will determine the level of review. Registrants are reminded that requests for acceleration of effectiveness will be considered as an acknowledgment by the issuer of its statutory obligations under the federal securities laws to provide appropriate disclosure of material information.

[83] *Investment Company Release No. 13768 (February 15, 1984).*

Any post-effective amendment filed under paragraph (b) of Rule 485 must include, on the signature page, the appropriate certification of the registrant and, if counsel prepared or reviewed the post-effective amendment, counsel's representation that the post-effective amendment does not contain disclosure that would make it ineligible to become effective under that paragraph. The facing page should be marked to indicate that the filing is made under paragraph (b).... Of course, the registrant remains responsible for determining whether any changes to its registration statement warrant a post-effective amendment to be filed under paragraph (a) or (b) of Rule 485.

1990 Comment I.C—Effective Date and Request for Acceleration

Registrants are encouraged to adopt and implement internal control procedures which will provide for the timely delivery of post-effective amendments to the Commission so that amendments become effective automatically and the issuance of orders is avoided. The appropriate use by registrants of the automatic acceleration provision of Rule 485 has enabled the staff to focus its resources in areas other than the time consuming and less productive tasks of processing orders to declare amendments effective.

In accordance with Rule 461 of Regulation C under the 1933 Act, requests for acceleration of the effective date of a registration statement must be made in writing by both the registrant and the principal underwriter.

PART A: INFORMATION REQUIRED IN A PROSPECTUS

Item 1. Front and Back Cover Pages

(a) *Front Cover Page*. Include the following information, in plain English under rule 421(d) under the Securities Act, on the outside front cover page of the prospectus:

(1) The Fund's name and the Class or Classes, if any, to which the prospectus relates.

(2) The exchange ticker symbol of the Fund's shares or, if the prospectus relates to one or more Classes of the Fund's shares, adjacent to each such Class, the exchange ticker symbol of such Class of the Fund's shares. If the Fund is an Exchange-Traded Fund, also identify the principal U.S. market or markets on which the Fund shares are traded.

(3) The date of the prospectus.

(4) The statement required by rule 481(b)(1) under the Securities Act.

2013 Guidance Regarding Rule 481 from SEC Division of Investment Management Guidance Update No 2013-05 (August 2013)/ Disclosure and Compliance Matters for Investment Company Registrants that Invest in Commodity Interests

III. Legend Requirement

Rule 481 under the Securities Act requires a fund to provide a legend in plain English on the outside front cover page that indicates that the SEC has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure in the prospectus and that any contrary representation is a criminal offense.[84] Although rule 481 sets forth examples of language that may be used for the legend, the rule also permits funds to use other clear and concise language. As a result, the staff would not object if a fund that invests in commodity interests includes in the required plain English legend language that also indicates that the CFTC has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure in the prospectus.

Instruction. A Fund may include on the front cover page a statement of its investment objectives, a brief (e.g., one sentence) description of its operations, or any additional information, subject to the requirement set out in General Instruction C.3(b).

(b) *Back Cover Page*. Include the following information, in plain English under rule 421(d) under the Securities Act, on the outside back cover page of the prospectus:

(1) A statement that the SAI includes additional information about the Fund, and a statement to the following effect:

Additional information about the Fund's investments is available in the Fund's annual and semi-annual reports to shareholders. In the Fund's annual report, you will find a discussion of the market conditions and investment strategies that significantly affected the Fund's performance during its last fiscal year.

[84] *17 CFR 230.481.*

Explain that the SAI and the Fund's annual and semi-annual reports are available, without charge, upon request, and explain how shareholders in the Fund may make inquiries to the Fund. Provide a toll-free (or collect) telephone number for investors to call: to request the SAI; to request the Fund's annual report; to request the Fund's semi-annual report; to request other information about the Fund; and to make shareholder inquiries. Also, state whether the Fund makes available its SAI and annual and semi-annual reports, free of charge, on or through the Fund's Web site at a specified Internet address. If the Fund does not make its SAI and shareholder reports available in this manner, disclose the reasons why it does not do so (including, where applicable, that the Fund does not have an Internet Web site).

Instructions.

1. A Fund may indicate, if applicable, that the SAI, annual and semi-annual reports, and other information are available by email request.

2. A Fund may indicate, if applicable, that the SAI and other information are available from a financial intermediary (such as a broker-dealer or bank) through which shares of the Fund may be purchased or sold.

3. When a Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for the SAI, the annual report, or the semi-annual report, the Fund (or financial intermediary) must send the requested document within 3 business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

4. A Fund that has not yet been required to deliver an annual or semi-annual report to shareholders under rule 30e-1 [17 CFR 270.30e-1] may omit the statements required by this paragraph regarding the reports.

5. A Money Market Fund may omit the sentence indicating that a reader will find in the Fund's annual report a discussion of the market conditions and investment strategies that significantly affect the Fund's performance during its last fiscal year.

(2) A statement whether and from where information is incorporated by reference into the prospectus as permitted by General Instruction D. Unless the information is delivered with the prospectus, explain that the Fund will provide the information without charge, upon request (referring to the telephone number provided in response to paragraph (b)(1)).

Instruction. The Fund may combine the information about incorporation by reference with the statements required under paragraph (b)(1).

(3) A statement that information about the Fund (including the SAI) can be reviewed and copied at the Commission's Public Reference Room in Washington, D.C., and that information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-202-551-8090. State that reports and other information about the Fund are available on the EDGAR Database on the Commission's Internet site at http://www.sec.gov, and that copies of

this information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the Commission's Public Reference Section, Washington, D.C. 20549-1520.

(4) The Fund's Investment Company Act file number on the bottom of the back cover page in type size smaller than that generally used in the prospectus (*e.g.*, 8-point modern type).

Investment Company Names ICA Release No. IC-24828 Adopting Rule 35d-1 (January 17, 2001)

[Note footnotes omitted other than footnotes 26, 42 & 43 of Release]

Names Indicating an Investment Emphasis in Certain Investments or Industries

We are adopting, substantially as proposed, the requirement that an investment company with a name that suggests that the company focuses its investments in a particular type of investment (*e.g.*, the ABC Stock Fund or XYZ Bond Fund) or in investments in a particular industry (*e.g.*, the ABC Utilities Fund or the XYZ Health Care Fund) invest at least 80% of its assets in the type of investment suggested by the name. The 80% requirement will allow an investment company to maintain up to 20% of its assets in other investments. In the case of mutual funds, these assets, for example, could include cash and cash equivalents that could be used to meet redemption requests.

Names Indicating an Investment Emphasis in Certain Countries or Geographic Regions

We are modifying our proposal to require investment companies with names that suggest that they focus their investments in a particular country (*e.g.*, The ABC Japan Fund) or in a particular geographic region (*e.g.*, The XYZ Latin America Fund) to meet a two-part 80% investment requirement. Rule 35d-1, as adopted, requires that an investment company with a name that suggests that it focuses its investments in a particular country or geographic region adopt a policy to invest at least 80% of its assets in investments that are tied economically to the particular country or geographic region suggested by its name. The investment company also must disclose in its prospectus the specific criteria that are used to select investments that meet this standard.

The disclosure approach that we are adopting will allow an investment company the flexibility to invest in additional types of investments that are not addressed by the three proposed criteria, but expose the company's assets to the economic fortunes and risks of the country or geographic region indicated by its name.[85]

[85] *As adopted, the 80% investment requirement will be based on an investment company's net assets plus any borrowings for investment purposes. For example, an investment company may invest in a foreign stock index futures contract traded on a U.S. commodities exchange, which may not meet any of the three proposed criteria but could expose the investment company to the economic fortunes and risks of the geographic region covered by the index. We note, however, that if an investment company uses a criterion that requires qualifying investments to be in issuers that derive a specified proportion of their revenues or profits from goods produced or sold, investments made, or services performed in the applicable country or region, or that have a specified proportion of their assets in that country or region, the Division, consistent with its current position, would expect the proportion used to be at least 50%, in order for the investments to be deemed to be tied economically to the country or region.*

Tax-Exempt Investment Companies

We are adopting substantially as proposed the requirement that an investment company that uses a name suggesting that its distributions are exempt from federal income tax or from both federal and state income taxes adopt a fundamental policy: (i) to invest at least 80% of its assets in investments the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; or (ii) to invest its assets so that at least 80% of the income that it distributes will be exempt, as applicable, from federal income tax or from both federal and state income tax. Consistent with current Division positions, the requirements would apply to a company's investments or distributions that are exempt from federal income tax under both the regular tax rules and the alternative minimum tax rules.

Applying the 80% Investment Requirement

Time of application

The 80% investment requirement generally applies, as proposed, at the time when an investment company invests its assets.

Assets to which requirement applies

* * *

The use of net assets rather than total assets was intended to reflect more closely an investment company's portfolio investments. Commenters were generally supportive of the pro posed use of net assets. Several commenters, however, recommended that the 80% investment requirement be applied to net assets plus borrowings used for investment purposes, arguing that this modification would more closely track the Commission's stated objective of preventing an investment company from circumventing the 80% investment requirement by investing borrowed funds in investments that are not consistent with its name. The Commission agrees with these commenters, and has modified the proposal accordingly.

Temporary Departure from 80% Requirement

Consistent with current Division positions, the rule, as adopted, will require investment companies to comply with the 80% investment requirement "under normal circumstances." The "under normal circumstances" standard will provide funds with flexibility to manage their portfolios, while requiring that they would normally have to comply with the 80% investment requirement. This standard will permit investment companies to take "temporary defensive positions" to avoid losses in response to adverse market, economic, political, or other conditions. In addition, it will permit investment companies to depart from the 80% investment requirement in other limited, appropriate circumstances, particularly in the case of unusually large cash inflows or redemptions. For example, a new investment company will be permitted to comply with the 80% investment requirement within a reasonable time after

commencing operations. We remind investment companies, however, that in the Division's view, an investment company generally must not take in excess of six months to invest net proceeds in order to operate in accordance with its investment objectives and policies. In addition, we would generally expect new mutual funds, which typically invest in relatively liquid assets and which receive cash from share purchases on an ongoing basis, to be fully invested within a much shorter time. We emphasize that an investment company should not use a name subject to the rule unless it intends to, and does, comply with the 80% investment requirement absent unusual circumstances.

Names Suggesting Guarantee or Approval by the U.S. Government

Consistent with the requirements of section 35(a) of the Investment Company Act, rule 35d-1, as adopted, prohibits an investment company from using a name that suggests that the company or its shares are guaranteed or approved by the United States government or any United States government agency or instrumentality. The prohibited types of names include names that use the words "guaranteed" or "insured" or similar terms in conjunction with the words "United States" or "U.S. government."

Other Investment Company Names

General

Rule 35d-1, as adopted, does not codify positions of the Division of Investment Management with respect to investment company names including the terms "balanced," "index," "small, mid, or large capitalization," "international," and "global."[86] In addition, the rule does not apply to fund names that incorporate terms such as "growth" and "value" that con-

[86] *See Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 25, 1994) at II.D. (rescinded by N-1A Amendments, supra note 6, at 13940 n.214) ("small, medium, and large capitalization"); Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Jan. 17, 1992) at II.A. (rescinded by N-1A Amendments, supra note 6, at 13940 n.214) ("index"); Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Jan. 3, 1991) at II.A. (rescinded by N-1A Amendments, supra note 6, at 13940 n.214) ("international" and "global").*

The terms "small, mid, or large capitalization" and "index" suggest a focus on a particular type of investment, and investment companies that use these terms will be subject to the 80% investment requirement of the rule. The term "balanced," however, does not suggest a particular investment focus, but rather a particular type of diversification among different investments, and "balanced" funds will not be subject to the rule. The Division takes the position that an investment company that holds itself out as "balanced" should invest at least 25% of its assets in fixed income senior securities and should invest at least 25% of its assets in equities. Cf. Former Guide 4 in the N-1A Guidelines Release, supra note 6 (rescinded by N-1A Amendments, supra note 6, at 13940 n.214) (requiring an investment company that purports to be "balanced" to maintain at least 25 percent of the value of its assets in fixed income senior securities).

The term "foreign" indicates investments that are tied economically to countries outside the United States, and an investment company that uses this term would be subject to the 80% requirement. The terms "international" and "global," however, connote diversification among investments in a number of different countries throughout the world, and "international" and "global" funds will not be subject to the rule. We would expect, however, that investment companies using these terms in their names will invest their assets in investments that are tied economically to a number of countries throughout the world. See Proposing Release, supra note 7, at 10960 n.38 and accompanying text ("The Division no longer distinguishes the terms 'global' and 'international.'").

note types of investment strategies as opposed to types of investments.[87] The Division will continue to scrutinize investment company names not covered by the proposed rule. In determining whether a particular name is misleading, the Division will consider whether the name would lead a reasonable investor to conclude that the company invests in a manner that is inconsistent with the company's intended investments or the risks of those investments.

Names and Average Weighted Portfolio Maturity and Duration

Investment companies investing in debt obligations often seek to distinguish themselves by limiting the maturity of the instruments they hold. These investment companies may call themselves, for example, "short-term," "intermediate-term," or "long-term" bond or debt funds. Historically, the Division of Investment Management has required investment companies with these types of names to have average weighted portfolio maturities of specified lengths. In particular, the Division has required an investment company that included the words "short-term," "intermediate-term," or "long-term" in its name to have a dollar-weighted average maturity of, respectively, no more than 3 years, more than 3 years but less than 10 years, or more than 10 years. Although the Proposing Release stated that the Division did not intend to continue to use these criteria, the Division has re-evaluated this position in light of its subsequent experience and the comments received on the Proposing Release. The Division has concluded that it will continue to apply these maturity criteria to investment companies that call themselves "short-term," "intermediate-term," or "long-term" because they provide reasonable constraints on the use of those terms.

We note, however, that there may be instances where the average weighted maturity of an investment company's portfolio securities may not accurately reflect the sensitivity of the company's share prices to changes in interest rates. The Commission and the Division, therefore, do not intend compliance with the Division's maturity guidelines to act as a safe harbor in determining whether a name is misleading. In a case, for example, where an investment company's name was consistent with the Division's maturity guidelines, but the "duration" of the company's portfolio was inconsistent with the sensitivity to interest rates suggested by the company's name, the name may be misleading.

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[87] *As a general matter, an investment company may use any reasonable definition of the terms used in its name and should define the terms used in its name in discussing its investment objectives and strategies in the prospectus. See Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 25, 1994) at II.D (rescinded by N-1A Amendments, supra note 6, at 13940 n.214) (using this approach for investment companies that include the words "small, mid, or large capitalization" in their names).*

Division of Investment Management Guidance Update No. 2013-12- November 2013 | (selected portion)

Fund Names Suggesting Protection From Loss

In the staff's view, when a mutual fund or other investment company ("fund") uses a name that suggests safety or protection from loss, the name may contribute to investor misunderstanding of the risks associated with an investment in the fund and, in some circumstances, could be misleading. The staff encourages any fund that exposes investors to market, credit, or other risks, and whose name suggests safety or protection from loss, to reevaluate the name and to consider changing the name, as appropriate, to eliminate the potential for investor misunderstanding.

The staff has recently heightened its scrutiny of fund names suggesting safety or protection from loss and has determined to object to names that may create an impression of protection or safety or absence of risk of loss, where the name does not include qualifying language that defines the scope and limits of such protection. We believe that the terms "protected," "guaranteed," and similar terms, when used in a fund name without some additional qualification, may contribute to investor misunderstanding about the potential for loss associated with an investment in the fund. As a result, in the disclosure review process, the staff recently requested that some existing and new funds change their names. The staff took this action in response to an increase in the use of the term "protected" in fund names in situations where that term was used without a qualification that would adequately describe the nature and limits of any protection offered by the fund.

For example, some funds that seek to manage the fund's volatility by investing a portion of the fund's assets in cash, short-term fixed income instruments, short positions on exchange-traded futures, or other investments included the term "protected" in their name. The staff was concerned that these names could convey to investors a level of protection from loss that was not present because the degree to which a managed volatility strategy may succeed or fail is uncertain. In response to the staff's recently articulated concerns, some funds have chosen to replace the term "protected" with terms such as "managed risk."

The staff has also become concerned about the inclusion of the term "protected" in a fund's name in some cases where the fund has entered into a contract with a third party to make up a shortfall in the net asset value of the fund. In those cases, the protection may be limited in various ways, including by contractual limits on the amount of protection or the window of time during which the third party is obligated to make up any shortfall in the fund's net asset value, or by contractual provisions for termination of the third party's obligation in certain scenarios. In addition, an investor in the fund is subject to credit risk associated with the third party provider, which could become unable to fulfill its obligation under the contract. For these reasons, the staff believes that a fund that has entered into a contract with a third party to make up a shortfall in the net asset value of the fund should not use a term like "protected" in its name unless the name adequately communicates the limitations of the

"protection" provided by the third party. To date, the staff has not identified any fund names that use the term "protected" in these circumstances and that adequately communicate the limitations of the third party "protection."

The staff acknowledges that a fund's name, like any other piece of information about a fund, cannot tell the whole story about the fund.[88] We also acknowledge that the staff has recently requested name changes in situations in which a fund had provided prospectus disclosures that explained limitations on the scope of "protection" provided by the fund that were not revealed by the name itself. We have made these requests because we believe that, in practice, investors sometimes focus on a fund's name to determine the fund's investments and risks, either because the name sometimes appears without the clarifying prospectus disclosures (*e.g.*, in advertisements) or because of the prominence of a fund's name or for other reasons.[89] As a result, the staff believes that when a fund uses a name that suggests safety or protection from loss investors may conclude, at least in certain circumstances, that the fund offers greater protection from loss than is the case. Accordingly, we encourage investment advisers and funds' boards of directors to carefully evaluate any fund name that suggests safety or protection from loss and to consider whether a name change is appropriate to address any potential for investor misunderstanding.

Frequently Asked Questions about Rule 35d-1 (Investment Company Names) (12/4/2001) (Selected Portions)

The staff of the Division of Investment Management has prepared these responses to frequently asked questions about new rule 35d-1, which addresses certain broad categories of investment company names that are likely to mislead investors about an investment company's investments and risks. The adopting release for rule 35d-1 can be found at www.sec.gov/rules/final/ic-24828.htm.

These responses represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved this information.

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Tax-Exempt Funds

Question 3

Q: How does rule 35d-1 apply to single-state tax-exempt funds? Are single-state tax-exempt funds required to satisfy the 80% investment requirement only with securities of issuers located in the named state?

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[88] *Investment Company Act Release No. 24828, Section I (Jan. 17, 2001) [66 FR 8509, at 8509-10 (Feb. 1, 2001)].*

[89] *See S. Rep. No. 293, 104th Cong., 2d Sess. 9 (1996) (noting that when making an investment decision, investors may focus on fund names to determine the fund's investment objective and level of risk).*

A: A fund with a name that suggests that its distributions are exempt from both federal and state income tax, *e.g.*, the Maryland Tax-Exempt Fund, must have a fundamental policy to invest, under normal circumstances, either: (i) at least 80% of the value of its assets in investments the income from which is exempt from both federal income tax and the income tax of the named state, or (ii) its assets so that at least 80% of the income that it distributes will be exempt from both federal income tax and the income tax of the named state. A single-state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state.

Single state tax-exempt funds are not subject to section (a)(3) of the rule (relating to funds with names that suggest investment in a specific country or geographic region).

Question 4

Q: Are funds with the term "municipal" in their names treated like tax-exempt funds under rule 35d-1(a)(4)?

A: Yes. The terms "municipal" and "municipal bond" in a fund's name suggest that the fund's distributions are exempt from income tax. Therefore, funds that use these terms in their names would be expected to comply with rule 35d-1(a)(4). However, funds that use the term "municipal" rather than "tax-exempt" may count securities that generate income subject to the alternative minimum tax toward the 80% investment requirement, while funds that use the term "tax-exempt" may not.

Question 5

Q: The SEC recently adopted rules that require a mutual fund to include standardized after-tax returns in advertisements and sales literature that include any quotation of performance and that represent or imply that the fund is managed to limit or control the effect of taxes on fund performance. Advertisements and sales literature for a fund that is eligible to use a name suggesting that its distributions are exempt from federal income tax or both federal and state income tax under rule 35d-1 are not, however, required to include standardized after-tax returns, unless they voluntarily choose to include after-tax performance information. All fund advertisements and sales literature are required to comply with the new after-tax return rules no later than December 1, 2001, but compliance with rule 35d-1 is not required until July 31, 2002. Prior to July 31, 2002, must a fund that relies on the exception for tax-exempt funds from the requirement to report standardized after-tax returns in advertising and sales literature meet the requirements of rule 35d-1(a)(4)?

A: Generally, yes. Rule 35d-1 was effective on March 31, 2001. Although funds are not required to comply with rule 35d-1 until July 31, 2002, any fund that relies on the exception for tax-exempt funds from the after-tax return advertising rule at any time must comply with

the eligibility requirements under rule 35d-1(a)(4) for using a name suggesting that the fund's distributions are exempt from federal income tax or from both federal and state income tax. As a practical matter, this means that, prior to July 31, 2002, in order to rely on the exception for tax-exempt funds from the after-tax return advertising rule, a tax-exempt fund, including a single state tax-exempt fund, need only comply with the eligibility requirements under rule 35d-1(a)(4) for using a name suggesting that the fund's distributions are exempt from federal income tax. The requirements set forth in rule 35d-1(a)(4) for a fund that has a name suggesting that its distributions are exempt from federal income tax are generally the same as those currently applied by the Division of Investment Management.

Specific Terms Commonly Used in Fund Names

Question 6

Q: Does rule 35d-1 apply to funds that use the terms "small-cap," "mid-cap," and "large-cap?"

A: Yes. Terms such as "small-, mid-, or large-capitalization" suggest a focus on a particular type of investment, and investment companies that use these terms will be subject to the 80% investment requirement of the rule. As a general matter, an investment company may use any reasonable definition of these terms and should define these terms in its discussion of its investment objectives and strategies in its prospectus. In developing a definition of the terms "small-, mid-, or large-capitalization," registrants should consider all pertinent references, including, for example, industry indices, classifications used by mutual fund rating organizations, and definitions used in financial publications. Definitions and disclosure inconsistent with common usage, including definitions relying solely on average capitalization, are considered inappropriate by the staff.

Question 7

Q: How does rule 35d-1 apply to a fund that uses the term "high-yield" in its name?

A: The term "high-yield" is generally understood in the financial and investment community to describe corporate bonds that are below investment grade, commonly defined as bonds receiving a Standard & Poor's rating below BBB or a Moody's rating below Baa. Therefore, a fund using the term "high-yield" in its name generally must have a policy to invest at least 80% of its assets in bonds that are below investment grade.

However, a fund that uses the term "high-yield" in conjunction with a term such as "municipal" or "tax-exempt" that suggests that the fund invests in tax-exempt bonds would not be required to invest at least 80% of its assets in bonds that meet these rating criteria. Because the market for below investment grade municipal bonds is smaller and relatively less liquid than its taxable counterpart, tax-free high-yield bond funds have historically invested to a greater degree in higher grade bonds than taxable high-yield funds. As a result, the use of

the term "high-yield" together with a term suggesting that the fund invests in tax-exempt bonds suggests that the fund has an investment strategy of pursuing a higher yield than other municipal or tax-exempt bond funds.

Question 8

Q: Does rule 35d-1 apply to a fund that uses the term "tax-sensitive" in its name?

A: No. The term "tax-sensitive" connotes a type of investment strategy rather than a focus on a particular type of investment. Therefore, use of the term "tax-sensitive" in a fund's name will not require the fund to comply with the 80% investment requirement of rule 35d-1.

We remind funds, however, that a particular fund name may be misleading under the anti-fraud provisions of the federal securities laws, even if it is not covered by rule 35d-1. In determining whether a particular name is misleading, the Division considers whether the name would lead a reasonable investor to conclude that the fund invests in a manner that is inconsistent with the fund's intended investments or the risks of those investments.

Question 9

Q: How does rule 35d-1 apply to a fund that uses the term "income" in its name?

A: Rule 35d-1 would not apply to the use of the term "income" where that term suggests an investment objective or strategy rather than a type of investment. When used by itself, the term "income" in a fund's name generally suggests that the fund emphasizes the achievement of current income and does not suggest a type of investment. For example, fund companies offering a group of "life cycle" funds, each of which invests in stocks, bonds, and cash in a ratio considered appropriate for investors with a particular age and risk tolerance, sometimes use the term "income" to describe the fund that places the greatest emphasis on achieving current income. Similarly, the term "growth and income" does not suggest that a fund focuses its investments in a particular type of investment, but rather suggests that a fund invests its assets in order to achieve both growth of capital and current income. Likewise, the term "equity income" suggests that a fund focuses its investments in equities and has an investment objective or strategy of achieving current income. By contrast, a term such as "fixed income" suggests investment in a particular type of investment and would be covered by rule 35d-1.

Question 10

Q: How does rule 35d-1 apply to a fund with a name that includes the term "global" or "international," followed by a term that suggests a particular type of investment, such as "fixed income?"

A: The terms "international" and "global" connote diversification among investments in a number of different countries throughout the world, and therefore the use of these terms

in a fund name is not subject to the rule. However, a fund that has a name containing both the term "global" or "international," and a term that suggests that the fund focuses its investments in a particular type of investment, *e.g.,* "fixed income," will be expected to comply with the 80% investment requirement with respect to the latter term.

Question 11

Q: Would rule 35d-1 require a fund that uses a term such as "intermediate term bond" in its name to invest at least 80% of its assets in intermediate term bonds?

A: No. The Division takes the position that a "short-term," "intermediate-term," or "long-term" bond fund should have a dollar-weighted average maturity of, respectively, no more than 3 years, more than 3 years but less than 10 years, or more than 10 years. Such a fund should, however, invest at least 80% of its assets in bonds in order to comply with rule 35d-1. Compliance with the Division's maturity guidelines is not intended to act as a safe harbor in determining whether a name is misleading. There may be instances where the dollar-weighted average maturity of a fund's portfolio securities may not accurately reflect the sensitivity of the fund's share price to changes in interest rates.

Question 12

Q: Are there any guidelines for a bond fund's use of a name that suggests that its portfolio has a specified duration, *e.g.,* "short-duration bond fund?"

A: The Division has not developed specific guidelines regarding a fund's use of a name, *e.g.,* "short-duration bond fund," suggesting that its bond portfolio has a particular duration. A fund that uses a name suggesting that its bond portfolio has a particular duration, *e.g.,* short, intermediate, or long, may use any reasonable definition of the terms used, and should explain its definition in its discussion of its investment objectives and strategies in the fund's prospectus. In developing a definition of a term that suggests a particular portfolio duration, registrants should consider all pertinent references, including, for example, classifications used by mutual fund rating organizations, definitions used in financial publications, and industry indices. Definitions and disclosure inconsistent with common usage are considered inappropriate by the staff. A fund that uses a name suggesting that its bond portfolio has a particular duration is not required to invest at least 80% of its assets in bonds of that duration.

Question 13

Q: A fund that uses the term "money market" in its name must invest solely in eligible securities and meet other investment requirements under rule 2a-7, in order for its name not to be deemed materially deceptive or misleading within the meaning of Section 35(d) of the Investment Company Act. Is a fund that uses the term "money market" in its name also required to comply with rule 35d-1?

A: Rule 35d-1 would require a fund using the term "money market" in its name to adopt a policy to invest at least 80% of its assets in the type of money market instruments suggested by its name. For example, a fund calling itself "The XYZ U.S. Treasury Money Market Fund" would be required to adopt a policy to invest at least 80% of its assets in U.S. Treasury securities. However, a generic money market fund, i.e., a money market fund that has a name suggesting that it invests in money market instruments generally (*e.g.,* "The XYZ Money Market Fund"), would not be required to specifically adopt a policy to invest at least 80% of its assets in eligible securities since rule 2a-7, in any event, requires the fund to invest solely in eligible securities.

Item 2. Risk/Return Summary: Investment Objectives/Goals

Disclose the Fund's investment objectives or goals. A Fund also may identify its type or category (*e.g.*, that it is a Money Market Fund or a balanced fund).

Item 3. Risk/Return Summary: Fee Table

Include the following information, in plain English under rule 421(d) under the Securities Act, after Item 2:

Fees and Expenses of the Fund

This table describes the fees and expenses that you may pay if you buy and hold shares of the Fund. You may qualify for sales charge discounts if you and your family invest, or agree to invest in the future, at least $[_____] in [name of fund family] funds. More information about these and other discounts is available from your financial professional and in [identify section heading and page number] of the Fund's prospectus and [identify section heading and page number] of the Fund's statement of additional information.

Shareholder Fees (fees paid directly from your investment)

Maximum Sales Charge (Load) Imposed on Purchases (as a percentage of offering price)	_____%
Maximum Deferred Sales Charge (Load) (as a percentage of__)	_____%
Maximum Sales Charge (Load) Imposed on Reinvested Dividends [and other Distributions] (as a percentage of__)	_____%
Redemption Fee (as a percentage of amount redeemed, if applicable)	_____%
Exchange Fee	_____%
Maximum Account Fee	_____%

Annual Fund Operating Expenses (expenses that you pay each year as a percentage of the value of your investment)

Management Fees	_____%
Distribution [and/or Service] (12b-1) Fees	_____%
Other Expenses	_____%
_____	_____%
_____	_____%
_____	_____%
Total Annual Fund Operating Expenses	_____%

Example

This Example is intended to help you compare the cost of investing in the Fund with the cost of investing in other mutual funds.

The Example assumes that you invest $10,000 in the Fund for the time periods indicated and then redeem all of your shares at the end of those periods. The Example also assumes that your investment has a 5% return each year and that the Fund's operating expenses remain the same. Although your actual costs may be higher or lower, based on these assumptions your costs would be:

1 year	3 years	5 years	10 years
$_____	$_____	$_____	$_____

You would pay the following expenses if you did not redeem your shares:

1 year	3 years	5 years	10 years
$_____	$_____	$_____	$_____

The Example does not reflect sales charges (loads) on reinvested dividends [and other distributions]. If these sales charges (loads) were included, your costs would be higher.

Portfolio Turnover

The Fund pays transaction costs, such as commissions, when it buys and sells securities (or "turns over" its portfolio). A higher portfolio turnover rate may indicate higher transaction costs and may result in higher taxes when Fund shares are held in a taxable account. These costs, which are not reflected in annual fund operating expenses or in the example, affect the Fund's performance. During the most recent fiscal year, the Fund's portfolio turnover rate was __% of the average value of its portfolio.

Instructions.

1. General.

(a) Round all dollar figures to the nearest dollar and all percentages to the nearest hundredth of one percent.

(b) Include the narrative explanations in the order indicated. A Fund may modify the narrative explanations if the explanation contains comparable information to that shown. The narrative explanation regarding sales charge discounts is only required by a Fund that offers such discounts and should specify the minimum level of investment required to qualify for a discount as disclosed in the table required by Item 12(a)(1).

(c) Include the caption "Maximum Account Fees" only if the Fund charges these fees. A Fund may omit other captions if the Fund does not charge the fees or expenses covered by the captions.

(d)(i) If the Fund is a Feeder Fund, reflect the aggregate expenses of the Feeder Fund and the Master Fund in a single fee table using the captions provided. In a footnote to the fee table, state that the table and Example reflect the expenses of both the Feeder and Master Funds.

(ii) If the prospectus offers more than one Class of a Multiple Class Fund or more than one Feeder Fund that invests in the same Master Fund, provide a separate response for each Class or Feeder Fund.

(e) If the Fund is an Exchange-Traded Fund,

(i) Modify the narrative explanation to state that investors may pay brokerage commissions on their purchases and sales of Exchange-Traded Fund shares, which are not reflected in the example; and

(ii) If the Fund issues or redeems shares in creation units of not less than 25,000 shares each, exclude any fees charged for the purchase and redemption of the Fund's creation units.

2. Shareholder Fees.

(a)(i) "Maximum Deferred Sales Charge (Load)" includes the maximum total deferred sales charge (load) payable upon redemption, in installments, or both, expressed as a percentage of the amount or amounts stated in response to Item 12(a), except that, for a sales charge (load) based on net asset value at the time of purchase, show the sales charge (load) as a percentage of the offering price at the time of purchase. A Fund may include in a footnote to the table, if applicable, a tabular presentation showing the amount of deferred sales charges (loads) over time or a narrative explanation of the sales charges (loads) (*e.g.*, __% in the first year after purchase, declining to __% in the ____year and eliminated thereafter).

(ii) If more than one type of sales charge (load) is imposed (*e.g.*, a deferred sales charge (load) and a front-end sales charge (load)), the first caption in the table should read "Maximum Sales Charge (Load)" and show the maximum cumulative percentage. Show the percentage amounts and the terms of each sales charge (load) comprising that figure on separate lines below.

(iii) If a sales charge (load) is imposed on shares purchased with reinvested capital gains distributions or returns of capital, include the bracketed words in the third caption.

(b) "Redemption Fee" includes a fee charged for any redemption of the Fund's shares, but does not include a deferred sales charge (load) imposed upon redemption, and, if the Fund is a Money Market Fund, does not include a liquidity fee imposed upon the sale of Fund shares in accordance with rule 2a-7(c)(2).

(c) "Exchange Fee" includes the maximum fee charged for any exchange or transfer of interest from the Fund to another fund. The Fund may include in a footnote to the table, if applicable, a tabular presentation of the range of exchange fees or a narrative explanation of the fees.

(d) "Maximum Account Fees." Disclose account fees that may be charged to a typical investor in the Fund; fees that apply to only a limited number of shareholders based on their particular circumstances need not be disclosed. Include a caption describing the maximum account fee (*e.g.*, "Maximum Account Maintenance Fee" or "Maximum Cash Management Fee). State the maximum annual account fee as either a fixed dollar amount or a percentage of assets. Include in a parenthetical to the caption the basis on which any percentage is calculated. If an account fee is charged only to accounts that do not meet a certain threshold (*e.g.*, accounts under $5,000), the Fund may include the threshold in a parenthetical to the caption or footnote to the table. The Fund may include an explanation of any non-recurring account fee in a parenthetical to the caption or in a footnote to the table.

3. Annual Fund Operating Expenses.

(a) "Management Fees" include investment advisory fees (including any fees based on the Fund's performance), any other management fees payable to the investment adviser or its affiliates, and administrative fees payable to the investment adviser or its affiliates that are not included as "Other Expenses."

(b) "Distribution [and/or Service] (12b-1) Fees" include all distribution or other expenses incurred during the most recent fiscal year under a plan adopted pursuant to rule 12b-1. [17 CFR 270.12b-1] Under an appropriate caption or a subcaption of "Other Expenses," disclose the amount of any distribution or similar expenses deducted from the Fund's assets other than pursuant to a rule 12b-1 plan.

(c)(i) "Other Expenses" include all expenses not otherwise disclosed in the table that are deducted from the Fund's assets or charged to all shareholder accounts. The amount of expenses deducted from the Fund's assets are the amounts shown as expenses in the Fund's statement of operations (including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X [17 CFR 210.6-07]).

(ii) "Other Expenses" do not include extraordinary expenses as determined under generally accepted accounting principles (see FASB ASC Subtopic 225-20, Income Statement-Extraordinary and Unusual Items). If extraordinary expenses were incurred that materially affected the Fund's "Other Expenses," disclose in a footnote to the table what "Other Expenses" would have been had the extraordinary expenses been included.

(iii) The Fund may subdivide this caption into no more than three subcaptions that identify the largest expense or expenses comprising "Other Expenses," but must include a total of all "Other Expenses." Alternatively, the Fund may include the components of "Other Expenses" in a parenthetical to the caption.

(d)(i) Base the percentages of "Annual Fund Operating Expenses" on amounts incurred during the Fund's most recent fiscal year, but include in expenses amounts that would have been incurred absent expense reimbursement or fee waiver arrangements. If the Fund has changed its fiscal year and, as a result, the most recent fiscal year is less than three months, use the fiscal year prior to the most recent fiscal year as the basis for determining "Annual Fund Operating Expenses."

(ii) If there have been any changes in "Annual Fund Operating Expenses" that would materially affect the information disclosed in the table:

(A) Restate the expense information using the current fees as if they had been in effect during the previous fiscal year; and

(B) In a footnote to the table, disclose that the expense information in the table has been restated to reflect current fees.

(iii) A change in "Annual Fund Operating Expenses" means either an increase or a decrease in expenses that occurred during the most recent fiscal year or that is expected to occur during the current fiscal year. A change in "Annual Fund Operating Expenses" does not include a decrease in operating expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in the Fund's assets.

(e) If there are expense reimbursement or fee waiver arrangements that will reduce any Fund operating expenses for no less than one year from the effective date of the Fund's registration statement, a Fund may add two captions to the table: one caption showing the amount of the expense reimbursement or fee waiver, and a second caption showing the Fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. The Fund should place these additional captions directly below the "Total Annual Fund Operating Expenses" caption of the table and should use appropriate descriptive captions, such as "Fee Waiver [and/or Expense Reimbursement]" and "Total Annual Fund Operating Expenses After Fee Waiver [and/or Expense Reimbursement]," respectively. If the Fund provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, including the expected termination date, and briefly describe who can terminate the arrangement and under what circumstances.

(f)(i) If the Fund (unless it is a Feeder Fund) invests in shares of one or more Acquired Funds, add a subcaption to the "Annual Fund Operating Expenses" portion of the table directly above the subcaption titled "Total Annual Fund Operating Expenses." Title the additional subcaption: "Acquired Fund Fees and Expenses." Disclose in the subcaption fees and expenses incurred indirectly by the Fund as a result of investment in shares of one or more Acquired Funds. For purposes of this item, an "Acquired Fund" means any company in which the Fund invests or has invested during the relevant fiscal period that (A) is an investment company or (B) would be an investment company under section 3(a) of the Investment Company Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the Investment Company Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)). If a Fund uses another term in response to other requirements of this Form to refer to Acquired Funds, it may include that term in parentheses following the subcaption title. In the event the fees and expenses incurred indirectly by the Fund as a result of investment in shares of one or more Acquired Funds do not exceed 0.01 percent (one basis point) of average net assets of the Fund, the Fund may include these fees and expenses under the subcaption "Other Expenses" in lieu of this disclosure requirement.

(ii) Determine the "Acquired Fund Fees and Expenses" according to the following formula:

$$AFFE = \frac{[(F_1/FY)*AI_1*D_1] + [(F_2/FY)*AI_2*D_2] + [(F_3/FY)*AI_3*D_3] + \text{Transaction Fees} + \text{Incentive Allocations}}{\text{Average Net Assets of the Registrant}}$$

Where:

AFFE = Acquired Fund fees and expenses;

F_1, F_2, F_3, . . . = Total annual operating expense ratio for each Acquired Fund;

FY = Number of days in the relevant fiscal year;

AI_1, AI_2, AI_3, . . = Average invested balance in each Acquired Fund;

D_1, D_2, D_3, . . . = Number of days invested in each Acquired Fund;

"Transaction Fees" = The total amount of sales loads, redemption fees, or other transaction fees paid by the Fund in connection with acquiring or disposing of shares in any Acquired Funds during the most recent fiscal year.

"Incentive Allocations" = Any allocation of capital from the Acquiring Fund to the adviser of the Acquired Fund (or its affiliate) based on a percentage of the Acquiring Fund's income, capital gains and/or appreciation in the Acquired Fund.

(iii) Calculate the average net assets of the Fund for the most recent fiscal year, as provided in Item 13(a) (see Instruction 4 to Item 13(a)).

(iv) The total annual operating expense ratio used for purposes of this calculation (F1) is the annualized ratio of operating expenses to average net assets for the Acquired Fund's most recent fiscal period as disclosed in the Acquired Fund's most recent shareholder report. If the ratio of expenses to average net assets is not included in the most recent shareholder report or the Acquired Fund is a newly formed fund that has not provided a shareholder report, then the ratio of expenses to average net assets of the Acquired Fund is the ratio of total annual operating expenses to average annual net assets of the Acquired Fund for its most recent fiscal period as disclosed in the most recent communication from the Acquired Fund to the Fund. For purposes of this Instruction: (i) Acquired Fund expenses include increases resulting from brokerage service and expense offset arrangements and reductions resulting from fee waivers or reimbursements by the Acquired Funds' investment advisers or sponsors; and (ii) Acquired Fund expenses do not include expenses (i.e., performance fees) that are incurred solely upon the realization and/or distribution of a gain. If an Acquired Fund has no operating history, include in the Acquired Funds' expenses any fees payable to the Acquired Fund's investment adviser or its affiliates stated in the Acquired Fund's registration statement, offering memorandum or other similar communication without giving effect to any performance.

(v) To determine the average invested balance (AI_1), the numerator is the sum of the amount initially invested in an Acquired Fund during the most recent fiscal year (if the investment was held at the end of the previous fiscal year, use the amount invested as of the end of the previous fiscal year) and the amounts invested in the Acquired Fund no less frequently than monthly during the period the investment is held by the Fund (if the investment was held through the end of the fiscal year, use each month-end through and including the fiscal year-end). Divide the numerator by the number of measurement points included in the calculation of the numerator (i.e., if an investment is made during the fiscal year and held for 3 succeeding months, the denominator would be 4).

(vi) A New Fund should base the Acquired Fund fees and expenses on assumptions as to the specific Acquired Funds in which the New Fund expects to invest. Disclose in a footnote to the table that Acquired Fund fees and expenses are based on estimated amounts for the current fiscal year.

(vii) The Fund may clarify in a footnote to the fee table that the Total Annual Fund Operating Expenses under Item 3 do not correlate to the ratio of expenses to average net assets given in response to Item 13, which reflects the operating expenses of the Fund and does not include Acquired Fund fees and expenses.

4. Example.

(a) Assume that the percentage amounts listed under "Total Annual Fund Operating Expenses" remain the same in each year of the 1-, 3-, 5-, and 10-year periods, except that an adjustment may be made to reflect any expense reimbursement or fee waiver arrangements that will reduce any Fund operating expenses for no less than one year from the effective date of the Fund's registration statement. An adjustment to reflect any expense reimbursement or fee waiver arrangement may be reflected only in the period(s) for which the expense reimbursement or fee waiver arrangement is expected to continue.

(b) For any breakpoint in any fee, assume that the amount of the Fund's assets remains constant as of the level at the end of the most recently completed fiscal year.

(c) Assume reinvestment of all dividends and distributions.

(d) Reflect recurring and non-recurring fees charged to all investors other than any exchange fees or any sales charges (loads) on shares purchased with reinvested dividends or other distributions. If sales charges (loads) are imposed on reinvested dividends or other distributions, include the narrative explanation following the Example and include the bracketed words when sales charges (loads) are charged on reinvested capital gains distributions or returns of capital. Reflect any shareholder account fees collected by more than one Fund by dividing the total amount of the fees collected during the most recent fiscal year for all Funds whose shareholders are subject to the fees by the total average net assets of the Funds. Add the resulting percentage to "Annual Fund Operating Expenses" and assume that it remains the same in each of the 1-, 3-, 5-, and 10-year periods. A Fund that charges account fees based on a minimum account requirement exceeding $10,000 may adjust its account fees based on the amount of the fee in relation to the Fund's minimum account requirement.

(e) Reflect any deferred sales charge (load) by assuming redemption of the entire account at the end of the year in which the sales charge (load) is due. In the case of a deferred sales charge (load) that is based on the Fund's net asset value at the time of payment, assume that the net asset value at the end of each year includes the 5% annual return for that and each preceding year.

(f) Include the second 1-, 3-, 5-, and 10-year periods and related narrative explanation only if a sales charge (load) or other fee is charged upon redemption.

5. *Portfolio Turnover.* Disclose the portfolio turnover rate provided in response to Item 13(a) for the most recent fiscal year (or for such shorter period as the Fund has been in operation). Disclose the period for which the information is provided if less than a full fiscal year. A Fund that is a Money Market Fund may omit the portfolio turnover information required by this Item.

6. *New Funds.* For purposes of this Item, a "New Fund" is a Fund that does not include in Form N-1A financial statements reporting operating results or that includes financial statements for the Fund's initial fiscal year reporting operating results for a period of 6 months or less. The following Instructions apply to New Funds.

(a) Base the percentages expressed in "Annual Fund Operating Expenses" on payments that will be made, but include in expenses, amounts that will be incurred without reduction for expense reimbursement or fee waiver arrangements, estimating amounts of "Other Expenses." Disclose in a footnote to the table that "Other Expenses" are based on estimated amounts for the current fiscal year.

(b) Complete only the 1- and 3-year period portions of the Example and estimate any shareholder account fees collected.

d. Fee Table

We are adopting, with modifications to address commenters' concerns and views expressed by investors in the focus groups, the fee table and example. The fee table and example disclose the costs of investing and immediately follow the fund's investment objectives.[90]

Breakpoint Discounts

We are requiring, substantially as proposed, that mutual funds that offer discounts on front-end sales charges for volume purchases (so-called "breakpoint discounts") include brief narrative disclosure alerting investors to the availability of those discounts.[91] Commenters generally supported the disclosure about breakpoint discounts, although many commenters, as well as focus group investors, provided suggestions for revising the narrative proposed.[92] We are modifying the proposal in two ways to address these comments.

First, we are adding to the required narrative a description of where investors can find additional information regarding breakpoint discounts.[93] Specifically, the narrative will be required to state that further information is available from the investor's financial professional, as well as identify the section heading and page number of the fund's prospectus and SAI where more information can be found. This information is intended to address the views of both commenters and investors in the focus groups that it would be helpful for more detailed information about breakpoint discounts to be readily available to investors.[94] Second, we are clarifying the instruction that the dollar level at which investors may qualify for breakpoint discounts that is required to be disclosed in the new item is the minimum level of investment required to qualify for a discount as disclosed in the table required by current Item 7(a)(1) of Form N-1A.[95] This change makes clear that the required dollar threshold to be disclosed is the same as disclosure that is already required in Form N-1A. This change, together with the added narrative about additional information, addresses commenters' concerns that the breakpoints disclosure does not capture the complexity and variety of policies regarding breakpoint discounts.[96]

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[90] *Item 3 of Form N-1A.*

[91] *Item 3 of Form N-1A; Instruction 1(b) to Item 3 of Form N-1A.*

[92] *See, e.g., AIM Letter, supra note 47; CFA Institute Letter, supra note 37; Fund Democracy et al. Letter, supra note 34; Letter of Manuela A. De Leon (Feb. 7, 2008); ICI Letter, supra note 34; Keil Letter, supra note 62; NAPFA Letter, supra note 44; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48; Focus Group Report, supra note 32, at 8.*

[93] *Item 3 of Form N-1A.*

[94] *See, e.g., CMFI Letter, supra note 44 (summary should indicate where additional information about breakpoint discounts is available); NAPFA Letter, supra note 44 (same); Focus Group Transcripts, supra note 32, at 17 (participant observes that "I'll go to the long-form and look that up and then make my decision.").*

[95] *Instruction 1(b) to Item 3 of Form N-1A. Item 7 of Form N-1A is being renumbered as Item 12 in this rulemaking.*

[96] *See, e.g., AIM Letter, supra note 47; ICI Letter, supra note 34; Russell Letter, supra note 48; Letter of Securities Industry and Financial Markets Association (Feb. 28, 2008) ("SIFMA Letter").*

Parenthetical to "Annual Fund Operating Expenses"

We are adopting, substantially as proposed, revisions to the heading "Annual Fund Operating Expenses" in the fee table. Specifically, we are revising the parenthetical following the heading to read "expenses that you pay each year as a percentage of the value of your investment" in place of "expenses that are deducted from Fund assets."[97] In recent years, we have taken significant steps to address concerns that investors do not understand that they pay costs every year when they invest in mutual funds, including requiring disclosure of these costs in shareholder reports.[98] Our revision further addresses those concerns by making clear that the expenses in question are paid by investors as a percentage of the value of their investments in the fund.

Many commenters supported the Commission's proposed revision.[99] We have deleted the word "ongoing" from the beginning of the parenthetical language to address commenters' concerns that this term incorrectly suggests that fund operating expenses are the same each year.[100] We are not modifying the parenthetical to address the views of some industry commenters that the statement incorrectly implies that shareholders directly pay fund expenses, when in fact expenses are paid out of fund assets.[101] The purpose of the revision is to make clear to investors that they, in fact, bear these expenses, and the proposed language conveys this fact. Our conclusion is supported by commenters representing investor groups.[102]

Portfolio Turnover Rate

We are adopting, with two modifications, the requirement that funds, other than money market funds, include brief disclosure regarding portfolio turnover immediately following the fee table example.[103] A fund will be required to disclose its portfolio turnover rate for the most recent fiscal year as a percentage of the average value of its portfolio. This numerical disclosure will be accompanied by a brief explanation of the effect of portfolio turnover on transaction costs and fund performance. Some concerns have been expressed in recent years regarding the degree to which investors understand the effect of portfolio turnover, and the resulting trans

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[97] *Item 3 of Form N-1A.*

[98] *Item 27(d)(1) of Form N-1A; Investment Company Act Release No. 26372 (Feb. 27, 2004) [69 FR 11244 (Mar. 9, 2004)] (adopting disclosure of costs in shareholder reports). See also General Accounting Office Report on Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition, at 66-81 (June 2000), available at http://www.gao.gov/archive/2000/gg00126.pdf (discussing lack of investor awareness of the fees they pay and investor focus on mutual fund sales charges rather than recurring fees).*

[99] *See, e.g., CFA Institute Letter, supra note 37; Clarke Letter, supra note 35; Fund Democracy et al. Letter, supra note 34.*

[100] *See, e.g., CFA Institute Letter, supra note 37; Clarke Letter, supra note 35; Fund Democracy et al. Letter, supra note 34; Evergreen Letter, supra note 41; Letter of Fenimore Asset Management (Feb. 28, 2008); Fidelity Letter, supra note 86; MFDF Letter, supra note 34; Oppenheimer Letter, supra note 44; T. Rowe Letter, supra note 49.*

[101] *See, e.g., Evergreen Letter, supra note 41; ICI Letter, supra note 34; Oppenheimer Letter, supra note 44; Putnam Letter, supra note 48; Russell Letter, supra note 48; T. Rowe Letter, supra note 49.*

[102] *See Fund Democracy et al. Letter, supra note 34.*

[103] *Instruction 5 to Item 3 of Form N-1A.*

action costs, on fund expenses and performance.[104] The requirement to provide brief portfolio turnover disclosure in the summary section of the prospectus is intended to address these concerns, and the proposed disclosure received support from a significant number of commenters.[105] Because we believe that it is important to address investors' lack of understanding of the effect of portfolio turnover and transaction costs on fund expenses and performance, we disagree with commenters opposing the disclosure of portfolio turnover rate on the grounds that such information is too complicated or unnecessary for the summary section.[106]

We are modifying the proposed required explanation of the effect of portfolio turnover to require that the explanation also address the adverse tax consequences that may result from a higher portfolio turnover rate when fund shares are held in a taxable account. We agree with commenters who suggested that adverse tax consequences, as well as higher transaction costs, should be expressly addressed by the explanation.[107] We are also making a technical revision to the final sentence of the proposed required explanation.[108]

We have determined not to adopt two significant suggestions that were made by commenters: first, that we require the impact of transaction costs to be reflected in a fund's expense ratio in the fee table and, second, that we require disclosure of portfolio turnover rates over a period greater than one year. While we believe that both of these suggestions have considerable merit, we have concluded that it is not feasible to implement either at the present time as discussed further below.

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[104] *See Investment Company Act Release No. 26313 (Dec. 18, 2003) [68 FR 74820 (Dec. 24, 2003)] (request for comment regarding ways to improve disclosure of transaction costs); Report of the Mutual Fund Task Force on Soft Dollars and Portfolio Transaction Costs (Nov. 11, 2004), available at http://www.finra.org/web/groups/rules_regs/documents/rules_regs/p012356.pdf.*

[105] *See, e.g., Biegel Letter, supra note 84; CFA Institute Letter, supra note 37; CMFI Letter, supra note 44; Fund Democracy et al. Letter, supra note 34; IDC Letter, supra note 61; Mahavier Letter, supra note 74; NAPFA Letter, supra note 44; Schnase Letter, supra note 35; Vanguard Letter, supra note 42. See also ICI Letter, supra note 34 (stating that it does not oppose the disclosure).*

[106] *See, e.g., American Century Letter, supra note 48; Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Evergreen Letter, supra note 41; Foreside Letter, supra note 74; McCormick Letter, supra note 74; Oppenheimer Letter, supra note 44; Russell Letter, supra note 48.*

[107] *See Fund Democracy et al. Letter, supra note 34; Letter from Representative Donald A. Manzullo (Feb. 26, 2008) ("Manzullo Letter").*

[108] *Item 3 of Form N-1A. We are deleting the reference to portfolio turnover rate as a percentage of the average value of the fund's "whole" portfolio in the explanation to reflect the fact that the rate is calculated without reference to securities whose maturities at the time of acquisition are one year or less. See Instruction 4(d)(ii) to current Item 8(a) of Form N-1A (describing how to calculate portfolio turnover rate; current Item 8 is being renumbered as Item 13).*

Several commenters expressed the view that the Commission should require that transaction costs be reflected in a fund's expense ratio in the fee table and that this disclosure would be more meaningful to investors than the rate of portfolio turnover.[109] The comments on this rulemaking, however, do not provide an adequate basis for prescribing a specific and accurate methodology for reflecting transaction costs in a fund's expense ratio.[110] We do agree with the commenters that portfolio turnover rate is an imperfect measure of portfolio transaction costs. While a higher portfolio turnover rate tends to result in higher transaction costs and a lower portfolio turnover rate tends to result in lower transaction costs, there is not necessarily a direct correlation between portfolio turnover rate and portfolio transaction costs. Nonetheless, in the absence of a basis for prescribing a better measure, we believe that portfolio turnover rate, though imperfect, is an appropriate indicator of transaction costs for purposes of the summary section.

A number of commenters argued that disclosing a portfolio turnover rate over a one-year period would not yield a representative portfolio turnover rate because portfolio turnover rates vary significantly over time depending on a variety of factors, including the need to meet redemption requests, unexpected cash inflows due to sharp swings in markets, or the occurrence of a significant event not likely to repeat in future years, such as a fund merger or a new portfolio manager restructuring the fund's holdings.[111] These commenters suggested that the Commission address this concern by, for example, requiring funds to disclose year-by-year turnover rates for a longer period (*e.g.*, 5-10 years) or an average turnover rate over a longer period of time (*e.g.*, five years).[112] We believe that requiring year-by-year turnover rates for multiple years in the summary section would not further our goal of providing concise, user-friendly disclosure, particularly in light of the fact that there is not necessarily a direct correlation between portfolio turnover and transaction costs. We note that portfolio turnover rates for each of the past five years are already required elsewhere in the prospectus.[113] We do not believe that there is a sufficient basis in the comments to require disclosure of an average turnover rate over a longer period of time (*e.g.*, five years). Doing so would require us to address a number of questions that have not been subject to adequate comment in this rulemaking, including devising a calculation methodology and addressing questions of comparability across funds that have been in existence for different periods of time.

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[109] *See, e.g., Fund Democracy et al. Letter, supra note 34; Letter from Representative George Miller, Senator Edward M. Kennedy, Representative Robert E. Andrews, Senator Tom Harkin, and Senator Herb Kohl (Mar. 13, 2008) ("Miller Letter").*

[110] *In addition, in 2003 the Commission issued a concept release that sought public comment on a number of issues related to the disclosure of mutual fund transaction costs. See Investment Company Act Release No. 26313, supra note 105, 68 FR at 74820. While most commenters who responded to the concept release felt that there should be greater transparency of mutual fund transaction costs, there was a wide range of opinions on what should be disclosed.*

[111] *See, e.g., CMFI Letter, supra note 44; Firehouse Letter, supra note 35; IDC Letter, supra note 61.*

[112] *See, e.g., CMFI Letter, supra note 44; Mahavier Letter, supra note 74.*

[113] *Item 13(a) of Form N-1A.*

Expense Reimbursement and Fee Waiver Arrangements

Finally, we are adopting, with modifications to address commenters' recommendations, the proposed amendments to the requirement that a fund disclose in its fee table gross operating expenses that do not reflect the effect of expense reimbursement or fee waiver arrangements, which result in reduced expenses being paid by the fund.[114] The adopted amendments will permit a fund to place two additional captions directly below the "Total Annual Fund Operating Expenses" caption in cases where there are expense reimbursement or fee waiver arrangements that will reduce any fund operating expenses for no less than one year from the effective date of the fund's registration statement.[115] We have eliminated the proposed requirement that the reimbursement or waiver arrangement has reduced operating expenses in the past, as suggested by two commenters, because this is irrelevant to the impact that the arrangements will have in the future.[116] The purpose of the permitted line items is to show investors how the arrangements will affect expenses in the future and not how they have affected expenses in the past.[117]

One caption will show the amount of the expense reimbursement or fee waiver, and a second caption will show the fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. Funds that disclose these arrangements will also be required to disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, including the expected termination date, and briefly describe who can terminate the arrangement and under what circumstances. We are adding an express requirement that the expected termination date of the arrangement be disclosed in order to address a commenter's concern that investors should be informed in cases where the commitment on a fee waiver becomes shorter than one year.[118]

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[114] *Instruction 3(d)(i) and 6(a) to Item 3 of Form N-1A. In an expense reimbursement arrangement, the adviser reimburses the fund for expenses incurred. Under a fee waiver arrangement, the adviser agrees to waive a portion of its fees in order to limit fund expenses.*

[115] *Instruction 3(e) to Item 3 of Form N-1A. A fund may not include the additional captions if the expense reimbursement or fee waiver arrangement may be terminated without agreement of the fund's board of directors (e.g., unilaterally by the fund's investment adviser) during the one-year period. If a fee waiver or expense reimbursement arrangement, in fact, terminates less than a year after the effective date of a fund's registration statement, the fund generally would be required to supplement or "sticker" its prospectus to reflect the termination. The "sticker" would be filed with the Commission in accordance with rule 497 under the Securities Act.*

[116] *Instruction 3(e) to Item 3. We are also making a similar change in the instructions to the fee table example. Instruction 4(a) to Item 3. See, e.g., Dechert Letter, supra note 50; Evergreen Letter, supra note 41.*

[117] *Because expense reimbursement and fee waiver arrangements of new funds will be disclosed in the same manner as existing funds as a result of the elimination of the proposed requirement described in the text, we are eliminating current Instruction 5(b) (renumbered as Instruction 6(b) in the Proposing Release) to Item 3 of Form N-1A, which pertains to new funds, rather than adopting the proposed revision to the Instruction.*

[118] *See, e.g., Fund Democracy et al. Letter, supra note 34.*

In computing the fee table example, a fund will be permitted to reflect any expense reimbursement or fee waiver arrangements that will reduce any operating expenses for no less than one year from the effective date of the fund's registration statement.[119] This adjustment may be reflected only in the periods for which the expense reimbursement or fee waiver arrangement is expected to continue. For example, if such an arrangement were expected to continue for one year, then, in the computation of 10-year expenses in the fee table example, the arrangement could only be reflected in the first of the 10 years.[120]

Commenters made several suggestions with respect to cost disclosure that we have determined not to implement at this time. First, a number of commenters suggested that the fee table in the summary section should simply disclose the total fees and expenses and should omit certain line item breakdowns of expenses that are currently required in the statutory prospectus.[121] Commenters argued that a more abbreviated presentation, such as a fund's total expense ratio, is preferable because they argued that the current breakdown of fees is not crucial information to an investor's investment decision.[122] We believe that this idea deserves further consideration, and we will consider it for possible future rulemaking.

Second, some commenters suggested that we consider alternative terms to describe sales loads or rule 12b-1 fees[123] because the terms are not easily understood by most investors.[124] We have concluded that it is more appropriate to consider these changes in the context of a full reconsideration of sales charges and rule 12b-1 rather than in the current rulemaking.[125] Finally, some commenters suggested that the fee table require some form of comparison of the fund's fees to a relevant benchmark based on the fees of similar funds.[126] The Commission shares the commenters' view that the ability to compare fees across mutual funds is extremely

[119] *Instruction 4(a) to Item 3 of Form N-1A. We have modified this instruction from the proposal to eliminate the requirement that the arrangement has reduced fund operating expenses during the most recently completed calendar year. This modification is consistent with the modification that is described at notes 117 and 118 and the accompanying text.*

We are also adopting, as proposed, a technical amendment to the instructions to the expense example to eliminate language permitting funds to reflect the impact of the amortization of initial organization expenses in the expense example numbers. Id. This language is unnecessary because initial organization expenses must be expensed as incurred and may no longer be capitalized. See American Institute of Certified Public Accountants, Statement of Position 98-5, Reporting on the Costs of Start-Up Activities (Apr. 3, 1998).

[120] *A fund may not reflect the arrangement in any period during which the arrangement may be terminated without agreement of the fund's board of directors (e.g., unilaterally by the fund's investment adviser).*

[121] *See, e.g., Capital Research Letter, supra note 34; Evergreen Letter, supra note 41; Fund Democracy et al. Letter, supra note 34.*

[122] *See Fund Democracy et al. Letter, supra note 34.*

[123] *"Rule 12b-1 fees" or "12b-1 fees" are fees paid out of fund assets pursuant to a distribution plan adopted under rule 12b-1 under the Investment Company Act [17 CFR 270.12b-1].*

[124] *See, e.g., Miller Letter, supra note 110; CFA Institute Letter, supra note 37; Manzullo Letter, supra note 108; Letter of Investor Rights Clinic at Pace University School of Law (Feb. 28, 2008) ("Pace Letter").*

[125] *The Commission last year hosted a roundtable that brought together representatives from mutual funds, financial services companies, and investor advocacy groups to discuss issues relating to rule 12b-1. See Commission Roundtable on Rule 12b-1 (Jun. 19, 2007) available at http://www.sec.gov/spotlight/rule12b-1.htm. Following the roundtable, we sought public comment on these topics and have received almost 1,500 comment letters.*

[126] *See, e.g., AARP Letter, supra note 34; Fund Democracy et al. Letter, supra note 34; Letter of Gary M. Keenan (Feb. 14, 2008).*

important to investors. To facilitate this comparison, we have designed the summary section to provide investors with key information in a standardized order. We also note that the Commission's ongoing interactive data initiative is intended to provide investors and other users with the tools necessary to facilitate comparisons of fee information. The Commission recently proposed rules that would, if adopted, require mutual funds to file the information in their fee tables in an interactive data format that would facilitate automated analysis of the information and comparison to other funds.[127] The interactive data format would allow users of fee table information to download cost and performance information directly into spreadsheets and analyze it using commercial off-the-shelf software.

Fund of Funds Investments (Release IC-27399; June 30, 2006)—

[Footnotes 68, 74, 75 & 76 omitted.]

D. Amendments to Disclosure Forms: Transparency of Fund of Funds Expenses

We are also adopting amendments to our disclosure requirements to require each fund that invests in shares of other funds to disclose in its prospectus fee table the expenses of funds in which it invests. The amendments are designed to provide investors with a better understanding of the actual costs of investing in a fund that invests in other funds, which have their own expenses that may be as high or higher than the acquiring fund's expenses.[128] Investors may not be aware of these potentially higher expenses. Most commenters supported these amendments, which we are adopting substantially as proposed.[129]

Open-End Funds. Form N-1A is used by open-end management funds to register under the Act and to offer their securities under the Securities Act. Form N-1A sets forth the disclosure requirements for fund prospectuses. Our amendments to Form N-1A require any registered open-end fund investing in shares of another fund to include in its prospectus fee table an additional line item titled "Acquired Fund Fees and Expenses" under the section that discloses total annual fund operating expenses.[130] The line item will set forth the acquiring fund's pro rata portion of the cumulative expenses charged by funds in which the acquiring fund invests. Those costs will be included in the acquiring funds' total annual fund operating

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[127] *See Investment Company Act Release No. 28298, supra note 28, 73 FR at 35442.*

[128] *Investment Company Act Release No. IC-23064 (Mar. 13, 1998).*

[129] *A fund of funds may have higher fees and expenses than a fund that invests directly in debt and equity securities.*

[130] *The item will appear directly above the line item titled "Total Annual Fund Operating Expenses." The proposed instructions to Form N-1A would have permitted funds to use terms in the fee table other than the term "Acquired Fund." We received no comment in response to our question whether the proposed instructions were consistent with the current fee table. We have decided not to permit funds to use other terms, however, because no variation is permitted for other line items in the fee table (except for the subcaptions that may be used under "Other Expenses" in order to identify the largest expenses comprising "Other Expenses"). Accordingly, the instruction, as adopted, is consistent with the other line items in the expense table, and allows investors to more easily compare disclosure among funds. In the event a fund uses another defined term to describe acquired funds in its prospectus, it may include this term in a parenthetical following the title of the new line item. See Instruction 3(f)(i) to Item 3 of Form N-1A.*

expenses, which will be reflected in the "Example" portion of the fee table.[131] One commenter suggested that we add an instruction to permit a fund to omit the new separate line item if the aggregate expenses attributable to acquired funds do not exceed 0.01 percent (one basis point) of average net assets of the acquiring fund. We agree with the commenter that the disclosure of this de minimis amount in a separate line item would not be important to investors. Therefore, the instructions to the amended fee table allow these expenses to be included in "Other Expenses."[132]

We also are adopting instructions to assist an acquiring fund in determining the amount of acquired funds' fees and expenses that must be reflected in its fee table. The acquiring fund must aggregate the amount of total annual fund operating expenses of acquired funds (which are indirectly paid by the acquiring fund) and transaction fees (which are directly paid by the acquiring fund over the past year) and express the total amount as a percentage of average net assets of the acquiring fund. Under this approach, the acquiring fund must determine the aver-

[131] *The fee table example requires the fund to disclose the cumulative amount of fund expenses of 1, 3, 5, and 10 years based on a hypothetical investment of $10,000 and an annual 5% return. See Item 3 of Form N-1A.*

[132] *See Comment Letter of ICI (Dec. 3, 2003). See Instruction 3(f)(i) to Item 3 of Form N-1A. Inclusion of the de minimis amount under "Other Expenses," however, ensures that the acquired funds' expenses will be included in the acquiring fund's total annual operating expense ratio.*

age invested balance and number of actual days invested in each acquired fund.[133] We also are adopting the proposed instruction that requires the acquiring fund to include in the expense calculation any transaction fee the acquiring fund paid to acquire or dispose of shares of a fund during the past fiscal year (even if it no longer holds shares of that fund).[134]

Our proposed instructions would have required an acquiring fund in the same fund complex as the acquired fund to calculate the acquired fund's actual total annual expense ratio for the period covering the acquiring fund's fiscal year. For funds in a different fund complex, our proposal would have required the acquiring funds to use the gross expense ratio disclosed in an acquired fund's most recent semi-annual report filed with the Commission, or if the fund does not file reports with the Commission or the gross expense ratio is not provided, to use the expense ratio provided in a recent communication from the acquired fund.

One commenter questioned whether funds in the same fund complex should have to calculate this special purpose expense ratio and recommended that an acquiring fund use the acquired fund's annual expense ratio as disclosed in its most recent semi-annual report filed with the Commission. We agree with the commenter that it is unnecessary to calculate a special purpose expense ratio for funds in the same fund complex because expense ratios typically do not fluctuate much from year to year. Therefore, acquired fund expense disclosure based on a special purpose expense ratio would in most cases be identical to or negligibly dif-

[133] *See Instruction 3(f)(ii) to Item 3 of Form N-1A (to calculate the pro rata share of total annual fund operating expenses for each acquired fund, an acquiring fund will divide the acquired fund's expense ratio by the number of days in the relevant calendar year, and multiply the result by the average invested balance and the number of days invested in the acquired fund). We have revised the divisor in the calculation for the daily expense ratio from the proposed 365 days to the number of days in the fiscal year to reflect that some fiscal years will have 366 days. One commenter asserted that our proposed formula in Instruction 3(f)(ii) to Item 3 of Form N-1A would not correspond to the expense ratio (i.e., the Ratio of Expenses to Average Net Assets) currently in Item 8 of Form N-1A, "Financial Highlights Information." The commenter stated that, as a result, the total annual fund operating expenses disclosed in response to Item 3 would be generally higher than those reflected in response to Item 8 because the expense ratio in Item 8 would only reflect expenses paid directly by the acquiring fund. See Comment Letter of ICI (Dec. 3, 2003). We agree that this potential discrepancy may be confusing to investors, and have revised the instruction to permit funds to address this discrepancy in a clarifying footnote to the fee table. See Instruction 3(f)(vii) to Item 3 of Form N-1A. We also have directed the staff to continue monitoring funds of funds' disclosure to determine whether additional disclosure of acquired funds' fees is needed, such as in the financial highlights section or shareholder reports.*

We are also revising Instruction 3(f)(v) to Item 3 of Form N-1A. The proposed instructions would have required the acquiring fund to calculate an "average invested balance" based on month-end balances. One commenter recommended that funds be permitted to calculate "average invested balances" based on the value of investment measured no less frequently than monthly to allow funds the flexibility of using daily balances. See Comment Letter of ICI (Dec. 3, 2003). We believe that the recommendation will allow the most accurate disclosure for funds that use the more frequent measure and have revised the instruction to allow the acquiring fund to calculate "average invested balance" based on the value of investment measured no less frequently than monthly.

[134] *See Instruction 3(f)(ii) to Item 3 of Form N-1A ("transaction fees" included in the calculation for acquired funds' fees and expenses include the total amount of sales loads, redemption fees, or other transaction fees paid by the acquiring fund in connection with acquiring or disposing of shares in acquired funds during the year). We clarified this instruction to indicate that "transaction fees" include fees paid in connection with acquiring and disposing of shares. If an acquired fund charges a performance fee, the fee would be included in the disclosure of acquired funds' fees and expenses. The amended instructions to Form N-1A would require an acquiring fund to include a performance fee that is accounted for as an incentive allocation, in conformance with the amended instructions to Form N-2. See infra notes 83, 84.*

ferent from the disclosure based on the expense ratio as disclosed in the most recent shareholder report. Accordingly, the instructions as adopted require an acquiring fund to calculate the acquired funds' expenses using the net expense ratios reported in the acquired funds' most recent shareholder reports.[135] We also believe that allowing acquiring funds to use the net expense ratio disclosed in shareholder reports (which may or may not be filed with the Commission depending on whether the fund is registered with the Commission), instead of reports filed with the Commission, will permit more acquiring funds to rely on a readily available expense ratio and will eliminate the need for any special communication between the funds.[136] If an acquired fund does not provide a net expense ratio in its most recent shareholder report or is a newly formed fund that has not prepared a report, the acquiring fund must use the acquired fund's total annual fund operating expenses over average annual net assets as reported in its most recent communication to the acquiring fund.[137]

The new disclosure requirements we are adopting today also will apply with respect to investments in any unregistered fund that would be an investment company under section 3(a) of the Act but for the exceptions provided in sections 3(c)(1) and 3(c)(7) of the Act.[138] Thus, a fund with a cash sweep arrangement will be required to report the expenses of the unregistered money market fund in which the acquiring fund invests.

Staff Responses to Questions Regarding Disclosure of Fund of Funds Expenses

The staff of the Division of Investment Management has prepared the following responses to certain questions raised in connection with amendments to the fee table adopted in the Fund of Funds release in June 2006. These amendments require funds to disclose in their fee tables the expenses of investing in other funds under a line item titled "Acquired Fund Fees and Expenses" ("AFFE").

These responses represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Securities and Exchange Commission, and the Commission has neither approved nor disapproved this information.

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[135] *See Instruction 3(f)(iv) to Item 3 of Form N-1A. The proposal would have required acquiring funds to use a gross expense ratio, which would have excluded the effect of waivers or reimbursements. Amended instruction 3(f)(iv) requires use of the net operating expense ratio, which includes the effect of waivers or reimbursements by the acquired fund's investment adviser or sponsor. We believe that permitting funds to use the net operating expense ratio that is disclosed in shareholder reports instead of the gross expense ratio (which may not be available in shareholder reports because it is not required disclosure) will significantly reduce the need for special calculations or communications between the acquiring and acquired fund because the acquiring fund will not have to adjust the net expense ratio disclosed in the shareholder report to exclude the effect of waivers and reimbursements.*

[136] *Funds may use the most recent shareholder report, whether it is an annual or semi-annual report. If the acquiring fund relies on a semi-annual report, however, it must use an annualized expense ratio.*

[137] *See Instruction 3(f)(iv) to Item 3 of Form N-1A. We also are conforming the instruction with respect to the expense ratio used for funds in a different fund complex in order to establish a uniform instruction. We believe that this revision will provide greater consistency among funds of funds' expense disclosures.*

[138] *See Instruction 3(f)(i) to Item 3 of Form N-1A.*

All responses refer to Item 3 of Form N-1A, but apply equally to similar items in Forms N-2 and N-3.

Question 1

Q: Instruction 3(f)(i) to Item 3 of Form N1-A requires a fund that invests in other funds (Acquired Funds) to disclose the fees and expenses associated with those investments. An "Acquired Fund" includes any company that would be an investment company under section 3(a) of the Investment Company Act but for the exceptions to that definition provided in sections 3(c)(1) and 3(c)(7) of the Act. In addition to hedge funds and other pooled investment vehicles discussed in the Adopting Release, some structured finance vehicles, such as collateralized debt obligations, may rely on section 3(c)(1) or 3(c)(7) of the Act. Must their expenses be included in an acquiring fund's fee table?

A: No. AFFE is intended to include the expenses of investments in investment companies, hedge funds, private equity funds, and other entities traditionally considered pooled investment vehicles. Accordingly, the staff would not recommend enforcement action if a fund does not include in the fee table expenses associated with investments in structured finance vehicles, collateralized debt obligations, or other entities not traditionally considered pooled investment vehicles.

Question 2

Q: Must an Acquiring Fund include in its calculation of AFFE, expenses the Acquired Fund incurred through its investment in other investment companies?

A: No. Instruction 3(f)(iv) to Item 3 of Form N-1A provides that the total annual operating expense ratio used for purposes of calculating AFFE is the annualized expense ratio disclosed in the Acquired Fund's most recent shareholder report. This expense ratio does not include expenses an Acquired Fund has incurred through its investment in other companies. (See question 3, however, with respect to disclosures for feeder funds.)

Question 3

Q: Are feeder funds required to include the AFFE in their prospectus fee tables?

A: Yes. Open-end feeder funds filing on Form N-1A must disclose in their fee tables the aggregate expenses of the feeder fund and the master fund (see Instruction 1(d)(i) to Item 3 of Form N-1A). The Form N-1A requirement pre-dates the new fund of fund disclosure amendments and has not been changed; the Commission added a similar Form N-2 requirement (see Instruction 10.h to Item 3 of Form N-2).

Question 4

Q: Instruction 3(f)(iv) to Item 3 of Form N-1A states that the annual operating expense ratio to be used for purposes of calculating AFFE is the ratio disclosed in an Acquired Fund's most recent shareholder report. Does "most recent" refer to the report available as of the Acquiring Fund's fiscal year end or as of the date of the Acquiring Fund's prospectus update in which the AFFE information will appear?

A: The term "most recent" refers to the Acquired Fund's shareholder report available at the time the Acquiring Fund calculates the AFFE. The Acquiring Fund should use the Acquired Fund's required expense ratio presented in the financial highlights table contained in the most recent annual or semi-annual report when the Acquiring Fund calculates the AFFE. If the semi-annual report is the most recent report, however, the Acquiring Fund must use an annualized expense ratio (see footnote 78 of the Adopting Release and accompanying text).

Question 5

Q: Instruction 3(f)(ii) to Item 3 of Form N-1A sets forth the formula for AFFE, which includes a calculation of the daily expense ratio and the number of days invested in an Acquired Fund. Should weekend days be included in these elements of the AFFE?

A: Yes, except for the calculation of average invested balance.

Daily Expense Ratio. The numerator in the AFFE formula includes a calculation of the daily expense ratio where "F" is the total annual expense ratio for each acquired fund and "FY" is the number of days in the fiscal year. Because F is an annualized expense ratio, FY must be either 365 or 366 days. Therefore, for purposes of calculating the daily expense ratio, weekend days must be included.

Average Invested Balance and Number of Days Invested in each Acquired Fund. The numerator in the AFFE formula also includes a calculation of average invested balance ("AI") in each acquired fund and the number of days invested in each Acquired Fund ("D"). Average invested balance is calculated based on, at a minimum, the monthly investment balance in the Acquired Fund. Therefore, average invested balance can be calculated using daily, weekly or monthly investment balances. The number of days invested is calculated using calendar days, which includes weekends (see Instruction 3(f)(v) to Item 3 of Form N-1A).

Question 6

Q: Instruction 3(f)(v) to Item 3 of Form N-1A states that the numerator for calculating average invested balance ("AI") for purposes of AFFE, is the amount initially invested in the Acquired Fund during the most recent fiscal year plus the amounts invested in the Acquired Fund measured no less frequently than monthly. Are the monthly measurements based on the market value of the investment in the Acquired Fund?

A: Yes. The amounts invested in an Acquired Fund are calculated using the value of the investment in the Acquired Fund as of the measurement date, which would take into account market appreciation (except for money market investments priced at amortized cost) (see footnote 72 of the Adopting Release). For example, if the Acquiring Fund calculates average daily investment in a registered open-end fund, the Acquiring Fund would base the value of that investment on the Acquired Fund's NAV at the end of each day, which would include any unrealized appreciation or loss with respect to the Acquiring Fund's investment.

Question 7

Q: As noted above, an "Acquired Fund" includes any company that would be an investment company under section 3(a) of the Investment Company Act but for the exceptions to that definition provided in sections 3(c)(1) and 3(c)(7) of the Act. If an Acquiring Fund lends portfolio securities and invests the cash collateral received in a money market fund or other cash sweep vehicle that meets the definition of "Acquired Fund," must the Acquiring Fund include the fees and expenses associated with the investment of the cash collateral in the calculation of AFFE?

A: No. Fees and expenses associated with investment of cash collateral received in connection with loans of portfolio securities in a money market fund or other cash sweep vehicle that meets the definition of Acquired Fund do not have to be included in the calculation of AFFE.

Question 8

Q: If an Acquiring Fund's investment in an Acquired Fund is a debt rather than equity interest, must the Acquiring Fund include expenses associated with the debt in the AFFE?

A: An Acquiring fund investing in debt must include any transaction fees it paid in connection with acquiring or disposing of a debt interest in an Acquired Fund but not its pro rata portion of the cumulative expenses charged by the Acquired Fund because these expenses do not impact its debt interest in the Acquired Fund. See Instruction 3(f)(ii) to Item 3 of Form N-1A and Footnote 73 of the Adopting Release and accompanying text.

Item 4. Risk/Return Summary: Investments, Risks, and Performance

Include the following information, in plain English under rule 421(d) under the Securities Act, in the order and subject matter indicated:

(a) *Principal Investment Strategies of the Fund.*

Based on the information given in response to Item 9(b), summarize how the Fund intends to achieve its investment objectives by identifying the Fund's principal investment strategies (including the type or types of securities in which the Fund invests or will invest principally) and any policy to concentrate in securities of issuers in a particular industry or group of industries.

(b) *Principal Risks of Investing in the Fund.*

(1) *Narrative Risk Disclosure.*

(i) Based on the information given in response to Item 9(c), summarize the principal risks of investing in the Fund, including the risks to which the Fund's portfolio as a whole is subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, and total return. Unless the Fund is a Money Market Fund, disclose that loss of money is a risk of investing in the Fund.

Instruction. A Fund may, in responding to this Item, describe the types of investors for whom the Fund is intended or the types of investment goals that may be consistent with an investment in the Fund.

(ii) (A) If the Fund is a Money Market Fund that is not a government Money Market Fund, as defined in §270.2a-7(a)(16) or a retail Money Market Fund, as defined in §270.2a-7(a)(25), include the following statement: You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

(B) If the Fund is a Money Market Fund that is a government Money Market Fund, as defined in §270.2a-7(a)(16), or a retail Money Market Fund, as defined in §270.2a-7(a)(25), and that is subject to the requirements of §270.2a-7(c)(2)(i) and/or (ii) of this chapter (or is not subject to the requirements of §270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to §270.2a-7(c)(2)(iii) of this chapter, but has chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §270.2a-7(c)(2)(i) and/or (ii)), include the following statement:

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The Fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

(C) If the Fund is a Money Market Fund that is a government Money Market Fund, as defined in §270.2a-7(a)(16), that is not subject to the requirements of §270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to §270.2a-7(c)(2)(iii) of this chapter, and that has not chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §270.2a-7(c)(2)(i) and/or (ii)), include the following statement:

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

Instruction. If an affiliated person, promoter, or principal underwriter of the Fund, or an affiliated person of such a person, has contractually committed to provide financial support to the Fund, and the term of the agreement will extend for at least one year following the effective date of the Fund's registration statement, the statement specified in Item 4(b)(1)(ii)(A), Item 4(b)(1)(ii)(B), or Item 4(b)(1)(ii)(C) may omit the last sentence ("The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time."). For purposes of this Instruction, the term "financial support" includes any capital contribution, purchase of a security from the Fund in reliance on §270.17a-9, purchase of any defaulted or devalued security at par, execution of letter of credit or letter of indemnity, capital support agreement (whether or not the Fund ultimately received support), performance guarantee, or any other similar action reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio; however, the term "financial support" excludes any routine waiver of fees or reimbursement of fund expenses, routine inter-fund lending, routine inter-fund purchases of fund shares, or any action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio.

(iii) If the Fund is advised by or sold through an insured depository institution, state that:

An investment in the Fund is not a deposit of the bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Instruction. A Money Market Fund that is advised by or sold through an insured depository institution should combine the disclosure required by Items 4(b)(1)(ii) and (iii) in a single statement.

(iv) If applicable, state that the Fund is non-diversified, describe the effect of non-diversification (*e.g.*, disclose that, compared with other funds, the Fund may invest a greater percentage of its assets in a particular issuer), and summarize the risks of investing in a non-diversified fund.

(2) *Risk/Return Bar Chart and Table.*

(i) Include the bar chart and table required by paragraphs (b)(2)(ii) and (iii) of this section. Provide a brief explanation of how the information illustrates the variability of the Fund's returns (e.g., by stating that the information provides some indication of the risks of investing in the Fund by showing changes in the Fund's performance from year to year and by showing how the Fund's average annual returns for 1, 5, and 10 years compare with

those of a broad measure of market performance). Provide a statement to the effect that the Fund's past performance (before and after taxes) is not necessarily an indication of how the Fund will perform in the future. If applicable, include a statement explaining that updated performance information is available and providing a Web site address and/or toll-free (or collect) telephone number where the updated information may be obtained.

(ii) If the Fund has annual returns for at least one calendar year, provide a bar chart showing the Fund's annual total returns for each of the last 10 calendar years (or for the life of the Fund if less than 10 years), but only for periods subsequent to the effective date of the Fund's registration statement. Present the corresponding numerical return adjacent to each bar. If the Fund's fiscal year is other than a calendar year, include the year-to-date return information as of the end of the most recent quarter in a footnote to the bar chart. Following the bar chart, disclose the Fund's highest and lowest return for a quarter during the 10 years or other period of the bar chart. [**amendment effective November 19, 2018:** If swing pricing policies and procedures were applied during any of the periods, include a general description of the effects of swing pricing on the Fund's annual total returns for the applicable period(s) presented in a footnote to the bar chart.]

(iii) If the Fund has annual returns for at least one calendar year, provide a table showing the Fund's (A) average annual total return; (B) average annual total return (after taxes on distributions); and (C) average annual total return (after taxes on distributions and redemption). A Money Market Fund should show only the returns described in clause (A) of the preceding sentence. All returns should be shown for 1-, 5-, and 10-calendar year periods ending on the date of the most recently completed calendar year (or for the life of the Fund, if shorter), but only for periods subsequent to the effective date of the Fund's registration statement. The table also should show the returns of an appropriate broad-based securities market index as defined in Instruction 5 to Item 27(b)(7) for the same periods. A Fund that has been in existence for more than 10 years also may include returns for the life of the Fund. A Money Market Fund may provide the Fund's 7-day yield ending on the date of the most recent calendar year or disclose a toll-free (or collect) telephone number that investors can use to obtain the Fund's current 7-day yield. For a Fund (other than a Money Market Fund or a Fund described in General Instruction C.3.(d)(iii)), provide the information in the following table with the specified captions:

AVERAGE ANNUAL TOTAL RETURNS

(For the periods ended December 31, ____)

	1 year	5 years [or Life of Fund]	10 years [or Life of Fund]
Return Before Taxes	____%	____%	____%
Return After Taxes on Distributions	____%	____%	____%
Return After Taxes on Distributions and Sale of Fund Shares	____%	____%	____%
Index **(reflects no deduction for [fees, expenses, or taxes])**	____%	____%	____%

(iv) Adjacent to the table required by paragraph 4(b)(2)(iii), provide a brief explanation that:

(A) After-tax returns are calculated using the historical highest individual federal marginal income tax rates and do not reflect the impact of state and local taxes;

(B) Actual after-tax returns depend on an investor's tax situation and may differ from those shown, and after-tax returns shown are not relevant to investors who hold their Fund shares through tax-deferred arrangements, such as 401(k) plans or individual retirement accounts;

(C) If the Fund is a Multiple Class Fund that offers more than one Class in the prospectus, after-tax returns are shown for only one Class and after-tax returns for other Classes will vary; and

(D) If average annual total return (after taxes on distributions and redemption) is higher than average annual total return, the reason for this result may be explained.

[**amendment effective November 19, 2018:**

(E) If swing pricing policies and procedures were applied during any of the periods, include a general description of the effects of swing pricing on the Fund's average annual total returns for the applicable period(s) presented.]

Instructions.

1. Bar Chart.

(a) Provide annual total returns beginning with the earliest calendar year. Calculate annual returns using the Instructions to Item 13(a), except that the calculations should be based on calendar years. If a Fund's shares are sold subject to a sales load or account fees, state that sales loads or account fees are not reflected in the bar chart and that, if these amounts were reflected, returns would be less than those shown.

(b) For a Fund that provides annual total returns for only one calendar year or for a Fund that does not include the bar chart because it does not have annual returns for a full calendar year, modify, as appropriate, the narrative explanation required by paragraph (b)(2)(i) (*e.g.*, by stating that the information gives some indication of the risks of an investment in the Fund by comparing the Fund's performance with a broad measure of market performance).

2. Table.

(a) Calculate a Money Market Fund's 7-day yield under Item 26(a); the Fund's average annual total return under Item 26(b)(1); and the Fund's average annual total return (after taxes on distributions) and average annual total return (after taxes on distributions and redemption) under Items 26(b)(2) and (3), respectively.

(b) A Fund may include, in addition to the required broad-based securities market index, information for one or more other indexes as permitted by Instruction 6 to Item 27(b)(7). If an additional index is included, disclose information about the additional index in the narrative explanation accompanying the bar chart and table (*e.g.*, by stating that the information shows how the Fund's performance compares with the returns of an index of funds with similar investment objectives).

(c) If the Fund selects an index that is different from the index used in a table for the immediately preceding period, explain the reason(s) for the selection of a different index and provide information for both the newly selected and the former index.

(d) A Fund (other than a Money Market Fund) may include the Fund's yield calculated under Item 26(b)(2). Any Fund may include its tax-equivalent yield calculated under Item 26. If a Fund's yield is included, provide a toll-free (or collect) telephone number that investors can use to obtain current yield information.

(e) Returns required by paragraphs 4(b)(2)(iii)(A), (B), and (C) for a Fund or Series must be adjacent to one another and appear in that order. The returns for a broad-based securities market index, as required by paragraph 4(b)(2)(iii), must precede or follow all of the returns for a Fund or Series rather than be interspersed with the returns of the Fund or Series.

3. Multiple Class Funds.

(a) When a Multiple Class Fund presents information for more than one Class together in response to Item 4(b)(2), provide annual total returns in the bar chart for only one of those Classes. The Fund can select which Class to include (e.g., the oldest Class, the Class with the greatest net assets) if the Fund:

(i) Selects the Class with 10 or more years of annual returns if other Classes have fewer than 10 years of annual returns;

(ii) Selects the Class with the longest period of annual returns when the Classes all have fewer than 10 years of returns; and

(iii) If the Fund provides annual total returns in the bar chart for a Class that is different from the Class selected for the most immediately preceding period, explain in a footnote to the bar chart the reasons for the selection of a different Class

(b) When a Multiple Class Fund offers a new Class in a prospectus and separately presents information for the new Class in response to Item 4(b)(2), include the bar chart with annual total returns for any other existing Class for the first year that the Class is offered. Explain in a footnote that the returns are for a Class that is not presented that would have substantially similar annual returns because the shares are invested in the same portfolio of securities and the annual returns would differ only to the extent that the Classes do not have the same expenses. Include return information for the other Class reflected in the bar chart in the performance table.

(c) When a Multiple Class Fund presents information for more than one Class together in response to Item 4(b)(2):

(i) Provide the returns required by paragraph 4(b)(2)(iii)(A) of this Item for each of the Classes;

(ii) Provide the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item for only one of those Classes. The Fund may select the Class for which it provides the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item, provided that the Fund:

(A) Selects a Class that has been offered for use as an investment option for accounts other than those described in General Instruction C.3.(d)(iii)(A);

(B) Selects a Class described in paragraph (c)(ii)(A) of this Instruction with 10 or more years of annual returns if other Classes described in paragraph (c)(ii)(A) of this Instruction have fewer than 10 years of annual returns;

(C) Selects the Class described in paragraph (c)(ii)(A) of this Instruction with the longest period of annual returns if the Classes described in paragraph (c)(ii)(A) of this Instruction all have fewer than 10 years of returns; and

(D) If the Fund provides the returns required by paragraphs 4(b)(2)(iii)(B) and (C) of this Item for a Class that is different from the Class selected for the most immediately preceding period, explain in a footnote to the table the reasons for the selection of a different Class;

(iii) The returns required by paragraphs 4(b)(2)(iii)(A), (B), and (C) of this Item for the Class described in paragraph (c)(ii) of this Instruction should be adjacent and should not be interspersed with the returns of other Classes; and

(iv) All returns shown should be identified by Class.

(d) If a Multiple Class Fund offers a Class in the prospectus that converts into another Class after a stated period, compute average annual total returns in the table by using the returns of the other Class for the period after conversion.

4. Change in Investment Adviser. If the Fund has not had the same investment adviser during the last 10 calendar years, the Fund may begin the bar chart and the performance information in the table on the date that the current adviser began to provide advisory services to the Fund subject to the conditions in Instruction 11 of Item 27(b)(7).

Excerpt from SEC Division of Investment Management Guidance Update No. 2014-08 (June 2014)/Guidance regarding Mutual Fund Enhanced Disclosure

The staff has observed that funds often provide clear and concise disclosure in response to the specific Summary Section requirements of Form N-1A. There are a significant number of prospectuses, however, in which disclosure remains complex, technical and duplicative. Further, the staff continues to see what it believes are unnecessarily long Summary Sections. In the Adopting Release, the Commission explicitly noted that it shares the concerns of some commenters that, over time, Summary Sections could get longer, undermining the usefulness of the summary.[139] While the Commission did not impose page limits on the Summary Section, stating that doing so could constrain appropriate disclosure, the Commission emphasized its intent that funds prepare a concise summary (on the order of three or four pages) that will provide key information.[140] Notwithstanding the Commission's expressed intent, it is not unusual for the staff to review filings with Summary Sections that are longer than ten pages for a single mutual fund and sometimes almost twenty pages in length.

[139] *Id. at 74 FR at 4551.*
[140] *Id.*

Based on comments the staff has provided, the staff highlights below certain rule and form requirements that, while not exhaustive of the disclosure requirements, are intended to focus funds on providing investors clear and concise disclosure:

- *Summarize the Principal Investment Strategies and Risks*: Form N-1A provides that the principal investment strategies and risks, required by Item 4 in the Summary Section, should be based on the information given in response to Item 9 of the Form, and should be a *summary* of that information.[141] The Form also provides that information included in response to Items 2 through 8 need not be repeated elsewhere in the prospectus.[142] Instead of a concise summary, however, the staff often observes in Item 4 of the Summary Section long, complex and detailed descriptions of principal investment strategies and risks that are dense, are not user-friendly, and do not appear to be summaries of the information in Item 9 later in the prospectus. The staff also often reviews prospectuses that substantially repeat the same principal investment strategies and risks disclosure in response to Item 4 and in response to Item 9. Indeed, many times this disclosure is identical.

  The layered disclosure regime adopted by the Commission may be undermined by Summary Sections that do not, in fact, summarize the information available elsewhere. In the staff's view, the repetition of substantially the same-or identical-information in response to both Items 4 and 9 often highlights that a fund has not provided a summary in response to Item 4. In addition, the unnecessary duplication of information increases the length of the prospectus. When the staff observes a Summary Section that is long, dense and complex and does not, in fact, appear to summarize a fund's principal strategies and risks, the staff will remind the fund that the Summary Section is intended to summarize the key information that is important to an investment decision, with more detailed information presented elsewhere. Further, when a fund substantially duplicates its disclosure, the staff will remind the fund that information need not be duplicated.

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[141]*Form N-1A requires a fund to disclose its principal investment strategies, including the type or types of securities in which the fund principally invests or will invest. See Items 4(a) and 9(b) of Form N-1A. Whether a particular strategy, including a strategy to invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the fund's investment objectives, and how the strategy affects the fund's potential risks and returns. See Instr. 2 to Item 9(b) of Form N-1A. In assessing what is a principal investment strategy, a fund should consider, among other things, the amount of the fund's assets expected to be committed to the strategy, the amount of the fund's assets expected to be placed at risk by the strategy, and the likelihood of the fund losing some or all of those assets from implementing the strategy. Id. Further, Form N-1A requires a mutual fund to disclose the principal risks of investing in the fund, including the risks to which the fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, or total return. See Items 4(b) and 9(c) of Form N-1A.*

[142]*General Instruction C.3.(a) of Form N-1A.*

- *Plain English Requirements*: Form N-1A provides that the Summary Section must be provided in plain English under Rule 421(d) under the Securities Act.[143] In addition, the prospectus, in its entirety, is subject to the requirement that the information be presented in a clear, concise, and understandable manner.[144] Similarly, Form N-1A also provides that the prospectus disclosure requirements "are intended to elicit information for an average or typical investor who may not be sophisticated in legal or financial matters."[145]

  Notwithstanding these requirements, the staff continues to observe the use of technical terms that are not explained in plain English. Funds also often use unnecessary defined terms, long, compound sentences, and long, dense paragraphs that the staff believes may be difficult for investors to read. The use of plain English principles in the Summary Section is intended to further the Commission's goal of encouraging funds to create useable summaries at the front of their prospectuses.[146] Failure to follow the plain English requirements undermines the usefulness of the Summary Sec tion, and, thus, the Summary Prospectus. Funds are reminded to revisit their disclosures in light of these requirements.

- *Summary Section Must Only Include Required or Permitted Information*: Form N-1A provides that the Summary Section of the prospectus "may not include disclosure other than that required or permitted by [Items 2 through 8]."[147] A fund may, however, include information elsewhere in the prospectus or in the SAI that is not otherwise required by Form N-1A.[148]

  The staff closely scrutinizes the disclosure in the Summary Section, and when information is included that is not required or permitted, comments that the information

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[143] *See General Instruction B.4.(c) of Form N-1A. Rule 421(d) [17 CFR 230.421(d)] requires an issuer to use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors sections of its prospectus. Specifically, Rule 421(d) lists the following plain English principles: (1) short sentences; (2) definite, concrete, everyday words; (3) active voice; (4) tabular presentation or bullet lists for complex material, wherever possible; (5) no legal jargon or highly technical business terms; and (6) no multiple negatives.*

[144] *Pursuant to Rule 421(b) [17 CFR 230.421(b)], the following standards must be used when preparing prospectuses: (1) present information in clear, concise sections, paragraphs, and sentences; (2) use descriptive headings and subheadings; (3) avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus; and (4) avoid legal and highly technical business terminology.*

[145] *General Instruction 3.C.l.(b) of Form N-1A. Form N-1A also provides that responses to the Items in the Form: (1) "should be as simple and direct as reasonably possible and should include only as much information as is necessary to enable an average or typical investor to understand the particular characteristics of the Fund"; (2) should avoid: "including lengthy and technical discussions; simply restating legal or regulatory requirements to which Funds generally are subject; and disproportionately emphasizing possible investments or activities of the Fund that are not a significant part of the Fund's investment operations"; (3) should "[a]void excessive detail, technical or legal terminology, and complex language"; and (4) should "avoid lengthy sentences and paragraphs that make the prospectus difficult for many investors to understand and detract from its usefulness." General Instruction 3.C.l.(c) of Form N-1A.*

[146] *Adopting Release, 74 FR at 4549.*

[147] *General Instruction C.2.(b) of Form N-1A.*

[148] *Id.*

should be moved out of the Summary Section. For example, to streamline the disclosure and foster comparison between funds, the staff, in particular, assesses whether information in the footnotes to the Fee Table is permitted or required. As another example, the staff often comments about the inclusion of purchase and sale information that is neither permitted nor required by Item 6 ("Purchase and Sale of Fund Shares"), which generally requires a fund to disclose its minimum initial or subsequent investment requirements, that the fund's shares are redeemable, and briefly identify the procedures for redeeming shares. Funds are reminded to include only information in the Summary Section that is either permitted or required by Form N-1A.

- *Inclusion of Non-Principal Strategies and Risks in the Prospectus*: As noted above, Form N-1A requires a fund to disclose its principal investment strategies and risks in its prospectus.[149] The Form provides that a fund should describe any investment strategies and risks that are not principal in the SAI.[150] Form N-1A, however, also provides that a fund may include (except in the Summary Section) information in the prospectus that is not otherwise required.[151] Many funds include in their prospectus additional information related to strategies and risks that are not principal. In the view of the staff, however, funds that include this additional information often do not clearly indicate which of the strategies and risks are principal and which are not principal. The staff believes that this can result in prospectus disclosure that does not clearly and concisely inform investors about how the fund principally intends to invest and the related risks. In such cases, the staff will comment that funds should distinguish which of the strategies and risks are principal and which are not principal.

- *Avoid Cross-References*: Form N-1A provides that, in responding to the required information in the prospectus, funds should avoid cross-references to the SAI or shareholder reports.[152] The Form further provides that "[c]ross references within the prospectus are most useful when their use assists investors in understanding the information presented and does not add complexity to the prospectus."[153] The staff frequently observes funds with numerous cross-references in the Summary Section, which the staff believes can add complexity. When appropriate, the staff suggests that the cross-references be deleted to streamline the Summary Section.

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[149] *See supra note 12.*

[150] *Item 16(b) of Form N-1A.*

[151] *General Instruction C.3.(b) of Form N-1A. Such information may be included so long as the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of the information that is required to be included. Id.*

[152] *General Instruction C.3.(a) of Form N-1A.*

[153] *Id.*

e. Investments, Risks, and Performance

Following the fee table and example, we are requiring, substantially as proposed, that a fund disclose its principal investment strategies and risks.[154] This includes the current bar chart and table illustrating the variability of returns and showing the fund's past performance.

We are modifying the narrative that is required to accompany the bar chart and performance table in one respect to address the views expressed by both focus group investors and commenters. A fund that makes updated performance information available on a Web site or at a toll-free (or collect) telephone number will be required to include a statement explaining this and providing the Web site address and/or telephone number.[155] A number of investors in focus groups expressed the view that the availability of updated performance information, particularly at a Web site, would be helpful.[156] In addition, many industry commenters noted that funds routinely make updated performance information available to investors either by Internet Web site or by telephone and suggested that the summary section direct investors to this information.[157] Particularly in light of our determination not to require quarterly updating of the Summary Prospectus, which is discussed below,[158] we believe that it will be helpful to investors for the summary section to indicate where updated performance information may be found. We are not modifying the required bar chart and performance table to add additional comparative information as suggested by several commenters.[159] Currently, funds are required to include an appropriate broad-based securities market index in the performance table.[160] We have determined not to require additional comparative performance information at this time because we are concerned that it would tend to undermine our goal of a concise, user-friendly summary of key information by contributing to the length and complexity of the

[154] *Item 4 of Form N-1A. To conform to other changes we are adopting to Form N-1A, the Instructions to Item 4 contain technical revisions that (1) amend cross-references to other Items in Form N-1A; and (2) eliminate language related to the presentation of performance information for more than one fund, given the requirement that information for each fund be presented separately. Instructions 2(e) and 3 to Item 4(b)(2) of Form N-1A.*

[155] *Item 4(b)(2)(i) of Form N-1A.*

[156] *See Focus Group Report, supra note 32, at 11; see, e.g., Focus Group Transcripts, supra note 32, at 49, 78.*

[157] *See, e.g., AIM Letter, supra note 47; American Century Letter, supra note 48; Capital Research Letter, supra note 34; Fidelity Letter, supra note 86; ICI Letter, supra note 34; Janus Letter, supra note 63; Oppenheimer Letter, supra note 44; Putnam Letter, supra note 48; Russell Letter, supra note 48; T. Rowe Letter, supra note 49.*

[158] *See discussion infra Part III.B.2.c.*

[159] *See, e.g., Letter of Scott Hastings (Feb. 11, 2008) (suggesting comparative disclosure of the portfolio manager's stated benchmark); Morningstar Letter, supra note 34 (same).*

[160] *Current Item 2(c)(2)(iii) of Form N-1A; Instruction 5 to current Item 22(b)(7) of Form N-1A. A fund is also permitted to include information for one or more other indexes. Instruction 6 to current Item 22(b)(7) of Form N-1A. If an additional index is included, a fund is required to disclose information about the additional index in the narrative explanation accompanying the bar chart and table (e.g., by stating that the information shows how the fund's performance compares with the returns of an index of funds with similar investment objectives).*

summary section. Further, as with cost information,[161] we believe that it is preferable for investors and other users of the prospectus to be given the flexibility to make a variety of performance benchmark comparisons. Our ongoing interactive data initiative is intended to provide the tools necessary to facilitate dynamic comparisons of this type, and we note that the information in the bar chart and performance table is covered by our recently proposed rules that would, if adopted, require mutual funds to file information in an interactive data format.[162]

New Form N-1A Adopting Release; Investment Company Act Release No. 23064 (February 10, 1998)

1. Risk/Return Summary: Investments, Risks, and Performance (Item 2).

The Commission proposed to require a risk/return summary at the beginning of every prospectus that would provide key information about a fund's investment objectives, principal strategies, risks, performance, and fees. The risk/return summary, also included in the Proposed Profile, was intended to respond to investors' strong preference for summary information about the fund in a standardized format. The proposed risk/return summary in a fund's prospectus would provide investors with a type of "executive summary" of key information about the fund in a standardized, easily accessible place that investors could use to evaluate and compare the fund to others, regardless of whether the fund uses a profile.

While most commenters supported the proposed risk/return summary, several questioned whether it was necessary in a prospectus. These commenters argued that the summary could repeat other information in the prospectus and that it would undermine the Commission's goal of making prospectus disclosure clear and concise.

The Commission is of the view that the prospectus risk/return summary will not undermine, but further, the goal of making prospectuses more useful for investors. The Commission believes that the disclosure in the risk/return summary need not generally repeat other information in the prospectus; much of the summary consists of information that Form N-1A would not require to be disclosed elsewhere in the prospectus, such as the bar chart, performance table, and fee table. The Commission has concluded that the possibility that the risk/ return summary could repeat some information appearing elsewhere in the prospectus isoutweighed by the benefits of providing investors with standardized and comparable fund information at the beginning of every prospectus and in the profile. Thus, the Commission is adopting the requirement that every prospectus and profile contain a risk/return summary.[163]

[161] *See supra note 127 and accompanying text.*

[162] *See Investment Company Act Release No. 28298, supra note 28, 73 FR at 35442.*

[163] *Items 2 and 3. Consistent with the goal of providing key information in a standardized summary, General Instruction C.3(b) to Form N-1A, as amended, precludes a fund from including information in the prospectus risk/return summary that is not required or otherwise permitted by Items 2 and 3. Form N-1A, as amended, does not require a fund to include any risk disclosure elsewhere in the prospectus if the requirements of Item 4 of Form N-1A are met by the disclosure in the fund's risk/return summary (i.e., if a fund is able to describe its risks, as required by Item 4, in its risk/ return summary, the fund would not need to describe those risks elsewhere in its prospectus).*

The Commission proposed to require that the risk/return information in the prospectus, like that in the Proposed Profile, appear in a specific sequence and in a question-and-answer format. Many commenters objected to the question-and-answer format, stating, among other things, that rigid adherence to the format would not necessarily result in effective communication of information to investors.[164] To allow funds to design effective disclosure documents, the Commission has determined not to require this format in the prospectus or the profile. Any fund that chose to do so could use a question-and-answer format in its prospectus, profile, or in both documents.

a. Investment Objectives and Principal Strategies

The Proposed Amendments would require a fund to disclose its investment objectives in the risk/return summary and to summarize, based on the information provided in its prospectus, how the fund intends to achieve those objectives. The purpose of the proposed disclosure was to provide a summary of the fund's principal investment strategies, including the specific types of securities in which the fund principally invests or will invest, and any policy of the fund to concentrate its investments in an industry or group of industries.[165] The Commission is adopting this requirement as proposed.[166]

The information contained in the risk/return summary about a fund's investment objectives and principal strategies is intended to meet the needs of an average or typical fund investor. Recognizing that disclosure about a fund's specific portfolio holdings may be important to some investors, the Proposed Amendments would require a fund to inform investors in its prospectus risk/return summary that additional information about the fund's investments is available in the fund's shareholder reports.[167] While supporting the proposed disclosure, most commenters suggested placing statements about how investors can obtain a fund's SAI, shareholder reports, and other information about the fund on the back cover page of the prospectus. According to these commenters, this disclosure would be easier for investors to find if it were located in one place rather than in different places in the prospectus. The Commission agrees with the commenters that typical fund investors may find a single reference to the availability of additional information helpful. Therefore, Form N-1A, as amended, requires all disclosure about the availability of additional information to appear on the back

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[164] *See Profile Adopting Release,* supra *note 1 (discussing commenters' critiques of the question-and-answer format).*

[165] *See infra notes 91-101 and accompanying text (discussing the criteria for determining whether a particular strategy is a principal strategy and disclosure about concentration policies).*

[166] *Items 2(a) and (b).*

[167] *The Commission proposed that the prospectus risk summary refer to fund shareholder reports. A fund's reports to its shareholders typically contain a discussion by the fund's management of the fund's performance ("MDFP"). The Commission believes that the information in a fund's MDFP, including the discussion of the fund's performance during its most recent fiscal year, could be useful to some investors considering an investment in the fund.*

The Proposed Amendments would require the risk/return summary to provide disclosure to the following effect:

Additional information about the fund's investments is available in the fund's annual and semi-annual reports to shareholders. In particular, the fund's annual report discusses the relevant market conditions and investment strategies used by the fund's investment adviser that materially affected the fund's performance during the last fiscal year. You may obtain these reports at no cost by calling - - .

cover page of the prospectus.[168] The Commission is adopting the disclosure as proposed, with minor adjustments to the language to ensure that the disclosure clearly explains the availability of additional information about a fund to a typical investor.[169]

b. Risks.

Summary Risk Disclosure. The Proposed Amendments would require the risk/return summary to include a discussion of the principal risks of investing in a fund that summarizes information about those risks set out in the fund's prospectus. Reflecting the Commission's proposed new approach to risk disclosure, this discussion was intended to summarize the risks of a fund's anticipated portfolio holdings as a whole, and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, and total return. Commenters generally supported the summary risk disclosure contemplated by the Proposed Amendments, agreeing that it would be specific and brief and would assist investors in identifying the principal risks of investing in a particular fund. The Commission is adopting this disclosure requirement with modifications to reflect certain commenters' suggestions.[170]

Several commenters asked the Commission to clarify the scope of the proposed summary risk disclosure, arguing that the requirement would not serve its purpose if the risk disclosure simply repeated information from other sections of the prospectus. In the Commission's view, the purpose of the summary risk disclosure in a fund's prospectus is to identify briefly the principal risks of investing in the particular fund and to emphasize those risks reasonably likely to affect the fund's performance. In light of this purpose, the Commission expects a fund, in meeting this requirement, to present only a succinct summary of the principal risks of investing in the fund and not to repeat the fuller discussion of these risks required elsewhere in the prospectus.[171] On the other hand, the Commission believes that it generally would be inconsistent with the summary risk requirement for a fund to include a "laundry list" of generic risk factors that may apply to any fund and that does not identify the risks of investing in the fund.

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[168] *Item 1(b). Rule 498, as adopted, requires this disclosure to appear in the profile risk/return summary. See Profile Adopting Release,* supra *note 1.*

[169] *The Commission has made a few revisions to the disclosure about the availability of additional information to make it clearer and more understandable for investors. Item 1(b)(1) of Form N-1A, as amended, requires a fund (other than a new fund) to include disclosure to the following effect on the back cover page of its prospectus:*

[170] *Item 2(c).*

[171] *See discussion of risk disclosure,* infra *Section II.A.3.b.*

The Commission proposed to require that the prospectus risk summary identify the types of investors for whom the fund may be an appropriate or inappropriate investment.[172] Commenters either opposed or raised significant concerns about this provision, arguing that it could be viewed as requiring a fund to determine whether its shares, among other things, are a suitable investment for a particular investor.[173] Commenters also stated that the disclosure would tend to be generic and not meaningful or useful for investors.

Additional information about the fund's investments is available in the fund's annual and semi-annual reports to shareholders. In the fund's annual report, you will find a discussion of the market conditions and investment strategies that significantly affected the fund's performance during its last fiscal year.

The Commission is persuaded by commenters that disclosure about the appropriateness of funds for particular investors should not be required in all fund prospectuses and has deleted this requirement from the prospectus risk summary. The Commission believes, however, that disclosure indicating whether a fund is appropriate for specific types of investors or is consistent with certain investment goals, even if generic in nature, may be useful for some investors and may provide a means for the fund to distinguish itself from other investment alternatives.[174] Therefore, Form N-1A, as amended, permits, but does not require, a fund to include disclosure in the narrative risk summary about the types of investors for whom the fund is intended or the types of investment goals that may be consistent with an investment in the fund.[175]

Under the Proposed Amendments, a fund could choose to discuss the potential rewards of investing in the fund in the risk summary as long as the discussion provided a balanced presentation of the fund's risks and rewards. One commenter strongly questioned this provision of the proposal, asserting that it would detract from a clear presentation of risks in the risk summary. The Commission has reconsidered this disclosure in light of the intended standardized and summary nature of the risk summary and has concluded that the disclosure

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[172] *As discussed in the Form N-1A Proposing Release,* supra *note 8, at 10902, the purpose of this disclosure was to help investors evaluate and compare funds based on their investment goals and individual circumstances.*

[173] *As several commenters pointed out, applicable regulatory rules for brokers and other investment professionals require that these determinations be made on the basis of a review of information about the unique circumstances of an individual investor. See, e.g., rule 2310(a) of the National Association of Securities Dealers, Inc. ("NASD") Conduct Rules, NASD Manual (CCH) 4261 (suitability of recommendations to customers) and rule 405 of the New York Stock Exchange, 2 N.Y.S.E. Guide (CCH) 2403 (the "know your customer" rule).*

[174] *In a recent review of fund prospectuses, the Division found many examples of this type of disclosure, which was usually included in a fund's discussion of the risks associated with an investment in the fund. For example, one fund disclosed that it was not an appropriate investment for investors seeking either preservation of capital or high current income or for those investors unable to assume the increased risks of higher price volatility and currency fluctuations associated with investments in international equities traded in non-U.S. currencies. Another fund urged investors to remember that the fund was an aggressive capital appreciation fund designed for long-term investors for a portion of their investments and was not designed for investors seeking income or conservation of capital. Tax-exempt funds frequently stated that an investment in the fund is not appropriate for Individual Retirement Accounts or other tax-advantaged accounts.*

[175] *Instruction to Item 2(c)(1)(i).*

should focus solely on the risks of investing in a fund. Thus, the Commission has determined standardized and summary nature of the risk summary and has concluded that the disclosure should focus solely on the risks of investing in a fund. Thus, the Commission has determined to eliminate the option to describe the rewards of investing in a fund in the risk summary. A fund desiring to add this disclosure elsewhere in its prospectus can do so subject to Form N-lA's general rule with respect to information that is not required to be in a prospectus. Under this general rule, a fund can disclose this information, so long as it is not incomplete or misleading and would not obscure or impede understanding of the information that is required to be in the prospectus.[176]

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Risk/Return Bar Chart and Table. The Proposed Amendments would require a fund's risk/return summary to include a bar chart showing the fund's annual returns for each of the last 10 calendar years and a table comparing the fund's average annual returns for the last 1-, 5-, and 10-fiscal years to those of a broad-based securities market index. Commenters generally supported the proposed bar chart and performance table, but had a number of suggestions about the content and presentation of the information in both. The Commission is adopting the proposed bar chart and table requirements with modifications to reflect suggestions of commenters.[177]

The bar chart reflects the Commission's determination that investors need improved disclosure about the risks of investing in a fund. The bar chart is intended to illustrate graphically the variability of a fund's returns (*e.g.*, whether a fund's returns for a 10-year period have changed significantly from year to year or were relatively even over the period) and thus provide investors with some idea of the risk of an investment in the fund.[178] The average annual return information in the table should enable investors to evaluate a fund's performance and risks relative to "the market." In the Form N-1A Proposing Release, the Commission requested comment about alternative presentations that could improve fund risk

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[176] *See General Instruction C.3(b).*

[177] *Item 2(c)(2). An example of the bar chart and performance table is attached as Appendix B to this release.*

[178] *In adopting the bar chart requirement, the Commission does not mean to suggest that all, or even a significant portion of all, fund investors equate variability in a fund's returns with the risks of investing in the fund. As discussed below, the Commission acknowledges that investors have a wide range of ideas of what "risk" means. See* infra *Section II.A.3. Nonetheless, the Commission's bar chart proposal was supported by many investors who expressed strong interest in seeing prospectuses include a version of the bar chart. Focus group participants, for instance, found the bar chart helpful in evaluating and comparing fund investments. Over 75% of individual investors responding to the Risk Concept Release favored a bar chart presentation of fund volatility. Risk Concept Release,* supra *note 18. See also ICI, UNDERSTANDING SHAREHOLDERS' USE OF INFORMATION AND ADVISERS (1997) ("ICI SHAREHOLDER USE STUDY") at 20 and 30 (discussing investors' interest in receiving and understanding fund risk information) and ICI RISK SURVEY,* supra *note 21. In addition, all commenters responding to the Commission's initiative to simplify money market fund prospectuses supported the proposal to replace the financial highlights information in money market fund prospectuses with a 10-year bar chart reflecting a money market fund's yield. See Summary of Comment Letters on Proposed Amendments to the Rules Regulating Money Market Fund Prospectuses Made in Response to Investment Company Act Release No. 21216, at 2 (File No. S7-21-95).*

disclosure.[179] In particular, the Commission expressed interest in disclosure that would show a fund's highest and lowest returns (or "range" of returns) for annual or other periods as an alternative, or in addition, to the bar chart. The Commission suggested that a fund could present the information in a separate table or could include it in the performance table.

In response to the Commission's request, some commenters suggested including in a fund's bar chart one or more indexes or other benchmarks (such as 3-month Treasury returns or the rate of inflation) to help investors evaluate the fund's returns by comparisons to other measures of market performance or economic factors.[180] Most commenters, however, opposed requiring additional information in the bar chart, asserting that it could complicate and reduce the effectiveness of the bar chart.

Several commenters supported the inclusion of return information in the bar chart on a quarterly or semi-annual rather than an annual basis. They argued that this change to the bar chart would respond to concerns that investors may not sufficiently appreciate that an investment in a fund may be subject to the risk of a short-term decline in value. This risk, commenters asserted, may not be apparent from the annual returns proposed to be shown in the bar chart. One commenter recommended that the Commission require quarterly returns in the bar chart so that investors would have more information about returns over shorter periods to use in assessing the variability reflected in a fund's past returns. The commenter argued that including returns on an annual basis in the bar chart may not show a significant amount of shorter-term price fluctuation.

The Commission acknowledges that a fund's returns may vary significantly and could decrease in value over short periods and that the annual returns in the bar chart will not necessarily reflect this pattern. On the other hand, the Commission is concerned that requiring quarterly returns over a 10-year period would make the bar chart more complex and less useful in communicating information to investors. In balancing the desire to make typical fund investors aware that fund shares may experience fluctuations over shorter periods with its underlying goal that fund documents communicate information in as straightforward and uncomplicated a manner as possible, the Commission has determined to require a fund to disclose, in addition to the bar chart, its best and worst returns for a quarter during the 10-year (or other) period reflected in the bar chart.[181] The Commission believes that this information will assist investors in understanding the variability of a fund's returns and the risks of investing in the fund by illustrating, without adding unwarranted complexity to the bar chart, that the fund's shares may be subject to short-term price fluctuations.

Presentation of Return Information. The Proposed Amendments would require a fund to include the bar chart and table in the risk section of the prospectus risk/return summary

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[179] *See Form N-1A Proposing Release,* supra *note 8, at 10907.*

[180] *Form N-1A, as amended, permits a fund to use other indexes in the presentation of the average annual return information in the table accompanying the bar chart. Instruction 2(b) to Item 2(c)(2).*

[181] *Item 2(c)(2)(ii).*

under a separate sub-heading that referred to both risk and performance. Several commenters argued that the separate sub-heading requirement was unnecessary and suggested that a fund should be able to choose whether to include any sub-heading. Consistent with the objective of encouraging funds to develop disclosure formats that are most helpful to investors, Form N-1A, as amended, does not require the sub-heading included in the Proposed Amendments.[182] To help investors use the information in the bar chart and table, Form N-1A, as amended, however, does require a fund to provide a brief narrative explanation of how the information illustrates the variability of the fund's returns.[183]

Bar Chart Return Information. The Proposed Amendments would require that a fund's prospectus bar chart show the fund's annual returns for the last 10 calendar years of the fund's existence. The purpose of the calendar year requirement was to facilitate the comparison of annual returns among funds, which typically have fiscal periods that do not correspond to the calendar year.[184] Unlike the proposed bar chart, the proposed performance table required disclosure of a fund's returns for fiscal year periods. In requiring this disclosure to be made for fiscal year periods, the proposal was consistent with existing disclosure requirements for the presentation of other financial information included in a fund's prospectus.

Several commenters argued that using different time periods for the proposed bar chart and performance table would confuse investors and urged the Commission to minimize potential investor confusion by adopting consistent time periods for this information. The Commission is persuaded by these comments and believes that requiring both the bar chart and the performance table to be based on calendar year periods will promote understandable information in fund prospectuses. Therefore, Form N-1A, as amended, requires calendar year periods for both the bar chart and table.[185] Rule 498, as adopted, also requires the bar chart and table in the profile to show calendar year data so that both the profile and the prospectus of a fund will have virtually the same risk/return information.[186]

The Commission is adopting, as proposed, the requirement that a fund calculate the annual returns in the bar chart using the same method required for calculating annual returns

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[182] *General Instruction C.1(a) to Form N-1A, as amended, encourages funds to use document design techniques that promote effective communication.*

[183] *Item 2(c)(2)(i).*

[184] *The Commission understands that funds increasingly organize themselves as series companies and tend to stagger the financial periods of their series so that audits and financial reporting periods are spread over an entire calendar year.*

[185] *Item 2(c)(2). Form N-IA, as amended, requires a fund to have at least one calendar year of returns before including the bar chart and requires a fund to modify the narrative explanation accompanying the bar chart and table if the fund does not include the bar chart (e.g., by stating that the information gives some indication of the risks of an investment in the fund by comparing the fund's performance with a broad measure of market performance). Form N-1A, as amended, also requires the bar chart of a fund in operation for fewer than 10 years to include calendar year returns for the life of the fund.*

[186] *Rule 498(c)(2)(iii). Unlike Form N-1A, as amended, rule 498, as adopted, requires average annual return information in the performance table in the profile to be as of the most recent calendar quarter and updated as soon as practicable after each quarter of a calendar year. See Profile Adopting Release,* supra *note 1. A fund would update the average annual return information included in its prospectus when filing the annual update of its registration statement required by section 10(a)(3) of the Securities Act.*

in the financial highlights information included in fund prospectuses.[187] The bar chart does not reflect sales loads assessed upon the sale of a fund's shares, although the average annual return information for the fund in the table would reflect the payment of any sales loads.[188] Commenters generally supported this presentation of annual return information. The Commission believes that, in light of the different types of sales loads that may be charged on funds shares, it would be difficult for funds to compute annual returns for the purposes of the bar chart and to communicate the information effectively to investors.[189] In addition, the Commission has concluded that more precise return information is not necessary for the bar chart to serve the purpose of graphically showing fund annual returns and illustrating the variability of an investment in a fund over a 10-year period.

Bar Chart Presentation. The Proposed Amendments would allow a single bar chart to include return information for more than one fund. Most commenters supported the proposal, agreeing that it would give funds the appropriate amount of flexibility to present the information in the bar chart in a manner designed to assist investors in making investment decisions. Under Form N-1A, as amended, the bar chart may include returns for more than one fund, subject to the general requirement that the information presented in the bar chart appear in a clear and understandable manner.[190]

Multiple Class Funds. Although the Commission proposed to permit return information for more than one fund to be included in a single bar chart, the Proposed Amendments would require a fund offering more than one class of its shares in a prospectus to limit the information in the fund's bar chart to one class. Commenters uniformly supported this approach, and the Commission is adopting it as proposed.[191] Unlike individual funds, classes of a fund represent interests in the same portfolio of securities, and the returns of each class differ only to the extent the classes do not have the same expenses; The Commission believes that including return information for all classes offered through a fund's prospectus is not necessary to provide some indication of the risks of investing in the fund. In addition, the table accompanying such a fund's bar chart would provide return information for each class offered in the prospectus so that investors would be able to identify and compare the performance of each class.[192]

The Proposed Amendments would require the bar chart of a fund offering more than one class of shares through a prospectus to reflect annual return information for the class offered

[187] *Instruction 1(a) to Item 2(c)(2). Form N-1A, as amended, requires a fund to present the corresponding numerical return adjacent to each bar. Item 2(c)(2)(ii).*

[188] *Instruction 2(a) to Item 2(c)(2). Form N-1A, as amended, requires a fund whose shares are sold subject to a sales load to disclose that the load is not reflected in the bar chart and that, if it were included, returns would be less than those shown. Instruction 1(a) to Item 2(c)(2).*

[189] *In contrast, sales loads can be accurately and fairly reflected in annual return information of the type contained in the table by deducting sales loads at the beginning (or end) of particular periods from a hypothetical initial fund investment.*

[190] *See General Instruction C.3(c).*

[191] *Instruction 3(a) Item 2(c)(2).*

[192] *Instruction 3(c) to Item 2(c)(2).*

in the prospectus that had the longest performance history over the last 10 years. When two or more classes have returns for at least 10 years, or returns for the same period but fewer than 10 years, the Proposed Amendments would require annual returns for the class with the greatest net assets as of the end of the most recent calendar year. Most commenters addressing the issue opposed this approach. They argued that, if all classes had existed for the same amount of time, the largest class could change from year to year, thus requiring a fund to change the class reflected in the bar chart. According to the commenters, changes in the information each year could be confusing for investors and result in unwarranted administrative burdens for funds. Commenters suggested that the Commission permit a fund having classes with performance histories extending over the same period of time to include the performance of any existing class in the bar chart, maintaining that the effect of expenses on the returns for different classes of shares is not significant.[193] The Commission is persuaded that allowing a multiple class fund in such a case to choose the class reflected in the fund's bar chart will simplify compliance with Form N-1A's requirements and provide investors with sufficient information to evaluate the variability of returns for any class of the fund. Therefore, Form N-1A, as amended, permits a fund to choose the class to be reflected in the bar chart, subject to certain limitations.[194] Under Form N-1A, as amended, the bar chart must reflect the performance of any class that has returns for at least 10 years (*e.g.*, a fund could not present a class in the bar chart with 2 years of returns when another class has returns for at least 10 years). In addition, if two or more classes offered in the prospectus have returns for different periods shorter than 10 years, the bar chart must reflect returns for the class that has returns for the longest period.

Tabular Presentation of Fund and Index Returns. The Proposed Amendments would require a table accompanying a fund's bar chart to present the fund's average annual returns for the last 1-, 5-, and 10-fiscal years (or for the life of the fund, if shorter) and to compare that information to the returns of a broad-based securities market index for the same periods. The purpose of including return information for a broad-based securities market index was to provide investors with a basis for evaluating a fund's performance and risks relative to the market. The proposed approach also was consistent with the line graph presentation of fund performance required in MDFP disclosure.[195]

Commenters generally supported the proposed performance table, but had several technical suggestions. The Commission is adopting the performance table with revisions to clarify the disclosure requirements for the table.[196]

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[193] *In making this argument, commenters cited rule 18f-3 under the Investment Company Act [17 CFR 270.18f-3], which provides that a class of shares may have different expenses for shareholder service fees, distribution fees, or other expenses actually incurred in a different amount by the class. The rule does not permit expenses for advisory or custodial fees, or other management fees, to vary among classes.*

[194] *Instruction 3(a) to Item 2(c)(2).*

[195] *See MDFP Adopting Release,* supra *note 15, at 19054.*

[196] *Item 2(c)(2)(ii). Consistent with the Proposed Amendments, Form N-1A, as amended, requires a fund to calculate average annual returns using the same method required to calculate fund performance included in advertisements, which reflects the payment of sales loads and recurring shareholder account fees. Instruction 2(a) to Item 2(c)(2) (incorporating the requirements of Item 21).*

One commenter suggested that the Commission allow funds that have existed for more than 10 years to include average annual returns for the life of the fund in the performance table. The Commission agrees that this information could be helpful for typical investors in such a fund. Form N-1A, as amended, permits, but does not require, a fund to include performance information in the table for the life of the fund if it exceeds 10 years.[197]

The Proposed Amendments would require a money market fund, in meeting the proposed performance table requirement, to provide its 7-day yield as of the end of its most recent fiscal year. One commenter questioned this requirement, arguing that it would result in money market funds giving outdated information to investors and suggested that disclosure describing how an investor can obtain the fund's current 7-day yield would be preferable. As amended, Form N-1A gives a money market fund the option of providing in its performance table its 7-day yield ending on the date of its most recent calendar year or disclosing a toll-free (or collect) telephone number that an investor can use to contact the fund to obtain its current 7-day yield.[198]

[197] *Item 2(c)(2)(iii). Form N-1A, as amended, permits a fund that has not had the same adviser for the last 10 years to begin the bar chart and performance information in the table on the date the new adviser began to provide advisory services to the fund, so long as certain conditions are met. Instruction 4 to Item 2(c)(2). Form N-1A, as amended, also requires a fund that changes the index shown in the table to explain the reasons for the change and provide information for both the newly selected and the former index. Instruction 2(c) to Item 2(c)(2). Each of these provisions is consistent with the requirement applicable to the MDFP line graph. Instructions 7 and 11 to Item 5(b).*

[198] *Item 2(c)(2)(iii).*

Disclosure of Mutual Fund After-Tax Returns—Adopting Release IC-24832 (January 18, 2001) [Also see commentary following Item 21]

[Footnotes omitted except for footnote 58.]

Required Disclosure of After-Tax Returns

The Commission is adopting, with modifications, the requirement that mutual funds disclose after-tax return, a measure of a fund's performance adjusted to reflect taxes that would be paid by an investor in the fund. As discussed more fully below, funds will be required to include after-tax return information in the risk/return summary of the prospectus. Funds will not generally be required to include after-tax returns in advertisements or other sales materials. Funds will, however, be required to include after-tax returns computed according to a standardized formula in sales materials that either include after-tax returns or include any other performance information together with representations that the fund is managed to limit taxes.

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We strongly encourage funds to develop web-based calculators and other tools that investors may use to compute their individualized after-tax return for a fund. This information will be very useful to investors in assessing how a particular fund has performed for them. We believe, however, that after-tax returns should be made available to all investors, not only to those who have the ability to access and use these web-based programs. In addition, personalized after-tax calculators often do not facilitate ready comparisons of different funds' after-tax performance.

Types of Return to Be Disclosed

As proposed, funds will be required to calculate after-tax returns using a standardized formula similar to the formula presently used to calculate before-tax average annual total return. We proposed to require funds to disclose after-tax return for 1-, 5-, and 10-year periods on both a "pre-liquidation" and "post-liquidation" basis, and we are adopting that requirement. Pre-liquidation after-tax return assumes that the investor continued to hold fund shares at the end of the measurement period, and, as a result, reflects the effect of taxable distributions by a fund to its shareholders but not any taxable gain or loss that would have been realized by a shareholder upon the sale of fund shares. Post-liquidation after-tax return assumes that the investor sold his or her fund shares at the end of the measurement period, and, as a result, reflects the effect of both taxable distributions by a fund to its shareholders and any taxable gain or loss realized by the shareholder upon the sale of fund shares. Pre-liquidation after-tax return reflects the tax effects on shareholders of the portfolio manager's purchases and sales of portfolio securities, while post-liquidation after-tax return also reflects the tax effects of a shareholder's individual decision to sell fund shares.

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In response to commenters' concerns about investor confusion, we are streamlining the returns required to be disclosed. Most commenters recommended that we revise the proposed pre-liquidation after-tax return figure to deduct fees and charges payable upon a redemption of fund shares, such as sales charges or redemption fees. This would make the pre-liquidation after-tax return figure comparable to currently required standardized before-tax returns, which also deduct fees and charges payable upon sale, and would result in comparable disclosure by funds that impose sales charges upon purchase and those that impose sales charges upon redemption. Commenters also argued that this modification would eliminate the need for the proposed pre-liquidation before-tax return figure with no deduction of fees and charges payable upon sale, thereby simplifying the presentation of before- and after-tax returns.

We agree and have eliminated pre-liquidation before-tax returns. This will result in three, rather than four, types of return, all of which are net of all fees and charges: before-tax return; return after taxes on distributions (pre-liquidation); and return after taxes on distributions and redemption (post-liquidation). To address concerns that investors could be confused by a pre-liquidation after-tax return measure that assumes no sale of fund shares for purposes of computing tax consequences but nonetheless reflects fees and charges payable upon a sale of fund shares, we have modified the captions in the performance table to focus investor attention on the taxes that are deducted, rather than whether or not the shareholder held or sold his shares.

Location of Required Disclosure

We are requiring, as proposed, that funds disclose after-tax returns in the performance table contained in the risk/return summary of the prospectus. The amendments also will have the effect of requiring that after-tax returns be included in any fund profile because a profile must include the prospectus risk/return summary. We proposed, but are not adopting, a requirement that after-tax returns be included in Management's Discussion of Fund Performance ("MDFP"), which is typically contained in the annual report. Funds will, however, be required to state in the MDFP that the performance table and graph do not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares.

We are requiring that after-tax returns be included in the prospectus and profile because, for the overwhelming majority of prospective investors who base their investment decision, in part, on past performance, after-tax returns can be useful in understanding past performance. Most commenters that addressed the issue of the appropriate location for after-tax return disclosure supported requiring disclosure of after-tax returns in fund prospectuses.

Several commenters recommended that after-tax returns not be included in fund profiles. Commenters were concerned that the length and complexity of the disclosure could overwhelm the remaining information in the profile, defeating the purpose of the summary disclosure document. We continue to believe, however, that after-tax returns should be included

in the fund profile because of the importance of past performance in many investors' investment decisions. We have, however, addressed the concerns expressed by commenters by simplifying the presentation of required after-tax returns.

We are concerned, however, that investors may be confused about whether the returns included in the performance table and graph in the MDFP have been calculated on a before- or after-tax basis. Therefore, funds will be required to include a statement in the MDFP that accompanies the performance table and graph to the effect that the returns shown do not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares.

Format of Disclosure

We are requiring, as proposed, that before and after-tax returns be presented in a standardized tabular format. Consistent with the modifications to the types of returns required, funds must present before- and after-tax returns as follows: [See text in Item]

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Before- and after-tax returns must be presented in the order specified, using the captions provided by Form N-1A. When more than one fund or series is offered in a prospectus, the before- and after-tax returns of each fund or series must be adjacent to one another. A prospectus may not, for example, present the before-tax returns for all funds, followed by the after-tax returns for all funds. We believe that this presentation will help investors to compare funds and to understand the differences among the different measures of return for any particular fund.

We have modified the captions in the performance table to focus investor attention on the taxes that are deducted, rather than whether or not the shareholder held or sold his shares. We have also modified the captions to clarify that returns are shown for the life of the fund, if shorter than the 5- or 10-year measurement periods, and that the language following the caption for the index may be modified, as appropriate, to be consistent with the index selected by the fund.

We have also simplified the presentation for funds that offer multiple classes of a fund in a single prospectus. We were persuaded by several commenters who argued that requiring after-tax returns for all classes of a fund, as proposed, could result in overwhelming or confusing disclosure to investors, and that, with the exception of expense ratio differences, which affect the level of dividend distributions, the tax burden of the various share classes will be similar. We have modified the amendments to require that a fund offering multiple classes in a single prospectus present the after-tax returns of only one class. The class selected must be offered to investors who hold their shares through taxable accounts and have returns for at least 10 years, or, if no such class has 10 years of return, be the class with the returns for the longest period.

A fund that offers multiple classes in a single prospectus must explain in the narrative that accompanies the performance table that the after-tax returns are for only one class offered by the prospectus and that the after-tax returns for other classes will vary. In addition, in order to facilitate comparisons among the returns shown, after-tax returns for the one class presented must be adjacent to the before-tax returns for that class and not interspersed with the before-tax returns of the other classes, returns of other funds, or with the return of the broad-based securities market index. The return of the broad-based securities index may either precede or follow the returns for the fund.

Exemptions from the Disclosure Requirement

We are exempting money market funds from the requirement to disclose after-tax returns, as proposed. We are also adopting, with modifications, our proposal to permit a fund to omit the after-tax return information in a prospectus used exclusively to offer fund shares as investment options for defined contribution plans and similar arrangements.

Specifically, we are permitting a fund to omit the after-tax return information in a prospectus used exclusively to offer fund shares as investment options to one or more of the following:

- a defined contribution plan that meets the requirements for qualification under section 401(k) of the Internal Revenue Code ("Code");
- a tax-deferred arrangement under section 403(b) or 457 of the Code;
- a variable contract as defined in section 817(d) of the Code;
- a similar plan or arrangement pursuant to which an investor is not taxed on his or her investment in the fund until the investment is sold; 54 or
- entities that are not subject to the individual federal income tax.

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The Commission carefully considered whether to exclude bond funds, generally, or tax-exempt funds, specifically, from the requirement to disclose after-tax returns. A number of commenters argued that bond funds should be exempt from disclosing after-tax returns because investors in bond funds are generally aware of the tax consequences of investing in these funds, the funds do not usually make unexpected distributions of capital gains, and the funds are bought for their yield and not their growth potential. Other commenters argued that bond funds should not be exempt because such funds may have significant capital gains or losses in volatile markets, certain types of bond funds commonly realize significant capital gains, and some managers of bond funds seek to avoid making capital gains distributions by using various tax management strategies.

Having considered the views expressed by commenters, we have decided not to exempt bond funds from disclosing after-tax returns. While investors may more readily understand the tax impact of owning a bond fund that makes few, if any, capital gains distributions, than

the tax impact of owning other funds, bond funds may have significant capital gains or losses, and we believe that it is important for after-tax return information to be available to their shareholders.

Similarly, while most, if not all, income distributed by a tax-exempt mutual fund generally will be tax-exempt, a tax-exempt mutual fund may also make capital gains distributions that are taxable and an investor is taxed on gains from the sale of fund shares. As a result, the performance of a tax-exempt fund may be affected by taxes, and taxes may have a greater or lesser impact on different tax-exempt funds. Therefore, we have decided not to exempt tax-exempt funds from the required disclosure.[199]

SEC Q&A Letter on New Form N-1A (October 2, 1998)

Bar Chart and Performance Table

1) Q: Should the disclosure of a fund's highest and lowest return for a quarter during the 10 calendar years or other period of the bar chart be for calendar quarters or fiscal quarters?

   A: Consistent with the other information in the bar chart and the performance table, the highest and lowest quarterly performance information should be based on calendar quarters.

2) Q: Item 2(c)(2)(ii) of Form N-1A requires that, if a fund's fiscal year is other than a calendar year, it must include year-to-date return information as of the end of the most recent quarter in a footnote to the bar chart. If such a fund does not have a full calendar year of performance information, must it provide year-to-date return information?

   A: No. As with the bar chart itself, year-to-date return information is not required, and is not permitted, until a fund has annual return information for at least one calendar year.

3) Q: May a load fund include in the performance table returns reflecting both the sales load and load-waived returns?

   A: No. Instruction 2(a) to Item 2(c)(2) requires calculation of average annual total returns in accordance with Item 1(b)(1). That Item requires a fund to include the maximum sales loads (including deferred sales loads) and recurring account fees in the calculation of average annual total returns.

[199] *A tax-exempt fund, like any other fund, may assume, when calculating after-tax returns, that no taxes are due on the portions of any distribution that would not result in federal income tax on an individual. Instruction 3(a) to Item 21(b)(2) and Instruction 3(a) to Item 21(b)(3) of Form N-1A.*

4) Q: Must a money market fund include the performance table in its prospectus and, if so, must the table include a comparison to a broad-based securities market index?

A: Item 2(c)(2)(iii) of Form N-lA requires a fund, including a money market fund, that has annual return information for at least one calendar year to include the performance table in its prospectus. While the performance table generally must include the returns of an appropriate broad-based securities market index, consistent with the requirements of Item 5, Management's Discussion of Fund Performance, a money market fund need not compare its performance to a broad-based securities market index. A money market fund may, at its option, include information for one or more other indices as permitted by Instruction 6 to Item 5(b).

5) Q: May a non-money market fund that does not disclose yield information in its risk/return summary provide a telephone number that investors can use to obtain current yield information?

A: Yes. Instruction 2(d) to Item 2(c)(2) of Form N-lA requires a non-money market fund that discloses yield to provide a toll-free (or collect) telephone number that investors can use to obtain current yield information. This requirement does not preclude a non-money market fund that does not disclose yield in its prospectus from providing a telephone number for that purpose. Thus, a non-money market fund, like a money market fund, has the option of providing yield information in its prospectus or disclosing a telephone number that investors can use to obtain current yield information.

SEC Generic Comment Letter for Investment Company CFOs (December 30, 1998)

Updating Performance Data in the Bar Chart

Several registrants have asked whether an investment company must update the performance information in the bar chart required in the prospectus of an open-end investment company when a calendar year-end or calendar quarter-end passes after the investment company has filed a post-effective amendment to its registration statement but before the effective date. Item 2(c)(2)(ii) of Form N-lA requires an investment company to provide its total returns for each of the last 10 calendar years in a bar chart. The Item also requires an investment company to include year-to-date return information as of the most recent quarter in a footnote to the bar chart, if the investment company's fiscal year-end is other than the calendar year-end. We interpret these requirements to mean that an investment company must disclose return information as of the calendar year-end or calendar quarter-end most recently completed prior to the date the investment company files its post-effective amendment that includes its financial statements.[200]

[200] *For example, if a fund files a post-effective amendment under rule 485(a) on November 30, then files a post-effective amendment including its financial statements under rule 485(b) on the following January 30, the fund must update its bar chart to include return information for the calendar year which ended between its first filing and its second filing.*

2013 Guidance Regarding Other Account Performance Presentations from SEC Division of Investment Management Guidance Update No 2013-05 (August 2013)/ Disclosure and Compliance Matters for Investment Company Registrants that Invest in Commodity Interests

II. Performance Presentations

At times, a new fund, with no (or a short) performance track record of its own, may seek to include in its prospectus the performance record of other funds or private accounts managed by the fund's investment adviser. A fund that pursues a strategy of investing in commodity interests, for example, may seek to include in its prospectus the performance records of other funds or private accounts that are managed by the fund's investment adviser and that also invest in commodity interests.

Section 34(b) of the Investment Company Act makes it unlawful for a fund to include in a registration statement filed with the SEC any untrue statement of a material fact, or to omit to state any fact necessary in order to make the information in a registration statement not materially misleading.[201] Section 34(b), however, does not prohibit a fund from including in its registration statement information that is not required by the applicable registration form. The general instructions for preparing a registration statement on Form N-1A or Form N-2 expressly contemplate that a fund may include non-required information. Those instructions state that a fund may include information in addition to that called for by the applicable items of the form, provided that "the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of" the required information.[202] The staff of the Division of Investment Management has previously expressed the view that a fund may include in its prospectus information concerning the performance of private accounts and other funds managed by the fund's adviser that have substantially similar investment objectives, policies, and strategies to the fund, provided that the information is not presented in a misleading manner and does not obscure or impede understanding of information that is required to be included in the fund's prospectus (including the fund's own performance information).[203]

We wish to emphasize that a fund, such as a newly registered fund that invests in commodity interests, that includes in its registration statement information concerning the performance of private accounts or other funds managed by the fund's adviser is responsible for

[201] *See the Matter of Fred Alger Management, Inc., Admin. Proc. File No. 3-7320, Investment Company Act Release No. 17358 (Feb. 26, 1990) (finding violation of Section 34(b) when a fund failed to include information in its prospectus necessary to make presentation of adviser's prior performance not materially misleading).*

In addition, rule 10b-5 under the Securities Exchange Act of 1934 makes it unlawful to make any untrue statement of a material fact in connection with the purchase or sale of any security or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. 17 CFR 240.10b-5.

[202] *General Instruction C.3(b) to Form N-1A; General Instruction 2 for Parts A and B to Form N-2.*

[203] *See, e.g., ITT Hartford Mutual Funds (pub. avail. Feb. 7, 1997) (fund may include in marketing materials performance information for other funds managed by the same adviser with investment objectives, policies, and strategies substantially similar to those of the fund); Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6,1996) (fund may include in prospectus performance information for private accounts managed by the fund's adviser with investment objectives, policies, and strategies substantially similar to those of the fund).*

ensuring that the information is not materially misleading. Specifically, we expect that a fund that includes the performance of other funds or private accounts managed by the fund's adviser in its registration statement would generally include the performance of all other funds and private accounts managed by the adviser that have investment objectives, policies, and strategies substantially similar to those of the fund. We note, in particular, that a fund should not exclude the performance of any other funds or private accounts that have substantially similar investment objectives, policies, and strategies if the exclusion would cause the performance shown to be materially higher or more favorable than would be the case if the funds or accounts were included. A fund should only exclude funds or private accounts if the exclusion would not cause the performance to be materially misleading.[204]

Item 5. Management

(a) *Investment Adviser(s).* Provide the name of each investment adviser of the Fund, including sub-advisers.

Instructions.

1. A Fund need not identify a sub-adviser whose sole responsibility for the Fund is limited to day-to-day management of the Fund's holdings of cash and cash equivalent instruments, unless the Fund is a Money Market Fund or other Fund with a principal investment strategy of regularly holding cash and cash equivalent instruments.

2. A Fund having three or more sub-advisers, each of which manages a portion of the Fund's portfolio, need not identify each such sub-adviser, except that the Fund must identify any sub-adviser that is (or is reasonably expected to be) responsible for the management of a significant portion of the Fund's net assets. For purposes of this paragraph, a significant portion of a Fund's net assets generally will be deemed to be 30% or more of the Fund's net assets.

(b) *Portfolio Manager(s).* State the name, title, and length of service of the person or persons employed by or associated with the Fund or an investment adviser of the Fund who are primarily responsible for the day-to-day management of the Fund's portfolio ("Portfolio Manager").

Instructions.

1. This requirement does not apply to a Money Market Fund.

2. If a committee, team, or other group of persons associated with the Fund or an investment adviser of the Fund is jointly and primarily responsible for the day-to-day management of the Fund's portfolio, information in response to this Item is required for each member of such committee, team, or other group. If more than five persons are jointly and primarily responsible for the day-to-day management of the Fund's portfolio, the Fund need only provide information for the five persons with the most significant responsibility for the day-to-day management of the Fund's portfolio.

[204] *See Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996) (fund may exclude similar accounts from a composite, so long as the exclusion would not cause the composite performance to be misleading).*

e. Management

We are adopting, as proposed, the requirement that the summary section include the name of each investment adviser and sub-adviser of the fund, followed by the name, title, and length of service of the fund's portfolio managers.[205] A fund will not be required to identify a sub-adviser whose sole responsibility is limited to day-to-day management of cash instruments unless the fund is a money market fund or other fund with a principal investment strategy of regularly holding cash instruments.[206] Also, a fund having three or more sub-advisers, each of which manages a portion of the fund's portfolio, will not be required to identify each sub-adviser, except that the fund will be required to identify any sub-adviser that is (or is reasonably expected to be) responsible for the management of a significant portion of the fund's net assets. For this purpose, a significant portion of a fund's net assets generally will be deemed to be 30% or more of the fund's net assets.[207] The portfolio managers required to be listed will be the same ones with respect to which information is currently required in the prospectus.[208]

Several commenters opposed requiring funds to disclose portfolio managers.[209] Two of these commenters argued that the identity and length of service of portfolio managers do not rise to the level of importance necessary to warrant inclusion in the summary.[210] However, the Commission continues to believe, along with other commenters,[211] that investors in a fund should be provided basic information about the individuals who significantly affect the fund's investment operations.

Some commenters noted that funds are often managed by teams and that disclosing the individuals making up such teams would make the summary section too long and would not add substantive disclosure.[212] We note that, as is currently the case, disclosure will be required only with respect to the members of a management team who are jointly and primarily responsible for the day-to-day management of the fund's portfolio.[213] We agree with other

[205] *Item 5 of Form N-1A. Additional disclosures regarding investment advisers and portfolio managers that are currently required in the prospectus will continue to be required, but not in the summary section. Item 10(a) of Form N-1A.*

[206] *Instruction 1 to Item 5(a) of Form N-1A. A fund will continue to be required to provide the name, address, and experience of all sub-advisers elsewhere in the prospectus. Item 10(a)(1)(i) of Form N-1A.*

[207] *Instruction 2 to Item 5(a) of Form N-1A.*

[208] *Item 10(a)(2) of Form N-1A.*

[209] *See, e.g., Capital Research Letter, supra note 34; ICI Letter, supra note 34; Vanguard Letter, supra note 42.*

[210] *See ICI Letter, supra note 34; Russell Letter, supra note 48.*

[211] *See, e.g., AARP Letter, supra note 34; Evergreen Letter, supra note 41; Financial Services Institute Letter, supra note 41. See also Focus Group Transcripts, supra note 32, at 11; id. at 30-31 (importance of fund managers); ICI Survey, supra note 84, at 8 (61% of respondents believed that the name of the portfolio manager was very important or somewhat important).*

[212] *See, e.g., Capital Research Letter, supra note 34; Clarke Letter, supra note 35; Ogg Letter, supra note 75.*

[213] *Instruction 2 to Item 5(b) of Form N-1A. In addition, if more than five persons are jointly and primarily responsible for the day-to-day management of a fund's portfolio, the fund need only provide the required information for the five persons with the most significant responsibility.*

commenters that investors have the same interest in the identity of the individuals who are primarily responsible for management, regardless of whether a fund is managed by an individual portfolio manager or a team.[214]

Item 6. Purchase and Sale of Fund Shares

(a) *Purchase of Fund Shares.* Disclose the Fund's minimum initial or subsequent investment requirements.

(b) *Sale of Fund Shares.* Also disclose that the Fund's shares are redeemable and briefly identify the procedures for redeeming shares (e.g., on any business day by written request, telephone, or wire transfer).

(c) *Exchange-Traded Funds.* If the Fund is an Exchange-Traded Fund,

(i) Specify the number of shares that the Fund will issue (or redeem) in exchange for the deposit or delivery of basket assets (i.e., the securities or other assets the Fund specifies each day in name and number as the securities or assets in exchange for which it will issue or in return for which it will redeem Fund shares) and explain that:

(A) Individual Fund shares may only be purchased and sold on a national securities exchange through a broker-dealer; and

(B) The price of Fund shares is based on Market Price, and because Exchange-Traded Fund shares trade at Market Prices rather than net asset value, shares may trade at a price greater than net asset value (premium) or less than net asset value (discount); and

(ii) If the Fund issues shares in creation units of not less than 25,000 shares each, the Fund may omit the information required by Items 6(a) and 6(b).

[amendment effective November 19, 2018:

(d) If the Fund uses swing pricing, explain the Fund's use of swing pricing; including what swing pricing is, the circumstances under which the Fund will use it, the effects of swing pricing on the Fund and investors, and provide the upper limit it has set on the swing factor. With respect to any portion of a Fund's assets that is invested in one or more open-end management investment companies that are registered under the Investment Company Act, the Fund shall include a statement 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, if applicable, state that the prospectuses for those companies explain the circumstances under which they will use swing pricing and the effects of using swing pricing.]

[214] *See Evergreen Letter, supra note 41; Keil Letter, supra note 62.*

Investment Company Swing Pricing Adopting Release
((Release Nos. 33-10234; IC32316; October 13, 2016)

II. Discussion

B. Disclosure and Reporting Requirements Regarding Swing Pricing

1. Amendments to Form N-1A …

Existing disclosure requirements in the prospectus and statement of additional information related to the pricing of fund shares, would apply to a fund's use of swing pricing. The following text was a footnote to the foregoing sentence: *See, e.g.*, Item 11(a)(1) of Form N-1A (requiring a description of the procedures for pricing fund shares, including an explanation that the price of fund shares is based on a fund's NAV and the method used to value fund shares); and Item 11(a)(2) of Form N-1A (requiring a statement as to when calculations of NAV are made and that the price at which a purchase or redemption is effected is based on the next calculation of NAV after the order is placed); *see also* Item 23 of Form N-1A (requiring in the statement of additional information a description of the method followed or to be followed by a fund in determining the total offering price at which its shares may be offered to the public and the method(s) used to value the fund's assets).

As we proposed, we have determined not to require funds to disclose their swing pricing threshold or swing factor in their prospectus disclosures on Form N-1A. … We share commenters' concerns regarding unfair trading, gaming, and other negative fund and market impacts that could occur if swing pricing thresholds were shared with the public and recommend that a fund consider these concerns (and determine that disclosure of a fund's swing threshold is in the best interests of the fund) before disclosing this information in its prospectus or elsewhere. Indeed, funds and advisers to funds generally should take into consideration the potential for gaming into account and any other potential consequences before making any such disclosure. As noted above, we are requiring a fund to disclose the swing factor upper limit to provide shareholders with additional transparency regarding a fund's use of swing pricing and the potential impact of that usage. [footnotes omitted]

Item 7. Tax Information

State, as applicable, that the Fund intends to make distributions that may be taxed as ordinary income or capital gains or that the Fund intends to distribute tax-exempt income. For a Fund that holds itself out as investing in securities generating tax-exempt income, provide, as applicable, a general statement to the effect that a portion of the Fund's distributions may be subject to federal income tax.

Item 8. Financial Intermediary Compensation

Include the following statement. A Fund may modify the statement if the modified statement contains comparable information. A Fund may omit the statement if neither the Fund nor any of its related companies pay financial intermediaries for the sale of Fund shares or related services.

Payments to Broker-Dealers and Other Financial Intermediaries.

If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information.

ENHANCED DISCLOSURE AND NEW PROSPECTUS DELIVERY OPTION FOR REGISTERED OPEN-END MANAGEMENT INVESTMENT COMPANIES
(Release Nos. 33-8998; IC-28584; January 13, 2009)

i. Financial Intermediary Compensation

The Commission is adopting the proposed requirement that the summary section of the prospectus conclude with disclosure regarding financial intermediary compensation. Commenters generally supported this requirement,[215] and we are modifying the requirement in two ways to address views expressed during investor focus groups and the concerns of commenters. Specifically, we are requiring the following statement, which could be modified provided that the modified statement contains comparable information:[216]

"Payments to Broker-Dealers and Other Financial Intermediaries

If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."

This disclosure will be new to fund prospectuses and is intended to identify the existence of compensation arrangements with selling broker-dealers or other financial intermediaries, alert investors to the potential conflicts of interest arising from these arrangements, and direct investors to their salesperson or the financial intermediary's Web site for further information. It is intended to address, in part, concerns that mutual fund investors lack adequate in-

[215] *See, e.g., Data Communiqué Letter, supra note 35; Firehouse Letter, supra note 35; Fund Democracy et al. Letter, supra note 34; ICI Letter, supra note 34; Keil Letter, supra note 62; NAPFA Letter, supra note 44; Schnase Letter, supra note 35; SIFMA Letter, supra note 97; Letter of USAA Investment Management Company (Feb. 28, 2008) ("USAA Letter"); Vanguard Letter, supra note 42; Letter of Wachovia Securities, LLC (Aug. 29, 2008). But see Letter of Capital Research and Management Company (Aug. 29, 2008) (opposing the financial intermediary disclosure requirement).*

[216] *Item 8 of Form N-1A.*

formation about certain distribution-related costs that create conflicts for broker-dealers and their associated persons.[217]

We have added a provision permitting a fund to omit the financial intermediary disclosure if neither the fund nor any of its related companies pay financial intermediaries for the sale of fund shares or related services.[218] This addresses the concerns of a number of commenters who expressed the view that the Commission should not require the narrative disclosure from funds to which the disclosure does not apply.[219] According to one commenter, such funds include, for example, no-load funds and funds sold directly to investors.[220]

We have also modified the proposed statement to clarify that payments to a broker-dealer or other financial intermediary may create a conflict of interest by influencing the broker-dealer or other intermediary to recommend a fund over another investment. This modification, made in response to investor comments from our focus groups, is intended to increase awareness of potential conflicts of interest.[221] We are, therefore, revising the narrative to expressly notify investors that a conflict of interest may exist with respect to the broker-dealer's recommendation. We have determined not to add a requirement that the disclosure include standardized language enumerating the types of compensation that may be provided to financial intermediaries, assuggested by one commenter.[222] Rather, we are adopting a statement that will alert investors generally to the payment of compensation and the potential conflicts arising from that payment An investor could then obtain further detail from his or her salesperson or the intermediary's Web site. As discussed further below, we intend to consider additional steps in the future that would further enhance investors' access to information about broker and intermediary compensation and conflicts of interest.

[217] *The Commission has recognized these concerns in a separate initiative in which the Commission proposed to require, among other things, disclosure of mutual fund distribution-related costs and conflicts of interest by selling broker-dealers and other financial intermediaries at the point of sale. Securities Act Release No. 8544 (Feb. 28, 2005) [70 FR 10521 (Mar. 4, 2005)]; Securities Act Release No. 8358 (Jan. 29, 2004) [69 FR 6438 (Feb. 10, 2004)]. One commenter to that proposal recommended use of a short-form "profile plus" disclosure document that would include, among other things, basic information about such potential conflicts of interest. See Letter of NASD (Mar. 31, 2005) available at http://www.sec.gov/rules/proposed/s70604/nasd033005.pdf. We intend to consider additional steps to enhance investor access to information prior to making an investment decision. See infra notes 200 and 201 and accompanying text.*

[218] *Item 8 of Form N-1A.*

[219] *See, e.g., CAI Letter, supra note 67; ICI Letter, supra note 34; Oppenheimer Letter, supra note 44; T. Rowe Letter, supra note 49; USAA Letter, supra note 153; Vanguard Letter, supra note 42. We note that Item 8 permits a fund to modify the narrative statement provided that the modified statement contains comparable information. For example, a fund that is offered as an underlying investment option for a variable annuity contract could modify the narrative statement to reflect payments made to the sponsoring insurance company for distribution and other services.*

[220] *See ICI Letter, supra note 34. We note, however, that no-load funds and directly-sold funds will be required to include the narrative disclosure in certain circumstances. For example, the disclosure will be required if a no-load fund pays servicing fees to a fund supermarket.*

[221] *See Focus Group Report, supra note 32, at 8 (stating that participants felt that new investors may not be aware of the potential conflict of interest); Focus Group Transcripts, supra note 32, at 16, 41.*

[222] *See NAPFA Letter, supra note 44 (requesting standardized language describing possible forms of compensation, such as surrender fees, payment for shelf space, commissions paid for fund transactions, principal mark-ups and mark-downs, fees derived from bid-ask spreads, and payments for marketing support and/or education of registered representatives).*

Item 9. Investment Objectives, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings

(a) *Investment Objectives.* State the Fund's investment objectives and, if applicable, state that those objectives may be changed without shareholder approval.

(b) *Implementation of Investment Objectives.* Describe how the Fund intends to achieve its investment objectives. In the discussion:

(1) Describe the Fund's principal investment strategies, including the particular type or types of securities in which the Fund principally invests or will invest.

Instructions.

1. A strategy includes any policy, practice, or technique used by the Fund to achieve its investment objectives.

2. Whether a particular strategy, including a strategy to invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the Fund's investment objectives, and how the strategy affects the Fund's potential risks and returns. In determining what is a principal investment strategy, consider, among other things, the amount of the Fund's assets expected to be committed to the strategy, the amount of the Fund's assets expected to be placed at risk by the strategy, and the likelihood of the Fund's losing some or all of those assets from implementing the strategy.

3. A negative strategy (*e.g.*, a strategy not to invest in a particular type of security or not to borrow money) is not a principal investment strategy.

4. Disclose any policy to concentrate in securities of issuers in a particular industry or group of industries (i.e., investing more than 25% of a Fund's net assets in a particular industry or group of industries).

5. Disclose any other policy specified in Item 16(c)(1) that is a principal investment strategy of the Fund.

6. Disclose, if applicable, that the Fund may, from time to time, take temporary defensive positions that are inconsistent with the Fund's principal investment strategies in attempting to respond to adverse market, economic, political, or other conditions. Also disclose the effect of taking such a temporary defensive position (*e.g.*, that the Fund may not achieve its investment objective).

7. Disclose whether the Fund (if not a Money Market Fund) may engage in active and frequent trading of portfolio securities to achieve its principal investment strategies. If so, explain the tax consequences to shareholders of increased portfolio turnover, and how the tax consequences of, or trading costs associated with, a Fund's portfolio turnover may affect the Fund's performance.

(2) Explain in general terms how the Fund's adviser decides which securities to buy and sell (*e.g.*, for an equity fund, discuss, if applicable, whether the Fund emphasizes value or growth or blends the two approaches).

(c) *Risks.* Disclose the principal risks of investing in the Fund, including the risks to which the Fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, or total return.

(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.

3. Investment Strategies and Risk Disclosure (Item 4)

In the Form N-1A Proposing Release, the Commission discussed its concerns about disclosure of fund investments and risks typically found in many fund prospectuses.[223] This disclosure generally consists of descriptions of the types of securities in which a fund may invest and the risks associated with each of those securities.[224] In the Commission's view, disclosing information about all of the securities in which a fund might invest does not help a typical fund investor evaluate how the fund's portfolio will be managed or the overall risks of investing in the fund. The disclosure also adds substantial length and complexity to fund prospectuses, which discourages investors from reading them.

The Commission has concluded that prospectus disclosure would be more useful to a typical fund investor if it emphasized the principal investment strategies of a fund and the principal risks of investing in the fund, rather than the characteristics and risks of each type of instrument in which the fund may invest.[225] The Commission believes that funds are appropriately viewed as a means through which a professional money manager provides its services to investors[226] and that, for that reason, the focus of disclosure about a fund's prospective investments should center on the fund's investment objectives and the principal means used by the fund's adviser to achieve those objectives. Consistent with this view, the Proposed Amendments would require prospectus disclosure that is designed to help investors understand how a particular fund's portfolio will be managed. The purpose of the Proposed Amendments was to implement more effectively the Commission's original goal in adopting Form N-1A that the prospectus should describe a fund's "fundamental characteristics."[227] Commenters generally supported the proposed approach to disclosure of the fund's investment operations and attendant risks, and the Commission is adopting it substantially as proposed.

a. Principal Investment Strategies, Investment Objectives and Implementation of Investment Objectives

To assist investors in determining whether a fund meets their investment needs, Form N-1A, as amended, continues to require prospectus disclosure of a fund's investment ob-

[223] *See Form N-1A Proposing Release,* supra *note 8, at 10909.*

[224] *The investments described often include instruments, such as liquid securities, repurchase agreements, and options and futures contracts, that do not have a significant role in achieving a fund's investment objectives.*

[225] *The ICI has supported prospectus disclosure that focuses primarily on a fund's broad investment objectives, practices, and associated risks, and not on particular types of securities in which the fund may invest. See, e.g., Letter from Paul Schott Stevens, General Counsel, ICI, to Jonathan G. Katz, Secretary, SEC, at 5 (Apr. 8, 1996); Letter from Paul Schott Stevens, General Counsel, ICI, to Jonathan G. Katz, Secretary, SEC, at 4-6 (July 28, 1995) ("1995 ICI Risk Comment Letter"); Letter from Amy B.R. Lancellotta, Associate Counsel, ICI, to C. Gladwyn Goins, Associate Director, Division of Investment Management, SEC, at 7 (Mar. 7, 1995).*

[226] *See "Can We Make Donkeys Fly?," Remarks by Barry P. Barbash, Director, Division of Investment Management, SEC, before the Business Law Section of the ABA, Washington, D.C., at 13 (Nov. 11, 1994); see also 1 T. LEMKE, G. LINS & A.T. SMITH III, REGULATION OF INVESTMENT COMPANIES § 1.01, at 1-1 (1997).*

[227] *See 1982 Form N-1A Proposing Release,* supra *note 13, at 815; 1983 Form N-1A Adopting Release,* supra *note 12, at 39729.*

jectives.[228] The Commission proposed to shift the focus of disclosure about how a fund intends to achieve its investment objectives away from the current practice of listing all types of securities in which a fund may invest to a discussion of the fund's overall portfolio management.[229] The Commission proposed to require a fund to disclose in its prospectus the principal strategies that it used to achieve its investment objectives, which would include the particular type or types of securities in which the fund will invest principally. This approach was designed to focus disclosure on a fund's anticipated investment operations rather than on investments that the fund might make. The Commission continues to believe that a clear, concise, and straightforward discussion of investment objectives and strategies is central to effective prospectus disclosure. Therefore, the Commission is adopting the requirement for a fund to disclose how it intends to achieve its investment goals as proposed.[230]

Under Form N-1A, as amended, whether a particular investment strategy (including a strategy to invest in a particular type of security) is a principal investment strategy depends upon the strategy's anticipated importance in achieving the fund's investment objectives and how the strategy affects the fund's potential risks and returns.[231] The Commission believes that a fund should disclose those strategies that are expected to be the most important means of achieving the fund's objectives and that the fund anticipates will have a significant effect on its performance. Form N-1A, as amended, requires a fund, when determining whether a strategy is a principal investment strategy, to consider, among other things, the portion of assets that it expects to commit to the strategy, the portion of assets that it expects to place at risk by the strategy, and the likelihood that it will lose some or all of those assets in implementing the strategy.[232]

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[228] *Item 4(a). A fund may refer to its investment objectives as investment goals or any other term that clearly communicates the principal investment design of the fund. Form N-1A, as amended, continues to require a fund to disclose in its prospectus when it may change its investment objectives without a shareholder vote. Id. Under current practice, some funds disclose in their prospectuses when a shareholder vote is required to change its investment objectives. The Commission believes that disclosure of this sort is of limited significance to the typical fund investor. In the Commission's view, most investors typically would not expect the investment objectives of their funds to change without their approval. Consistent with this view, Form N-1A, as amended, requires a fund to disclose in its SAI, and not in its prospectus, when a shareholder vote is required to change its investment objectives. Item 12(c)(1)(vii).*

[229] *Form N-1A currently requires a fund to disclose the types of securities in which it invests or will invest principally, as well as any "special investment practices and techniques" that the fund will use in connection with investing in those securities. Form N-1A also requires disclosure, subject to certain limitations, about "significant investment policies or techniques" that a fund intends to use. One of those limitations directs a fund to limit prospectus disclosure about practices that place no more than 5% of the fund's assets at risk. Many funds disclose in their prospectuses information about securities and investment practices that do not, and may not ever, place more than 5% of the fund's assets at risk, often to retain the flexibility to exceed the 5% threshold in the future. The Commission proposed to eliminate the 5% standard. Form N-1A Proposing Release,* supra *note 8, at 10909. The standard has been deleted in Form N-1A, as amended.*

[230] *Item 4(b). Instruction 1 to Item 4(b)(1) defines a strategy to include any policy, practice, or technique used to achieve a fund's investment objectives.*

[231] *Instruction 2 to Item 4(b)(1). Form N-1A currently directs a fund not to disclose so-called "negative" practices (i.e., practices in which a fund may not or does not intend to engage). Instruction 3 to Item 4(b)(1) retains this limitation by providing that a negative strategy is not a principal investment strategy. Avoiding disclosure about negative strategies is intended to ensure that prospectus disclosure states what the fund will do to achieve its investment objectives, rather than what the fund will not do.*

[232] *Instruction 2 to Item 4(b)(1). As amended, Form N-1A requires a fund to disclose strategies that are not principal strategies in the SAI. Item 12(b).*

The Commission intends that focusing disclosure on a fund's principal investment strategies[233] will improve the fund's prospectus by eliminating discussions of securities and strategies that do not have a significant role in achieving the fund's investment objectives. Under Form N-1A, as amended, for example, it generally will be unnecessary for a fund (other than, for example, a money market fund) to disclose in its prospectus its cash management practices (*e.g.*, entering into overnight repurchase agreements), because these practices are not typically among the principal investment strategies that a fund uses to achieve its investment objectives.[234]

The Proposed Amendments would require a fund, in discussing its principal investment strategies in its prospectus, to explain in general terms how the fund's adviser decides what securities to buy and sell. This requirement sought to provide investors with essential information about the fund's investment approach and how the fund's portfolio would be managed. One commenter questioned this requirement, arguing that it could place undue emphasis on a fund's decisions to invest in or sell particular securities and result in boilerplate disclosure. The Commission continues to believe that a general discussion of the methods of analysis and investment strategies that a fund's adviser will use in managing the fund will provide typical investors with information that will help in deciding whether to invest in a fund. Therefore, the Commission is adopting the proposed disclosure requirement regarding the manner in which the investment adviser determines to buy and sell securities.[235]

Concentration. The Commission proposed to continue to require a fund to disclose in its prospectus any policy to concentrate its investments in any industry or group of industries. This requirement reflects the view that such a policy is likely to be central to a fund's ability to achieve its investment objectives,[236] and that a fund that concentrates its investments will be subject to greater risks than funds that do not follow the policy. The Commission's staff has taken the position for purposes of the concentration disclosure requirement that a fund investing more than 25% of its assets in an industry is concentrating in that industry.[237] The Proposed Amendments incorporated this percentage test into Form N-1A.

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[233] *A bond fund, for example, typically would discuss generally the maturities, durations, ratings, and types of issuers of the bonds in which the fund invests principally.*

[234] *Under the disclosure principles incorporated into Item 4 of Form N-1A, as amended, a fund that has a principal investment strategy of allocating its assets among stocks, bonds, and money market instruments also would need to disclose its use of cash equivalents. Whether a fund needs to include disclosure in its prospectus about matters such as holding or trading stock futures and option contracts, engaging in securities lending, purchasing securities on a "when-issued" basis, or investing in liquid or restricted securities will depend on the extent to which these instruments or practices have a significant role in achieving the fund's investment objectives. A fund generally would not need to include disclosure about restricted securities in its prospectus because investments in this type of security usually would not be so significant as to constitute a principal investment strategy of the fund. Whether a fund's use of stock futures, option contracts, or other derivatives would need to be disclosed in the fund's prospectus would depend in large part on whether the strategy poses the risk of substantial gains or losses for the fund.*

[235] *Instruction 4 to Item 4(b)(1).*

[236] *That such a policy can be central to a fund's meeting its investment objective is suggested by section 89(b)(1) of the Investment Company Act [15 U.S.C. 80a-8(b)(1)], which requires a fund to disclose in its registration statement any policy to concentrate its investments in a particular industry or group of industries. Under section 13(a)(3) [15 U.S.C. 80a-13(a)(3)], a fund must obtain shareholder approval to change a policy to concentrate its investments.*

[237] *Guide 19 to Form N-1A.*

Commenters supported requiring a fund to disclose in its prospectus its policies on industry concentration,[238] and the Commission continues to believe that 25% is an appropriate benchmark to gauge the level of investment concentration that could expose investors to additional risk. Therefore, the Commission is adopting this disclosure requirement as proposed.[239]

Temporary Defensive Positions. The Proposed Amendments would require disclosure about a fund's policy that permits the fund to take "temporary defensive positions" to respond to adverse market, economic, political, or other conditions. The purpose of the requirement was to make investors aware of potential changes in a fund's investments that are not generally contemplated by, or are otherwise inconsistent with, a fund's principal investment objectives and policies. In particular, the Proposed Amendments would require a fund to disclose the percentage of its assets that may be committed to temporary defensive positions (*e.g.*, up to 100% of the fund's assets), the risks, if any, associated with the positions, and the likely effect of these positions on the fund's performance. Although commenters generally supported disclosure that a fund may take temporary defensive positions, they found problematic disclosure of the percentage of assets that may be committed to temporary defensive positions and the likely effect of these positions on the fund's performance.

Commenters argued that, to maintain flexibility, a fund typically would disclose that all of its assets could be committed to temporary positions. The commenters maintained that such disclosure was boilerplate and would not be meaningful to investors. In addition, commenters asserted that funds would find it difficult to predict the likely effect of temporary defensive positions on their performance.

The Commission believes that a typical fund investor would want to know about investment positions that a fund can take from time to time that are inconsistent with the fund's central investment focus. On the other hand, the Commission is aware that, in practice, the disclosure about temporary investment positions currently appearing in some fund prospectuses is so lengthy and detailed as to suggest incorrectly that a fund's temporary investment policies are more important than the fund's investment objectives and the principal investment strategies used to achieve them. The Commission believes that disclosure of this sort, which discusses possible but not probable investments of funds, is inconsistent with the

[238] *Some commenters questioned an existing position of the Commission's staff regarding the ability of a fund to adopt a policy of shifting between concentrated and non-concentrated status. One commenter requested reconsideration of the staff's long-standing position that a fund cannot, consistent with the provisions of sections 8(b)(1) and 13(a)(3), have an investment policy permitting the fund to concentrate or not concentrate its investments as determined by the fund's board in its discretion. The commenter argued that this position was too rigid and that a fund's board of directors should have the flexibility to shift the fund's concentration policy, subject to making appropriate disclosure to fund shareholders. The Commission recognizes that fund investment practices have changed as a result of the growth of securities markets and assets invested in funds. The Commission believes that it may be appropriate to reconsider the issue raised by the commenter, but has concluded that the issue should not be reconsidered in the context of the revisions of Form N-1A being adopted today. The Commission has requested that the Division review its positions on concentration, consulting with industry representatives as appropriate, with a view toward allowing funds a greater degree of flexibility in establishing concentration policies.*

[239] *Instruction 4 to Item 4(b)(1).*

fundamental disclosure principles underlying Form N-1A. In the Commission's view, however, disclosure that a fund may take temporary defensive positions to respond to market conditions will alert investors to the possibility that a fund may vary its investments on a temporary basis. Therefore, Form N-1A, as amended, requires a fund to disclose, if applicable, that in response to unfavorable market conditions it may make temporary investments that are not consistent with its principal investment objectives and policies.[240]

Portfolio Turnover. Form N-1A currently requires all funds to state their portfolio turnover rates in their financial highlights tables included in their prospectuses.[241] Under the Proposed Amendments, a fund would be required to supplement the information in its financial highlights table by disclosing certain information about its portfolio turnover rate if it anticipated having a turnover rate of 100% or more in the coming year.[242] The disclosure would be required to include an explanation of the tax consequences and effect of increased trading costs on the fund's performance.[243] Most commenters questioned or opposed the proposed disclosure about portfolio turnover rate. Some commenters suggested that the Commission move this disclosure to the SAI or require it in the MDFP in fund shareholder reports. Other commenters argued that a fund's portfolio turnover rate may reflect the fund's response to particular market events, or special circumstances affecting the fund's investments, that are difficult to predict. These commenters argued further that the unpredictable nature of fund portfolio turnover rates would lead to generic or boilerplate disclosure that would not be meaningful to investors in assessing various funds. The commenters suggested that Form N-1A should instead require disclosure about portfolio turnover rates as part of a discussion of a fund's principal investment strategies when a fund's investment approach is expected to include active and frequent trading (as opposed to, *e.g.*, a "buy and hold" strategy).

The Commission continues to believe that a discussion about a fund's portfolio turnover in some cases is relevant to typical fund investors. The Commission notes, for instance, that increased portfolio turnover can on some occasions result in tax consequences that can be significant to investors and that can be viewed as a cost to an investor of holding fund shares.

Moreover, investors may find information about portfolio turnover particularly relevant in light of recent changes to the tax laws that reduce the tax rate on capital gains.[244] The Commission agrees with commenters, however, that disclosure about portfolio turnover and its consequences should be made only if an increased portfolio turnover rate is likely to result

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[240] *Instruction 6 to Item 4(b)(1).*

[241] *Item 3 of Form N-1A. Form N-1A, as amended, retains this requirement. Item 9.*

[242] *See Form N-1A Proposing Release,* supra *note 8, at 10910.*

[243] *The Proposed Amendments would require a fund to disclose its anticipated portfolio turnover rate and what that rate means (e.g., that a portfolio turnover rate of 200% is equivalent to the fund buying and selling all of the securities in its portfolio twice in the course of a year). The Proposed Amendments also would require a fund to explain the tax consequences to shareholders of the fund's high portfolio turnover rate. In addition, the Proposed Amendments would require a fund to explain how trading costs associated with the fund's high portfolio turnover may affect the fund's performance.*

[244] *See* infra *note 164.*

from the fund's investment objectives and principal investment strategies and would have a significant effect on a fund's returns. Therefore, Form N-1A, as amended, requires a fund to discuss the consequences of its portfolio turnover rate if the fund anticipates that active and frequent trading of portfolio securities will be a likely result of implementing its principal investment strategies.[245]

Classification and Policies. The Commission proposed to move to the SAI disclosure about a fund's legal status as an open-end management company,[246] as well as disclosure relating to certain policies identified under the Investment Company Act, such as borrowing money, issuing senior securities, underwriting securities issued by other persons, investing in real estate or commodities, and making loans.[247] Commenters supported moving this disclosure, agreeing that it is not likely to be significant to a typical fund investor. Form N-1A, as amended, requires the disclosure to appear in the SAI.[248]

b. Risk Disclosure

Risk disclosure in fund prospectuses typically consists of detailed, and often technical, descriptions of the risks associated with particular securities in which a fund may invest. Just as disclosure about each type of security in which a fund may invest does not appear to communicate effectively to investors how the fund's portfolio will be managed, disclosure about the risks associated with each type of security in which the fund may invest does not effectively communicate to them the overall risks of investing in the fund. In the Commission's view, disclosing the risks of each possible portfolio investment, rather than the overall risks of investing in a fund, does not help investors evaluate a particular fund or compare the risks of the fund with those of other funds. The Commission proposed, consistent with its conclusion that mere inventories of potential portfolio securities do not assist typical investors in selecting among funds, to modify prospectus disclosure requirements in Form N-1A about the risks associated with specific securities. The Proposed Amendments would require a fund to disclose the risks to which the fund's particular portfolio as a whole is expected to be subject

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[245] *Instruction 7 to Item 4(b)(1).*

[246] *As explained in the Form N-1A Proposing Release, this information is technical in nature and repetitive of other information required to be disclosed elsewhere in a fund's prospectus. All funds that register on Form N-1A must be classified as management companies under section 4 of the Investment Company Act and subclassified as open-end companies under section 5. 15 U.S.C. 80a-4, -5. Funds may be further subclassified as diversified or non-diversified under section 5.*

[247] *Section 8 of the Investment Company Act requires a fund to disclose these policies in its registration statement. Section 8 also requires a fund to disclose in its registration statement its policies on concentration and portfolio turnover, see* supra *notes 100 and 105 and accompanying text, and any other policies that the fund deems fundamental or that may not be changed without shareholder approval. Although they are not required to do so, some funds disclose in their prospectuses their policies with respect to the practices identified in section 8. As noted in the Form N-1A Proposing Release,* supra *note 8, at 10911, the Proposed Amendments sought to provide a clearer directive to disclose these policies in the SAI. To the extent it is a principal investment strategy of a fund within the meaning of Item 4(b)(1) of Form N-1A, as amended, however, a practice identified in section 8 would be required to be disclosed in the fund's prospectus.*

[248] *Items 12(a) and (c). Form N-1A, as amended, continues to require a non-diversified fund to disclose its non-diversified status in the prospectus. See Item 2(c)(iv). In particular, the Form requires a non-diversified fund to describe the effects of non-diversification (e.g., by indicating that, compared to diversified funds, the fund may invest a greater percentage of its assets in a particular issuer) and to disclose the risks of investing in the fund.*

and to discuss the circumstances that are reasonably likely to affect adversely the fund's net asset value, yield, or total return. Commenters generally supported the proposed approach to the disclosure of risk, and the Commission is adopting it as proposed.[249]

The Commission notes that a fund could meet the risk disclosure requirements of Form N-1A, as amended, by including in its prospectus a discussion of the risks of the asset class or classes that the fund expects to hold principally, together with a discussion of the risks to the fund of holding specific types of securities within the asset class or classes. Under such an approach, a fund investing in the equity securities of companies with small market capitalizations, for example, would discuss market risk as a general risk of holding equity securities, as well as the specific risks associated with investing in small capitalization companies (*e.g.*, that these stocks may be more volatile and have returns that vary, sometimes significantly, from the overall stock market).[250]

The Commission did not propose to require a fund to disclose information designed to quantify its expected risk levels, citing, among other things, the lack of a broad consensus as to what measure of risk would best serve fund investors.[251] Comments submitted in response to the Commission's Risk Concept Release asserted that investors have too wide a range of investment goals and ideas of what "risk" means to be well served by a single quantitative risk measure. In addition, commenters argued that, if the Commission mandated a risk measure, investors might rely on it as a definitive standard despite the lack of general agreement on how to measure risk. As adopted, the prospectus risk/return summary and amendments to the general risk disclosure requirements of Form N-1A are designed to improve fund risk disclosure without raising the concerns associated with Commission-mandated quantitative information. While it is not adopting specific quantitative risk disclosure requirements, the Commission believes that new approaches to measuring risk are emerging and that quantitative risk information may be useful to some investors.[252] The Commission notes that a fund may include quantitative risk disclosure in its prospectus if the information is presented in a manner consistent with the guidelines on the inclusion of information not required by Form N-1A.[253]

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[249] *Item 4(c). The requirement that a fund disclose the risks to which its particular portfolio as a whole is subject is intended to elicit risk disclosure specific to that fund. In meeting this requirement, a growth fund, for example, would be required to disclose the risks of the types of growth stocks in which the fund invests or expects to invest, as opposed to describing the general risks of equity securities.*

[250] *The Commission emphasizes that this approach is one way, but not the only way, that a fund can seek to use in meeting the risk disclosure requirements of Form N-1A, as amended.*

[251] *See Form N-1A Proposing Release,* supra *note 8, at 10911. The Risk Concept Release requested comment whether quantitative risk measures, such as standard deviation, beta, and duration, would help investors evaluate and compare fund risks. Risk Concept Release,* supra *note 18, at 17176. While more than half of the individual commenters and some industry members expressed a desire for some form of quantitative risk information, commenters did not broadly support any one risk measure. In addition, a number of commenters strongly criticized requiring disclosure of quantitative risk information. See, e.g., 1995 ICI Risk Comment Letter,* supra *note 87, at 10-16 (questioning, among other things, the feasibility of developing a single, all-encompassing measure of fund risk and whether quantitative information would be understood and accurately used by fund investors).*

[252] *See e.g., Walbert, What's the Risk?, INSTITUTIONAL INVESTOR, June 1997, at 188; Whitford, Why Risk Matters, FORTUNE, Dec. 29, 1997, at 147.*

[253] *See General Instruction C.3(b).*

Relevant Portions of SEC Generic Comment Letters and Other Relevant SEC Guidance

1994 Comment II.E—Temporary Defensive Position

Many investment companies adopt "temporary defensive position" investment policies to be followed when significant adverse market, economic, political, or other circumstances require immediate action to avoid losses.[254] Such a policy permits a fund to deviate temporarily from fundamental and non-fundamental investment policies (*e.g.*, any policy required by Guide 1 to Form N-1A and the concentration policy) without a shareholder vote or without prior or contemporaneous notification to shareholders during exigent situations. A fund may resort to a temporary defensive position only under abnormal market or economic situations and, while in such a temporary defensive position, invest in securities that the fund and its investment adviser believe appropriate under such circumstances.

Consistent with the foregoing, if a fund has a temporary defensive position policy, its prospectus should state, succinctly, (1) that it has adopted such a policy, (2) the kinds of securities that may be used, and (3) the extent (*e.g.*, up to 100 percent of its assets) to which the fund may deviate from its normal investment policies while maintaining a temporary defensive position. The staff believes that the phrase "temporary defensive position," (particularly the word "defensive") suggests that, in assuming such a position, a fund will invest in securities less risky than those in which the fund normally invests. If securities in which a fund may invest when taking a defensive posture are not less risky than those in which the fund typically invests, the fund must include disclosure of that fact and any applicable risk disclosure. See Guide 3 to Form N-1A.

2013 Guidance Regarding Disclosure of Derivatives and Associated Risks from SEC Division of Investment Management Guidance Update No 2013-05 (August 2013)/ Disclosure and Compliance Matters for Investment Company Registrants that Invest in Commodity Interests

The staff of the Division has previously provided its observations regarding derivatives-related disclosures by funds in registration statements and shareholder reports.[255] We wish to reiterate the views expressed previously and, in particular, to highlight our concern that funds adequately disclose the risks associated with investments in commodity interests.

Form N-1A, the form used by mutual funds 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"), requires a fund to disclose in its prospectus its principal investment strategies, including the type or types of securities in which the fund principally invests or will invest.[256] Further, Form N-1A requires a mutual fund to disclose in its prospectus the principal

[254] *It may not be appropriate, however, for certain funds to adopt such a policy, e.g., funds that endeavor to track an index.*

[255] *Letter from Barry D. Miller, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to Karrie McMillan, General Counsel, Investment Company Institute (July 30, 2010).*

[256] *See Items 4(a) and 9(b)(1) of Form N-1A. Whether a particular strategy, including a strategy to invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the fund's investment objectives, and how the strategy affects the fund's potential risks and returns. See Instruction 2 to Item 9(b)(1) of Form N-1A. In assessing what is a principal investment strategy, a fund should consider, among other things, the amount of the fund's assets expected to be committed to the strategy, the amount of the fund's assets expected to be placed at risk by the strategy, and the likelihood of the fund losing some or all of those assets from implementing the strategy. Id.*

risks of investing in the fund, including the risks to which the fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, or total return.[257] Investment strategies used by a fund that are not principal strategies, and the risks of those strategies, should generally be disclosed in the fund's statement of additional information.[258]

Similarly, Form N-2, the form used by closed-end funds to register under the Investment Company Act and to offer their securities under the Securities Act, requires a closed-end fund to describe the investment objectives and policies that will constitute its principal portfolio emphasis, including the types of securities in which the fund invests or will invest principally.[259] Form N-2 also requires a closed-end fund to discuss principal risk factors associated with investment in the fund specifically as well as factors generally associated with investment in a fund with investment objectives, investment policies, capital structure, or trading markets similar to those of the fund.[260] Finally, Form N-2 also requires discussion of the types of investments that will be made by the fund, other than those that will constitute its principal portfolio emphasis, and any policies or practices relating to those investments.[261]

As we have previously stated, we believe that all funds that use or intend to use derivative instruments should assess the accuracy and completeness of their disclosure, including whether the disclosure is presented in an understandable manner using plain English.[262] Further, any principal investment strategies disclosure related to derivatives should be tailored specifically to how a fund expects to be managed and should address those strategies that the fund expects to be the most important means of achieving its objectives and that it anticipates will have a significant effect on its performance.[263] In determining the appropriate disclosure, a fund should consider the degree of economic exposure the derivatives create, in addition to the amount invested in the derivatives strategy.[264] This disclosure also should describe the purpose that the derivatives are intended to serve in the portfolio (*e.g.*, hedging, speculation, or as a substitute for investing in conventional securities),[265] and the extent to which derivatives are expected to be used.

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[257] *See Items 4(b)(1) and 9(c) of Form N-1A.*

[258] *See Item 16(b) of Form N-1A.*

[259] *See Item 8.2 of Form N-2.*

[260] *See Item 8.3(a) of Form N-2*

[261] *See Item 8.4 of Form N-2.*

[262] *Letter from Barry D. Miller, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to Karrie McMillan, General Counsel, Investment Company Institute, at 4 (July 30, 2010).*

[263] *In the staff's view, a fund that references types of derivatives in its principal investment strategies disclosure that the fund does not expect to use in connection with the fund's principal investment strategies has not provided disclosure that is consistent with the intent of the registration form requirements. Any strategy that is not a principal investment strategy, including one involving derivatives, should be clearly described as non-principal in the registration statement. See Item 16(b) of Form N-1A; Item 8.4 of Form N-2.*

[264] *See Instruction 2 to Item 9(b)(1) of Form N-1A. Derivatives-related disclosure should also be provided commensurate with the level of derivatives exposure of a fund. For example, a small investment in some derivatives does not necessarily correlate with little effect on a fund's performance because of the impact of leverage. Alternatively, a fund may have significant exposure to derivatives, but that exposure may not make the fund substantially riskier (e.g., exposure by an international fund to currency forwards, entered into to hedge against the currency risk of securities that trade in those currencies, would more likely reduce the fund's overall risk rather than increase it).*

[265] *For example, some funds invest in the combination of an equity-linked derivative and fixed-income securities to create the economic equivalent of investing directly in the underlying equity security. Some funds invest in derivatives in an attempt to enhance returns, i.e., to magnify the gain. Still other funds may invest in interest rate swaps to hedge against their interest rate exposure.*

Additionally, the disclosure concerning the principal risks of the fund should similarly be tailored to the types of derivatives used by the fund, the extent of their use, and the purpose for using derivatives transactions.[266] The risk disclosure in the prospectus for each fund should provide an investor with a complete risk profile of the fund's investments taken as a whole, rather than a list of risks of various derivative strategies, and should reflect anticipated derivatives usage. We note that investment strategies that employ derivatives, including commodity interests, may introduce risks in addition to those associated with investments in the cash markets, and that we expect funds that use such strategies to address those risks in their disclosures where the information is material to investors. Such a fund should, for example, disclose material risks relating to volatility, leverage, liquidity, and counterparty creditworthiness that are associated with trading and investments in derivatives that are engaged in, or expected to be engaged in, by the fund.

Finally, a fund should assess on an ongoing basis the completeness and accuracy of the derivatives-related disclosures in its registration statement in light of its actual operations. In particular, a fund should assess, based upon its actual operations, whether it is meeting the requirements to completely and accurately disclose its anticipated principal investment strategies and risks. A fund should review its use of derivatives when it updates its registration statement annually and assess whether it needs to revise the disclosures in its registration statement that describe its principal derivatives strategies and risks. Revisions may also be required at other times in light of a fund's actual operations.[267]

2010 Guidance Regarding Derivatives-Related Disclosures by Investment Companies

Form N-lA, the form used by mutual funds to register under the Investment Company Act of 1940 and to offer their securities under the Securities Act of 1933, requires a fund to disclose its principal investment strategies, including the type or types of securities in which the fund principally invests or will invest.[268] Further, Form N-l A requires a mutual fund to disclose the principal risks of investing in the fund, including the risks to which the fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, or total return.[269] Investment strategies used by a fund that are not principal strategies and the risks of those strategies should generally be disclosed in the fund's Statement of Additional Information.[270]

[266] *Some funds generically describe the risks of investing in derivatives, yet different derivatives are subject to varying risks. For example, derivatives that are not traded on an exchange may be subject to heightened liquidity and valuation risks.*

[267] *See, e.g., In the Matter of OppenheimerFunds, Inc., and OppenheimerFunds Distributor, Inc., Admin. Proc. File No. 3-14909, Securities Act Release No. 9329 (June 6, 2012) (finding violations of Section 34(b) of the Investment Company Act and Section 17(a)(2) of the Securities Act when a fund, which had disclosed that its returns would mainly be a function of investments in high-yield bonds, failed to disclose its practice of using total return swaps to obtain leveraged exposure to residential mortgage-backed securities, and the risks associated therewith).*

[268] *See Items 4(a) and 9(b) of Form N-1A. Whether a particular strategy, including a strategy lo invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the fund's investment objectives, and how the strategy affects the fund's potential risks and returns. See Instr. 2 to Item 9(b) of Form N-1A. In assessing what is a principal investment strategy, a fund should consider, among other things, the amount of the fund's assets expected to be committed to the strategy, the amount of the fund's assets expected to be placed at risk by the strategy, and the likelihood of the fund losing some or all of those assets from implementing the strategy. Id.*

[269] *See Items 4(b) and 9(c) of Form N-l A.*

[270] *See Item 16(b) of Form N-l A.*

When this disclosure framework was adopted in 1998, the Commission noted that it intended the prospectus disclosure to focus on a fund's principal investment strategies in order to provide investors with more useful information about the fund's investment approach and how the fund's portfolio will be managed.[271] The Commission stated that a fund should disclose in its prospectus those strategies that it expects to be the most important means of achieving the fund's objectives and that the fund anticipates will have a significant effect on its performance.[272] The Commission also stated that it intended to focus the prospectus disclosure on how a fund achieves or intends to achieve its investment objectives, and to move the disclosure away from the practice of listing all types of securities in which it may invest.[273] That is, the approach was designed to focus disclosure on a fund's anticipated investment operations, rather than on investments that the fund might make.[274]

We have observed derivatives-related disclosures by some funds that we believe may not be consistent with the intent of Form N-I A's requirements described above and which could be improved. Our primary observation is that some funds provide generic disclosures about derivatives that, in our view, may be of limited usefulness for investors in evaluating the anticipated investment operations of the fund, including how the fund's investment adviser actually intends to manage the fund's portfolio and the consequent risks.[275]

The generic disclosures vary from highly abbreviated disclosures that briefly identify a variety of derivative products or strategies, to lengthy, often highly technical, disclosures that detail a wide variety of potential derivative transactions without explaining the relevance to the fund's investment operations. Regardless of the style and format, funds with generic derivatives-related disclosures: (1) typically state as a principal investment strategy that they will or may engage in derivative transactions, and then often enumerate all or virtually all types of derivatives as potential investments; (2) may provide generic language about the purpose for using derivatives (*e.g.,* derivatives may be used for "hedging or non-hedging purposes"); and (3) may characterize broadly the extent of the transactions (*e.g.,* the fund may invest "all" of its assets in derivatives).[276] Whereas funds with abbreviated disclosures typically list the types of derivatives, with little or no explanation of the nature of the instruments, those with lengthy, often highly technical, disclosures typically provide an extensive and complex explanation of the various derivatives that might be used and is not always provided in plain English.

Funds that provide abbreviated disclosures typically also provide generic risk disclosure, which, while appropriately citing various potential risks (*e.g.,* correlation, counterparty, credit,

[271]*See Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916, 13926 (Mar 23, 1998)].*

[272]*Id.*

[273]*Id. ("(D)isclosing information about all of the securities in which a fund might invest does nor help a typical fund investor evaluate how the fund's portfolio will be managed or the overall risks of investing in the fund.").*

[274]*Id.*

[275]*Id. See also Items 4(a) and 9(b) of Form N-l A (requiring a fund to disclose how it "intends to achieve its investment objectives").*

[276]*Our observation about the practice by some funds of listing under principal investment strategies all possible fund investments is not limited to derivatives. When the staff of the Division of Investment Management observes such disclosure, it will continue to provide comments, as appropriate, that consistent with the intent of Form N-lA's requirements, a fund should not list all types of possible investments, but rather focus on the principal strategies and investments that the fund intends to use to achieve its investment objectives.*

leverage, liquidity, market, and valuation risks), again provide limited explanation of those risks and may not be tailored to the specific derivative instruments in which a fund invests or will invest principally. Funds that provide lengthy, often highly technical, disclosures generally provide risk disclosure that is more tailored to each specific type of derivative, but the complex and lengthy disclosure reduces its usefulness for investors.

The types of generic disclosures discussed above may not enable investors to distinguish which, if any, derivatives are in fact encompassed in the principal investment strategies of the fund or specific risk exposures they will entail. Indeed, while more abbreviated disclosures could lead some investors to believe that a fund's exposure to derivatives is minimal, we have observed that some funds employing this type of disclosure, in fact, appear to invest significantly in derivatives and thereby may have substantial exposure to derivatives-related risks. Conversely, the comprehensive nature of lengthy, often highly technical, derivatives-related disclosures could lead some investors to believe that a fund with such disclosure would have substantial exposure to derivative transactions, yet we have observed that some funds providing this disclosure actually appear to have relatively small exposure to derivatives.[277]

Reliance upon generic, even standardized, derivatives-related disclosures is further evidenced by the practice of some fund complexes that provide the same derivatives-related disclosures for multiple funds, even though the various funds have significantly different exposures to derivatives.[278] Such a practice again demonstrates that the disclosure is not always being tailored to each particular fund and thus may not provide investors with meaningful information about the fund's anticipated investment operations or how the fund's portfolio will be managed.

Given these observations, we believe that all funds that use or intend to use derivative instruments should assess the accuracy and completeness of their disclosure, including whether the disclosure is presented in an understandable manner using plain English. Further, any principal investment strategies disclosure related to derivatives should be tailored specifically to how a fund expects to be managed and should address those strategies that the fund expects to be the most important means of achieving its objectives and that it anticipates will have a significant effect on its performance.[279] In determining the appropriate disclosure, a fund should consider the degree of economic exposure the derivatives create, in addition to

[277] *We have also observed funds with derivatives-related disclosures in their registration statements that do not appear to communicate the significant derivatives exposure reflected in the financial statements or the Management's Discussion of Fund Performance ("MDFP"), contained in the annual reports to shareholders. Below, we include observations about derivatives-related disclosures included in fund shareholder reports and financial statements. See infra "Shareholder Reports and Financial Statements Disclosures"; see also infra footnotes 18 and 19 and accompanying text (describing MDFP disclosure requirements).*

[278] *For example, some funds may use all types of derivatives, others use some types, and still others use derivatives sparingly. Investors are left with no way to distinguish the risk exposure of a particular fund. While the fund's financial statements and the MDFP in its annual report may help explain the risk exposure, the prospectus itself should include adequate disclosure for an investor to determine the principal investment strategies and risks of the fund.*

[279] *In the staffs' view, referencing all types of derivatives, if such derivatives are not expected to be used in connection with the fund's principal strategies, is not consistent with the intent of Form N-l A's requirements. Any strategy that is not a principal investment strategy, including one involving derivatives, should be clearly described as non-principal in the registration statement See Item 16(b) of Form N-l A.*

the amount invested in the derivatives strategy.[280] This disclosure also should describe the purpose that the derivatives are intended to serve in the portfolio (*e.g.*, hedging, speculation, or as a substitute for investing in conventional securities),[281] and the extent to which derivatives are expected to be used.

Additionally, the disclosure concerning the principal risks of the fund should similarly be tailored to the types of derivatives used by the fund, the extent of their use, and the purpose for using derivative transactions.[282] The risk disclosure in the prospectus for each fund should provide an investor with a complete risk profile of the fund's investments taken as a whole, rather than a list of the risks of various derivative strategies, and should reflect anticipated derivatives usage.

Finally, a fund should assess the completeness and accuracy of the derivatives-related disclosures in its registration statement in light of its actual operations. In particular, a fund should assess, based upon its actual operations, whether it is meeting the disclosure requirements to completely and accurately disclose its anticipated principal investment strategies and risks. A fund should review its use of derivatives when it updates its registration statement annually - particularly disclosures in its shareholder reports and assess whether it needs to revise the disclosures in its registration statement that describes its principal derivatives strategies and risks.

1994 Comment II.F—Derivatives

More and more funds are investing in derivative instruments, which may include, for example, financial futures contracts, forward foreign currency contracts, mortgage-backed and asset-backed securities, options, inverse floaters and interest rate swaps. The staff is currently conducting a comprehensive review of funds uses of, and disclosures regarding, derivative instruments. The staff anticipates that, upon completion of its review, it may undertake various rulemaking initiatives.

In the course of its review, the staff has found, in many cases, fund disclosures regarding derivative instruments to be lengthy and highly technical in nature. We strongly encourage registrants to review their existing disclosure concerning derivative instruments to identify areas of such disclosure that can be deleted, reduced or modified to enhance investor understanding about pertinent risks.

[280] *See Instr. 2 to Item 9(b) of Form N-l A. Derivatives-related disclosure should also be provided commensurate with the level of derivatives exposure of a fund. For example, a small investment in some derivatives does not necessarily correlate with little effect on a fund's performance because of the impact of leverage Alternatively, a fund may have significant exposure to derivatives, but that exposure may not make the fund substantially riskier (e.g., exposure by an international fund to currency forwards, entered into to hedge against the currency risk of securities that trade in those currencies would more likely reduce the fund's overall risk, rather than increase it).*

[281] *For example, some funds invest in the combination of an equity-linked derivative and fixed-income securities to create the economic equivalent of investing directly in the underlying equity security. Some funds invest in derivatives in an attempt to enhance returns, i.e., to magnify the gain. Still other funds may invest in interest rate swaps to hedge against their interest rate exposure.*

[282] *As noted, some funds generically describe the risks of investing in derivatives, yet different derivatives are subject to varying risks. For example, derivatives that are not traded on an exchange may be subject to heightened liquidity and valuation risks.*

In this regard, if more than 5% of a fund's net assets are at risk from its involvement in derivative instruments and derivative-based transactions, its prospectus should (1) identify the types of derivative-based transactions in which it will engage; (2) briefly describe the characteristics of such transactions or instruments; (3) state the purpose for which the fund will use derivatives; and (4) identify the risks of derivative instruments and derivative-based transactions. See Items 4(b) and 4(c) of Form N-1A, Guide 3 thereto and Item 8 of Form N-2.

1993 Comment V.B—Investments in Derivative Instruments

In a letter to the Investment Company Institute dated December 6, 1991, the staff expressed its concern about money market funds investing in highly volatile instruments known as "inverse floaters". The letter stated that an investment in inverse floaters amounts to a leveraging of a fund's portfolio which is a form of portfolio management that is highly inappropriate for a fund attempting to maintain a stable net asset value. The letter also stated that, although the face maturity of an inverse floater may be less than 397 days, such an investment will expose the money market fund to a degree of interest rate risk and volatility more characteristic of a long-term instrument.

Other instruments, such as ricochet floating rate notes and capped floaters, have emerged recently that combine short-term maturities with the higher interest rates (and volatility) of longer-term instruments. Capped floaters are floating rate instruments that become fixed income instruments after a preset interest cap has been reached. Ricochet floating rate notes are floating rate instruments that decline inversely when a benchmark rate (such as LIBOR) rises beyond a preset cap. Such instruments are just as inappropriate for money market funds as inverse floaters. Those purchasing these instruments for money market funds may be relying on paragraph (d)(1) of Rule 2a-7. That paragraph, and the Rule as a whole, limit the permissible portfolio instruments of a money market fund to instruments that have a low level of volatility to provide a greater assurance that the money market fund will continue to maintain a stable price per share that fairly reflects the current net asset value per share. *See* Investment Company Act Release No. 13380 (July 8, 1983). Any other interpretation would call into question the Commission's authority to exempt these portfolios from the mark-to-market accounting otherwise required by the Investment Company Act.

1993 Comment V.D—Diversification

Section 8 of the Investment Company Act requires a fund to recite the classification and subclassification, as defined in Sections 4 and 5 of the Act, within which the fund will operate. If it is a management company, it must recite whether it is closed-end or open-end and whether it is diversified or non-diversified, as defined by Section 5 of the Act. The diversification requirements of Section 5(b) are less restrictive than the diversification requirements under Rule 2a-7. The staff will allow a money market fund, otherwise in compliance with Rule 2a-7, to make its compliance with the rule an operating policy rather than a fundamental policy of the fund. Because such an operating policy is more restrictive than the fundamental policy, the prospectus of the fund should explain that (i) the fund will operate in accordance with the fund's operating policy which complies with Rule 2a-7, and (ii) the fundamental policy would give the fund the ability to invest, with respect to twenty five percent of the fund's assets, more than five percent of its assets in any one issuer only in the event that Rule 2a-7 is amended in the future.

1993 Comment II.H—Hub and Spoke Funds

An increasing number of funds are electing to use a "hub and spoke" structure for portfolio management and distribution. In these arrangements (also known as "master-feeder" or "core-feeder" funds), a hub holds and manages the investment portfolio while one or more spokes offers shares to the public and invests all of its assets in the "hub" fund. The registration statement for the spoke should include all information required by Form N-1A as if the distribution function of the spoke and the management function of the hub were contained in a single fund. In addition, the prospectus should describe any unique features of these arrangements. In particular, the staff looks for the following disclosure regarding these arrangements:

(a) A general description of the hub and spoke structure on the cover page of the prospectus and how it differs from a traditional mutual fund. For example, the disclosure should explain that the spoke fund intends to achieve its investment objective by investing exclusively in another investment company rather than in a portfolio of securities, and that its investment experience will correspond directly with the investment experience of the hub.

(b) Information regarding the hub fund, including:

(i) its investment objectives and policies;

(ii) its management and administration including its investment adviser, administrator, custodian and any other persons providing services to the hub fund; and,

(iii) its financial statements, including its balance sheet, statement of operations, statement of changes in net assets, and schedule of investments.

(c) A statement that other mutual funds may invest in the hub fund and that their expenses and, correspondingly, their yields/returns may differ from those of the spoke fund. The prospectus should also include a telephone number for information regarding the availability of other spoke funds.

(d) A unified fee table disclosing all fees of both funds. The brief narrative following the fee table should explain that the table summaries both hub and spoke expenses and should refer to the text of the prospectus for a detailed description of these expenses.

(e) A discussion of the factors considered by the directors of the spoke fund including:

(i) whether the directors/trustees of the spoke fund believe that it will achieve any economies of scale by investing in the hub fund; and,

(ii) whether the aggregate of the fees assessed at the hub and spoke levels will be more or less than if the spoke invested directly in the securities held by the hub.

(f) A discussion of the pass-through voting procedures followed by the spoke fund when the hub fund requests a vote of its security holders (*i.e.*, the spoke funds).

(g) The consequences in the event a spoke fund is required to redeem its shares of the hub because its shareholders do not approve a change in the spoke's investment objectives parallel to changes approved for the hub by a majority of shareholders of all spoke funds. The spoke's inability to find a substitute hub or equivalent investment management could have a significant impact upon its shareholders' investments.

The spoke fund, the hub fund, and the directors and principal officers of both funds should sign the registration statement under the Securities Act of 1933. The facing page of the registration statement should state that the hub fund has executed the registration statement.

If a traditional open-end fund elects to convert to a hub and spoke arrangement, the conversion will not constitute a change in the fund's fundamental policy if: (1) the fund had reserved in its prospectus the right to undertake this Conversion in the future; and, (2) it does not have a fundamental policy that is otherwise inconsistent with investing in the securities of a hub fund. The fund may look through to the hub's investments to determine consistency with its fundamental policies of diversification and concentration. [*See* Appendix VI NASAA Guidelines for Registration of Master Fund/Feeder Funds]

1993 Comment II.1—Options and Futures

In the generic comment letter dated January 11, 1990, registrants were encouraged to abbreviate their prospectus disclosure concerning options and futures transactions in the interest of prospectus simplification. This change should not be interpreted as encouraging the elimination of pertinent risk disclosure from the prospectus.[283]

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[283]*The amount of the registrant's net assets that are at risk for purposes of determining whether "more than five percent of net assets are at risk" is not limited to the initial amount of the registrant's assets that are invested in a particular practice, for example, the purchase price of an option. The amount of net assets at risk is determined by reference to the potential liability or loss that may be incurred by the registrant in connection with a particular practice. See Instructions to Item 8.4 of Form N-2, Investment Company Act Release No. 19115 (November 20, 1992), effective January 1, 1993, 57 F.R. 56826. [See below] Examples of the risks that should be considered include, but are not necessarily limited to, the following;*

(1) Options and futures may fail as hedging techniques in cases where the price movements of the securities underlying the options and futures do not follow the price movements of the portfolio securities subject to the hedge.

(2) The loss from investing in futures transactions is potentially unlimited.

(3) Gains and losses on investments in options and futures depend on the portfolio manager's ability to predict correctly the direction of stock prices, interest rates, and other economic factors.

(4) The fund will likely be unable to control losses by closing its position where a liquid secondary market does not exist.

[Item 8.4 of Form N-2 and instructions: Other Policies: Briefly discuss the types of investments that will be made by the Registrant, other than those that will constitute its principal portfolio emphasis (as discussed in Item 8.2), and any policies or practices relating to those investments.

Instructions

a. This discussion should receive less emphasis in the prospectus than that required by Item 8.2 and, if appropriate in light of Instructions b and c below, may be omitted or limited to the information necessary to identify the type of investment, policy, or practice.

b. Do not discuss a policy that prohibits a particular practice) or permits a practice that the Registrant has not used within the past twelve months (or since its initial public offering, if that period is shorter) and does not intend to use in the future.

(Continued on next page)

1991 Comment II.B—Concentration and Diversification Policies Regarding Foreign Government Securities

Securities issued by a foreign government, its agencies and instrumentalities ("foreign government securities") are not considered "government securities" as defined in the 1940 Act. For diversified companies, these securities should be included as "other securities" for purposes of Section 5(b)(1). In identifying an "issuer of a foreign government security" for purposes of Section 5(b)(1), the staff applies the criteria for identifying the issuer discussed in Investment Company Act Release No. 9785 (May 31, 1977) relating to municipal securities.

In addition, foreign government securities may not be excluded from a registrant's concentration policy. A registrant may not reserve freedom of action to concentrate in securities issued by a foreign government without clearly indicating when and under what specific conditions any changes between concentration and non-concentration will be made.

Item 10. Management, Organization, and Capital Structure

(a) ***Management.***

(1) Investment Adviser.

(i) Provide the name and address of each investment adviser of the Fund, including sub-advisers. Describe the investment adviser's experience as an investment adviser and the advisory services that it provides to the Fund.

(ii) Describe the compensation of each investment adviser of the Fund as follows:

(A) If the Fund has operated for a full fiscal year, state the aggregate fee paid to the adviser for the most recent fiscal year as a percentage of average net assets. If the Fund has not operated for a full fiscal year, state what the adviser's fee is as a percentage of average net assets, including any breakpoints.

(B) If the adviser's fee is not based on a percentage of average net assets (*e.g.*, the adviser receives a performance-based fee), describe the basis of the adviser's compensation.

(Continued)

c. If a policy limits a particular practice so that no more than five percent of the Registrant's net assets are at risk, or if the Registrant has not followed that practice within the last year (or since its initial public offering, if such period is shorter) in such a manner that more than five percent of net assets were at risk and does not intend to follow such practice so as to put more than five percent of net assets at risk, limit the prospectus disclosure about such practice to that necessary to identify the practice. Disclose whether or not the Registrant will provide prior notice to security holders of its intention to commence or expand the use of such practice.

Instruction:

The amount of the Registrant's net assets that are at risk for purposes of determining whether "more than 5 percent of net assets are at risk" is not limited to the initial amount of the Registrant's assets that are invested in a particular practice, e.g., the purchase price of an option. The amount of net assets at risk is determined by reference to the potential liability or loss that may be incurred by the Registrant in connection with a particular practice.

(iii) Include a statement, adjacent to the disclosure required by paragraph (a)(1)(ii) of this Item, that a discussion regarding the basis for the board of directors approving any investment advisory contract of the Fund is available in the Fund's annual or semi-annual report to shareholders, as applicable, and providing the period covered by the relevant annual or semi-annual report.

Instructions.

1. If the Fund changed advisers during the fiscal year, describe the compensation and the dates of service for each adviser.

2. Explain any changes in the basis of computing the adviser's compensation during the fiscal year.

3. If a Fund has more than one investment adviser, disclose the aggregate fee paid to all of the advisers, rather than the fees paid to each adviser, in response to this Item.

(2) *Portfolio Manager.* For each Portfolio Manager identified in response to Item 5(b), state the Portfolio Manager's business experience during the past 5 years. Include a statement, adjacent to the foregoing disclosure, that the SAI provides additional information about the Portfolio Manager's(s') compensation, other accounts managed by the Portfolio Manager(s), and the Portfolio Manager's(s') ownership of securities in the Fund. If a Portfolio Manager is a member of a committee, team, or other group of persons associated with the Fund or an investment adviser of the Fund that is jointly and primarily responsible for the day-to-day management of the Fund's portfolio, provide a brief description of the person's role on the committee, team, or other group (e.g., lead member), including a description of any limitations on the person's role and the relationship between the person's role and the roles of other persons who have responsibility for the day-to-day management of the Fund's portfolio.

(3) *Legal Proceedings.* Describe any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the Fund or the Fund's investment adviser or principal underwriter is a party. Include the name of the court in which the proceedings are pending, the date instituted, the principal parties involved, a description of the factual basis alleged to underlie the proceeding, and the relief sought. Include similar information as to any legal proceedings instituted, or known to be contemplated, by a governmental authority.

Instruction. For purposes of this requirement, legal proceedings are material only to the extent that they are likely to have a material adverse effect on the Fund or the ability of the investment adviser or principal underwriter to perform its contract with the Fund.

(b) ***Capital Stock.*** Disclose any unique or unusual restrictions on the right freely to retain or dispose of the Fund's shares or material obligations or potential liabilities associated with holding the Fund's shares (not including investment risks) that may expose investors to significant risks.

5. Management, Organization, and Capital Structure (Item 6)

a. Management and Organization

The Commission proposed to abbreviate disclosure in the prospectus about a fund's management and organization and move certain of this information to the SAI. Commenters generally supported the Proposed Amendments, and the Commission is adopting them as proposed with modifications to reflect suggestions of commenters.

Management Disclosure. Under existing Form N-1A, all funds must disclose the rate of fees that they pay their investment advisers in their fee tables. As stated above, the Commission has retained this requirement, which the Commission believes is among the core requirements of the Form. The Proposed Amendments would continue to require, in addition to the disclosure contained in the fee table, prospectus disclosure about investment advisory services provided to, and investment advisory fees paid by, a fund. Some commenters recommended eliminating disclosure about the investment advisory fees, which they argued is merely duplicative of the information in the fee table. The Commission disagrees with this argument. The Commission believes that a concise and straightforward description of the services that an investment adviser provides to a fund along with disclosure of the investment advisory fee rate for a recent fiscal year, as well as providing this information in a single place in a prospectus, can help a typical investor understand the management of the fund. Therefore, the Commission is adopting the disclosure requirements as proposed.[284]

In the Form N-1A Proposing Release, the Commission requested comment whether information about the amount of fees paid to a sub-adviser or sub-advisers of a fund helps investors evaluate and compare the fund to other funds. The Commission also asked whether this type of disclosure obscures the aggregate investment advisory fee paid by a particular fund.[285] Most commenters supported disclosure of the aggregate fee only, maintaining that information about individual sub-advisory fees is not relevant to investors because it does not help them compare the fees charged by different funds. The Commission is persuaded that information about sub-advisory fees is not necessary for a typical fund investor, but may be of interest to some investors. Therefore, Form N-1A, as amended, requires prospectus disclosure of the aggregate advisory fees paid by a fund and disclosure in the SAI of the amount of sub-advisory fees paid by the fund.[286]

Portfolio Manager. The Proposed Amendments would continue to require prospectus disclosure indicating the person or persons responsible for the day-to-day management of a fund's portfolio. Under the Proposed Amendments, and as currently permitted by instructions to Form N-1A, a fund could, in meeting this requirement, indicate that a committee was responsible for a

[284] *Item 6(a).*

[285] *See Form N-1A Proposing Release,* supra *note 8, at 10912.*

[286] *Instruction 3 to Item 6(a)(1) and Item 15(1)(3).*

fund's portfolio management if, under the organizational arrangements of the fund (or its investment adviser), no one person was responsible for making recommendations to the committee.

One commenter criticized the proposed portfolio manager disclosure requirement, arguing that it may have the effect of creating the false impression that the identity of the individual portfolio manager of a fund is paramount to the fund's performance. According to the commenter, the collective experience, resources, personnel, and reputation of a fund's investment adviser often are of greater importance to the fund's performance than the fund's portfolio manager. The commenter recommended that, to enable funds to describe their management structures more accurately than they can under Form N-1A's existing provisions, the Commission require disclosure of the identity of a fund's portfolio manager only when a change in the identity of the manager would be material to investors (*e.g.*, when a fund group promotes the identity of individual portfolio managers). The commenter suggested that the Commission, in the alternative, clarify the disclosure obligations of a fund for which the day-to-day responsibilities for the fund's portfolio investments are shared by a committee and certain individuals.

The Commission is not persuaded that it should adopt the commenter's recommendation that the Commission tie portfolio manager disclosure to a fund group's marketing efforts. Such a recommendation is substantially similar to proposals considered and rejected by the Commission when it adopted Form N-1A's existing portfolio manager disclosure requirement.[287] The Commission believes that typical investors in a fund should have clear and succinct information about the individuals who significantly affect the fund's investment operations. In the Commission's experience, Form N-lA's existing requirement appropriately serves this purpose and should not be changed significantly. To the Commission's knowledge, the requirement has not generally resulted in funds inaccurately describing the individuals responsible for their management.

Although the Commission believes that Form N-1A's portfolio manager disclosure requirements should not be changed significantly, the Commission has concluded that it is appropriate to provide additional guidance in Form N-1A as to the disclosure obligations of a fund for which day-to-day management responsibilities are shared. New instructions to Form N-1A's portfolio manager disclosure requirements have been added for this purpose.[288]

Legal Proceedings. The Proposed Amendments would continue to require prospectus disclosure of any material pending legal proceedings involving a fund, its investment adviser, or principal underwriter. The Commission also proposed to expand Form N-1A's legal proceedings disclosure requirement to cover those proceedings contemplated by a governmental authority. In proposing this change, the Commission sought to conform Form N-1A's requirements to those included in other Commission forms applying to other types of issuers.[289]

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[287] *See MDFP Adopting Release,* supra *note 15, at 19051-52.*

[288] *Instructions to Item 6(a)(2).*

[289] *See Item 12 of Form N-2 [17 CFR 274.11 a-1] for closed-end investment companies; Item 103 of Regulation S-K [17 CFR 229.103] for non-investment company issuers. See also Investment Company Act Release No. 19155 (Nov. 30, 1992) [57 FR 56862] (modifying Form N-2 to conform to Item 103).*

Some commenters questioned the requirement that a fund disclose contemplated proceedings, arguing that a fund would find it difficult to assess whether proceedings of a governmental entity are in fact contemplated. The Commission is not persuaded by this argument and has adopted the legal proceedings requirement as proposed.[290] In support of its decision, the Commission notes that issuers that have been subject to the requirement appear not to have experienced significant difficulty in complying with it.

Board of Directors. Form N-1A currently requires a fund to include in its prospectus a brief description of the responsibilities of the fund's board of directors under the applicable laws of the jurisdiction in which the fund is organized. Recognizing that the disclosure provided by a fund in response to this item typically recites the substance of specific legal requirements, the Commission proposed to move this disclosure to the SAI. Commenters supported disclosing the director information in the SAI, arguing that the information does not help a typical investor make a decision to invest in a fund. Form N-1A, as amended, requires a fund to disclose this information in the SAI.[291]

The Commission requested comment in the Form N-1A Proposing Release whether a fund's prospectus should include the names, experience, and compensation of a fund's directors, as well as information, such as addresses and telephone numbers, indicating how a shareholder could contact the directors.[292] The Commission also requested comment whether this information, if required, should be given only for a fund's independent directors, accompanied by disclosure of the number of independent directors in comparison to the number of directors on the fund's board.[293]

Most commenters strongly opposed additional disclosure about directors in the prospectus. While a few commenters supported identifying the directors in the prospectus, most argued that this information is not essential to a typical investor in making a decision about investing in a fund and would only serve to lengthen the prospectus. The commenters recommended that the SAI or annual report to shareholders would be a better place for disclosing the identity of directors.

Commenters addressing the issue uniformly opposed requiring a fund to disclose directors' compensation in the prospectus, arguing that these fees are only a small part of total fund expenses and are not relevant to a typical investor in a making a decision to invest in a fund. The commenters also noted that director compensation is disclosed in a fund's SAI, where it can be used by those investors interested in the information, and in a fund's proxy statement, where it can be assessed by all shareholders of the fund in the context of an election of directors.[294]

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[290] *Item 6(a)(3).*

[291] *Item 13(a).*

[292] *Form N-1A Proposing Release* supra *note 8, at 10912.*

[293] *The Investment Company Act contains a number of requirements relating to the composition of a fund's board. See, e.g., sections 10(a) and 15(f) of the Investment Company Act [15 U.S.C. 80a-10(a), -15(f)].*

[294] *Item 13(d); Item 22(b)(6) of Schedule 14A [17 CFR 240.14a-101].*

All commenters addressing the issue emphatically opposed the disclosure of information in either the prospectus or the SAI indicating how shareholders can contact directors. Commenters, particularly independent directors of funds, argued that this information would result in an unwarranted loss of privacy for board members and numerous calls to directors to which they would be ill-equipped to respond. Commenters also argued that disclosure of this information would serve as a disincentive for qualified individuals to serve as directors and that all investor comments regarding a fund should be directed to representatives of the fund's management, and not to its directors.

The Commission believes that mandating more information about fund directors than is available under its existing disclosure rules may be appropriate in light of independent directors' role as "watchdogs" of fund shareholders as contemplated by the Investment Company Act.[295] The Commission, however, is not convinced, particularly in light of the overwhelmingly negative comment on this issue, that the prospectus is the appropriate document for this disclosure. Therefore, Form N-1A, as amended, does not require additional in formation of the sort described in the Proposed Amendments to be provided about a fund's directors. The Commission, however, has directed the Division to consider director disclosure issues as part of an initiative to improve shareholder reports.[296]

Management and Organization. The Commission proposed to move to the SAI two items of disclosure about a fund's management and organization that the Commission believes are only of minimal importance to typical fund investors. The Proposed Amendments would no longer require a fund to disclose in its prospectus the name of any person that controls the fund's investment adviser and the name of any person that controls the fund.[297] The Proposed Amendments also would no longer require a fund to state in its prospectus, if applicable, that the fund engages in brokerage transactions with affiliated persons and allocates brokerage transactions based on the sale of fund shares.[298] The information called for in response to these two items typically results in generic disclosure that restates applicable legal requirements and does not appear to assist investors in deciding whether to invest in a particular fund. Commenters generally

[295] *These responsibilities of directors include, among other things: (i) evaluating and approving the fund's investment advisory and principal underwriting contracts (sections 15(a), (c) [15 U.S.C. 80a-15(a), (c)]) and the use of fund assets to pay for the distribution of fund shares (rule 12b-1); (ii) selecting the fund's independent public accountants (section 32(a)(1) [15 U.S.C. 80a-31(a)(1)]); and (iii) reviewing and approving transactions with affiliates under various rules (e.g., rule 10f-3 [17 CFR 270.10f-3]; rule 17a-7 [17 CFR 270.17a-7]; rule 17e-1 [17 CFR 270.17e-1]). Directors have fiduciary duties to the fund and its shareholders under section 36(a) of the Investment Company Act [15 U.S.C. 80a-35(a)] and under state law. See 3 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 838 (rev. perm. ed. 1994); Hanson Trust PLC v. ML SCM Acquisition, inc., 781 F.2d 264, 275 (2d Cir. 1986). See also Burks v. Lasker, 441 U.S. 471 (1979) (upholding the authority of independent directors to take actions under state law to the extent not inconsistent with the policies of the Investment Company Act and the Investment Advisers Act of 1940 [15 U.S.C. 80b-1, et seq.] (the "Advisers Act")).*

[296] *See supra note 119 and accompanying text.*

[297] *Transactions between controlling persons and a fund are subject to restrictions under the Investment Company Act. See, e.g., section 17 [15 U.S.C. 80a-17] and rules 17a-6 and 17d-1 [17 CFR 270.17a-6, .17d-1].*

[298] *Payment of commissions to affiliated brokers is governed by section 17(e) of the Investment Company Act [15 U.S.C. 80a-17(e)] and rule 17e-1 [17 CFR 270.17e-1].*

supported placing this information in the SAI. Form N-IA, as amended, requires a fund to disclose information in the SAI regarding controlling persons of the investment adviser and brokerage transactions with affiliated persons.[299] The Commission proposed to move to the SAI disclosure about a fund's form of organization along with the date and state of the fund's incorporation. Because most funds are organized in one of a few states as corporations or business trusts, disclosure about a fund's organization does not appear to help investors evaluate a particular fund or compare the fund to other funds. For that reason, the Commission is adopting its proposal to move information about a fund's organization to the SAI.[300]

The Proposed Amendments would not include the disclosure about a fund's expenses currently required by Form N-1A in the discussion of the fund's management. This information is included in the fee table and the financial highlights table. Additional information about fund expenses also is available in a fund's SAI. Eliminating repetitive information is one of the basic objectives of the Commission's efforts to improve fund disclosure documents. Consistent with this goal, Form N-1A, as amended, does not require this additional information about fund expenses in disclosure about a fund's management.

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[299] *Item 15(a) and 16(b)(1).*

[300] *11(a). The Commission proposed to continue to require a fund to disclose its form of organization and place of incorporation in the prospectus if a fund is organized outside the United States and registered under section 7(d) of the Investment Company Act [15 U.S.C. 80a-7(d)]. Although this type of organization is permitted by the Investment Company Act, only a limited number of funds that are organized and incorporated outside of the United States have registered under the Act. A fund organized in this manner would be subject to certain legal requirements under the Investment Company Act, regardless of whether those requirements were described in the fund's prospectus. Following one of Form N-1A's underlying principles to avoid prospectus disclosure that simply restates applicable legal provisions, the Commission has determined to incorporate this disclosure requirement in Item 11(a) of the SAI.*

b. Capital Structure

The Proposed Amendments would continue to require prospectus disclosure about any limits on the transferability of, and material obligations or potential liabilities associated with, a fund's shares. One commenter suggested that disclosure should appear in the SAI rather than in the prospectus, asserting that the information is technical and generally does not vary among funds. The commenter recommended that the Commission instead limit disclosure in a fund's prospectus to unusual provisions that may pose special risks to the fund's shareholders. The Commission agrees that descriptions of all potential restrictions and possible consequences of holding fund shares are of only marginal significance to typical investors in selecting among funds. Form N-1A, as amended, thus requires prospectus disclosure of only unique or unusual restrictions or potential liabilities associated with holding a fund's shares (other than investment risks) that may expose an investor in the fund to significant risks.[301] Under Form N-1A, as amended, a fund would be required to discuss in its SAI generally applicable legal provisions relating to holding fund shares.[302]

The Proposed Amendments would move disclosure about shareholder voting rights to the SAI. In explaining this decision, the Commission stated that the Investment Company Act sets out specific rights of fund shareholders,[303] which typically results in this disclosure being generic in nature and of little consequence to investors in evaluating and comparing funds. Commenters generally supported including this information in the SAI, agreeing that it is not essential to an investment decision. Form N-1A, as amended, requires this disclosure in the SAI.[304]

Form N-1A currently requires a fund to describe in its prospectus any class of senior securities issued by the fund, and any "other class" of its shares that is outstanding. In the Com-

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[301] *Item 6(b). The prospectuses of funds organized as business trusts under Massachusetts law sometimes include disclosure that, under Massachusetts law, fund shareholders may be held personally liable as partners for the fund's obligations under certain limited circumstances. In adopting Form N-1A in 1983, the Commission stated that disclosure of possible contingent shareholder liability under this form of organization should not be required if a fund believes that, because of arrangements to protect shareholders, the likelihood of loss or expense to shareholders is remote. 1983 Form N-1A Adopting Release,* supra *note 12, at 37933-34. See 3 T. FRANKEL, THE REGULATION OF MONEY MANAGERS 79 (1980) (for funds organized as Massachusetts business trusts, personal liability generally is considered remote). In connection with the Proposed Amendments, the staff undertook a review of fund prospectus disclosure. The review indicated, among other things, that certain funds continue to include disclosure about Massachusetts business trusts and state that shareholder liability is remote. In the Commission's view, this disclosure appears to be unwarranted, and the Commission encourages funds to re-evaluate whether this disclosure is necessary in light of the Commission's goal to minimize the disclosure of events that have only a remote possibility of affecting an investor's investment in a fund. See Form N-1A Proposing Release,* supra *note 8, at 10913.*

[302] *Item 17(a).*

[303] *The Investment Company Act requires all fund shares to have equal voting rights and prescribes the vote required for certain significant matters. See, e.g., section 18(i) [15 U.S.C. 80a-18(i)] (equal voting rights); section 15(a) [15 U.S.C. 80a-15(a)] (approval of investment advisory contract); section 16(a) [15 U.S.C. 80a-16(a)] (election of directors); section 13(a) [15 U.S.C. 80a-13(a)] (changes in fundamental investment policies). See also section 2(a)(42) [15 U.S.C. 80a-2(a)(42)] (defining "voting security" and a "vote of a majority of the outstanding voting securities" for purposes of the Investment Company Act); rules 18f-2, 18f-3 [17 CFR 270.18f-2, -3] (specifying certain voting rights with respect to series funds and multiple class funds, respectively).*

[304] *Item 17(a).*

mission's experience, disclosure in fund prospectuses made in response to this require ment merely restates legal requirements in the Investment Company Act and its rules, which limit a fund's ability to issue certain classes of shares or senior securities.[305] The Commission concluded that disclosure of this sort is only of minimal significance to a typical investor in deciding whether to invest in a fund, and proposed to delete it from fund prospectuses.[306] Commenters agreed with the Commission's conclusion, and Form N-1A, as amended, does not require prospectus disclosure of information about other classes of fund shares (including senior securities).[307] The SAI would continue to require a fund to disclose the rights of any authorized securities of the fund other than capital stock.[308]

DISCLOSURE REGARDING PORTFOLIO MANAGERS OF REGISTERED MANAGEMENT INVESTMENT COMPANIES
[Release Nos. 33-8458; IC-26533; August 23, 2004]

II. DISCUSSION

A. Identification of Portfolio Management Team Members

The Commission is adopting, with modifications to address commenters' concerns, proposed amendments to Forms N-1A and N-2, the registration forms for mutual funds and closed-end funds, that will require those funds to identify in their prospectuses each member of a committee, team, or other group of persons associated with the fund or its investment adviser that is jointly and primarily responsible for the day-to-day management of the fund's portfolio. The amendments we are adopting will require funds to state the name, title, length of service, and business experience of each member of a portfolio management team.

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We note that, under the amendments we are adopting, disclosure is only required with respect to members of a management team who are jointly and primarily responsible for the

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[305] *Under section 18(f) of the Investment Company Act, a fund generally is prohibited from issuing senior securities. By its terms, however, this prohibition does not preclude a fund from borrowing from any bank, so long as the borrowing is undertaken in accordance with the requirements of the Investment Company Act. See section 18(f)(1) (a fund must have asset coverage of at least 300 percent of all borrowings). In addition, the Commission has taken the position that certain types of portfolio transactions that involve leverage engaged in by a fund would not be deemed senior securities if the fund establishes a segregated account with liquid assets that collateralize 100% of the market value of the obligations under these transactions. See Investment Company Act Release No. 10666 (Apr. 18, 1979) [44 FR 25128]; see also Merrill Lynch Asset Management, L.P. (pub. avail. July 2, 1996) (staff no-action letter). Series funds and multiple class funds, each of which may raise issues under section 18(f), are expressly contemplated by section 18(f)(2) of the Investment Company Act and related rules 18f-2 and 18f-3.*

[306] *Under the proposal, a fund, however, would be required to disclose information in its prospectus about any series or class of the fund offered in the prospectus. Form N-1A, as amended, adopts this requirement. See, e.g., Item 8(c).*

[307] *Form N-1A, as amended, does not require disclosure in the prospectus of any measures taken by a fund (e.g., formation and maintenance of segregated accounts) to ensure that certain instruments that it holds are not deemed senior securities for purposes of the Investment Company Act's limitations. Form N-1A, as amended, would continue to require a fund that has a fundamental policy to borrow monies or that employs leverage to include disclosure about these practices in its prospectus. See* supra *Section II.A.3.a (discussing required disclosure of principal investment strategies).*

[308] *Item 17(b).*

day-to-day management of the fund's portfolio. To the extent that a fund is managed by a committee, team, or other group that includes additional members who are not jointly and primarily responsible for day-to-day management, identification of these individuals is not required. Thus, if a fund has a management team that includes analysts who make securities recommendations with respect to the portfolio, but do not have decision-making authority, these individuals would not have to be identified, unless they are jointly and primarily responsible for day-to-day management of the fund's portfolio. An analyst could be jointly and primarily responsible for day-to-day management if, for example, the individual who has decision-making authority over the fund's portfolio routinely adopts the analyst's recommendations.

We are, however, modifying our proposal in response to the commenters' concerns to provide that if more than five persons are jointly and primarily responsible for the day-to-day management of a fund's portfolio, the fund need only provide the required information for the five persons with the most significant responsibility. This will permit funds with large numbers of persons that are jointly and primarily responsible for portfolio management to provide information about the key decision-makers rather than lengthy disclosure about numerous individuals that would obscure other important information in the prospectus.

The determination of the members of a portfolio management team who are jointly and primarily responsible for the day-to-day management of a fund's portfolio will depend on the facts and circumstances of the particular fund. For example, in the case of a fund with a large management team, where a single "lead member" is responsible for implementing and monitoring the overall portfolio management of the fund, it may be appropriate to identify this single "lead member" as the portfolio manager. Some funds with large management teams are "research-driven" funds that may have portfolio management teams with as many as 50 members, each of whom is allocated a specified portion of the portfolio over which he or she has independent responsibility for research, stock selection, and portfolio construction. A research-driven fund may have a coordinator with responsibility for allocating the portfolio among the various managers and analysts, implementing trades on behalf of analysts on the team, reviewing the overall composition of the portfolio to ensure its compliance with its stated investment objectives and strategies, and monitoring cash flows. In such a case, it may be appropriate for a fund to identify the coordinator as its portfolio manager. If a research-driven fund does not have such a portfolio coordinator or similar position, it may be appropriate to provide the required information for the five persons with the most significant responsibility for the day-to-day management of the fund's portfolio, for example, the managers with the largest percentages of assets under management.

The amendments also require a fund to provide a brief description of each member's role on the management team (e.g., lead member). We are modifying the proposal to clarify that a fund's description of a member's role on a committee, team, or group must include a description of any limitations on the person's role and the relationship between the person's role and the roles of other persons who have responsibility for the day-to-day management of the fund's portfolio. This responds to commenters' suggestions that we require additional dis-

closure regarding the structure of each management team. The amended requirement is intended to provide investors with a clearer understanding of what an identified portfolio manager does and does not do in the course of day-to-day management of the fund, and the ways in which the responsibilities of any identified portfolio manager relate to those of other members of a portfolio management team, including members who may not be identified in the prospectus as portfolio managers. It will also assist investors in funds with large management teams, such as research-driven funds, in understanding how the responsibilities of an identified portfolio manager may differ from those of a manager who manages a fund on his or her own or with a small team of other managers. For example, if a portfolio management team for a balanced fund has one team member who is responsible only for the overall allocation of the fund's assets among equities, bonds, and money market instruments, and other team members who are responsible only for selection of securities within a particular segment of the fund, the fund's disclosure should describe these limitations in describing each member's role.

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F. Removal of Exclusion for Index Funds

We are removing the current provision in Form N-1A that excludes a fund that has as its investment objective replication of the performance of an index from the requirement to identify and provide disclosure regarding its portfolio managers. We are removing this exclusion in order to shed light on the alignment of index fund portfolio managers with investors' interests and on their potential conflicts of interest. Commenters were split on the proposed removal of the index fund exclusion.... We are removing the current index fund exclusion because we continue to believe that concerns about the alignment of portfolio managers and their conflicts of interest are important to investors in index funds.

DISCLOSURE REGARDING APPROVAL OF INVESTMENT ADVISORY CONTRACTS BY DIRECTORS OF INVESTMENT COMPANIES [Release Nos. 33-8433; 34-49909; IC-26486; June 23, 2004]

II. DISCUSSION

A. Disclosure Requirement in Shareholder Reports

***[W]e also agree with commenters who argued that it is important for investors to have access to information about advisory contract approvals before investing in a fund. For that reason, we are requiring that a fund prospectus state that a discussion regarding the board of directors' basis for approving any investment advisory contract is available in the fund's annual or semi-annual report to shareholders, as applicable. This disclosure will be required to indicate the dates covered by the relevant shareholder report, so that a shareholder may easily request the appropriate report. The disclosure will be required to appear adjacent to other prospectus disclosure about the fund's investment adviser.

Item 11. Shareholder Information

(a) ***Pricing of Fund Shares.*** Describe the procedures for pricing the Fund's shares, including:

(1) An explanation that the price of Fund shares is based on the Fund's net asset value and the method used to value Fund shares (market price, fair value, or amortized cost); except that if the Fund is an Exchange-Traded Fund, an explanation that the price of Fund shares is based on market price.

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.

(2) A statement as to when calculations of net asset value are made and that the price at which a purchase or redemption is effected is based on the next calculation of net asset value after the order is placed.

(3) A statement identifying in a general manner any national holidays when shares will not be priced and specifying any additional local or regional holidays when the Fund shares will not be priced.

Instructions.

1. In responding to this Item, a Fund may use a list of specific days or any other means that effectively communicates the information (*e.g.*, explaining that shares will not be priced on the days on which the New York Stock Exchange is closed for trading).

2. If the Fund has portfolio securities that are primarily listed on foreign exchanges that trade on weekends or other days when the Fund does not price its shares, disclose that the net asset value of the Fund's shares may change on days when shareholders will not be able to purchase or redeem the Fund's shares.

(b) ***Purchase of Fund Shares.*** Describe the procedures for purchasing the Fund's shares.

(c) ***Redemption of Fund Shares.*** Describe the procedures for redeeming the Fund's shares, including:

(1) Any restrictions on redemptions.

(2) Any redemption charges, including how these charges will be collected and under what circumstances the charges will be waived.

[(3) If the Fund has reserved the right to redeem in kind.]

[The above paragraph (c)(3) is to be removed and subsequent paragraphs renumbered accordingly, effective January 17, 2017, with a compliance date of June 1, 2017.]

(3) Any procedure that a shareholder can use to sell the Fund's shares to the Fund or its underwriter through a broker-dealer, noting any charges that may be imposed for such service.

Instruction. The specific fees paid through the broker-dealer for such service need not be disclosed.

(4) The circumstances, if any, under which the Fund may redeem shares automatically without action by the shareholder in accounts below a certain number or value of shares.

(5) The circumstances, if any, under which the Fund may delay honoring a request for redemption for a certain time after a shareholder's investment (*e.g.*, whether a Fund does not process redemptions until clearance of the check for the initial investment).

(6) Any restrictions on, or costs associated with, transferring shares held in street name accounts.

[The below paragraphs (c)(7) and (c)(8) are to be added effective January 17, 2017, with a compliance date of June 1, 2017.]

(7) The number of days following receipt of shareholder redemption requests in which the fund typically expects to pay out redemption proceeds to redeeming shareholders. If the number of days differs by method of payment (e.g., check, wire, automated clearing house), then disclose the typical number of days or estimated range of days that the fund expects it will take to pay out redemptions proceeds for each method used.

(8) The methods that the fund typically expects to use to meet redemption requests, and whether those methods are used regularly, or only in stressed market conditions (e.g., sales of portfolio assets, holdings of cash or cash equivalents, lines of credit, interfund lending, and/or ability to redeem in kind).

Investment Company Liquidity Risk Management Programs;
(Release Nos. 33-10233; IC-32315; October 13, 2016)

III. Discussion

L. Disclosure and Reporting Requirements Regarding Liquidity Risk and Liquidity Risk Management

1. Amendments to Form N-1A

a. Timing of the Redemption of Fund Shares

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In consideration of these comments, and in a modification to the proposal, we are adopting amendments to Item 11 of Form N-1A to require a fund to disclose the number of days following receipt of shareholder redemption requests in which the fund typically expects to pay redemption proceeds to redeeming shareholders, rather than the number of days in which the fund will pay redemption proceeds as proposed. Funds may wish to consider also disclosing whether payment of redemption proceeds may take longer than the number of days that the fund typically expects and may take up to seven days as provided in the Investment Company Act.

We appreciate commenters' concerns, and believe that this adjustment to the language in Form N-1A will give funds flexibility to provide disclosures about redemption procedures that do not inappropriately limit a fund's ability to meet redemptions to the exact timing previously disclosed in its prospectus. We continue to believe that requiring this disclosure will inform the public about a critical aspect of a shareholder's relationship with a fund – when the shareholder can expect redemption proceeds. Funds generally should disclose timing that reflects their actual operational procedures for meeting redemption rather than generic disclosures about fund redemptions, regardless of what other funds in the industry may disclose. We continue to believe that it is in the public interest to inform investors on the timing of when fund shareholders should expect redemption proceeds. We believe that this disclosure requirement will also enhance consistency in fund disclosures regarding the timing in which a fund will pay redemption proceeds, thereby improving the information provided to shareholders and the ability of investors to compare redemption procedures across funds. [footnotes omitted]

b. Methods Used to Meet Shareholder Redemption Obligations

… We believe requiring that the description of the procedures for redeeming fund shares include a description of the methods a fund typically expects to use to meet redemption requests will improve disclosure about another critical aspect of a shareholder's relationship with a fund – how a shareholder can expect to receive redemption proceeds. We appreciate the concerns expressed by commenters and believe that the modified language in the form provides some needed flexibility for funds while at the same time providing investors with improved information concerning redemption procedures. Furthermore, this disclosure requirement will increase consistency in fund disclosure documents regarding fund redemption practices and improve the comparability of such information across funds. Absent this amendment, disclosures concerning the methods funds use to pay redemption proceeds will continue to vary across funds.

We believe that requiring specific disclosure on the methods a fund uses to pay redemption proceeds could improve investor knowledge on how a fund manages liquidity and its redemption obligations to shareholders. At the foundation of the prospectus disclosure framework is the provision to all investors of user-friendly information that is key to an investment decision. Additionally, given the increase in open-end funds pursuing alternative and fixed income strategies with varied liquidity risks, the sources of liquidity and methods used to meet shareholder redemptions are key information that investors need.

Methods to meet redemption obligations may include, for example, sales of portfolio assets, holdings of cash or cash equivalents, the use of lines of credit and/or interfund lending, and in-kind redemptions. Funds may also use redemption fees to help mitigate dilution and address transaction costs associated with shareholder activity. We also believe that requiring this disclosure could encourage funds to consider their operations and ensure that the methods they may use to meet shareholder redemption obligations in normal and reasonably foreseeable stressed markets are viable.

As noted above, Form N-1A requires funds to disclose whether they reserve the right to redeem their shares in kind instead of in cash and to describe the procedures for such redemptions. As proposed, we are amending Form N-1A to incorporate this disclosure requirement into Item 11(c)(8) discussed above. We understand that the use of in-kind redemptions (outside of the ETF context) historically has been rare and that many funds reserve the right to redeem in kind only as a tool to manage liquidity risk under emergency circumstances or to manage the redemption activity of a fund's large institutional investors. We also are aware that there are often logistical issues associated with redemptions in kind and that these issues can limit the availability of in-kind redemptions as a practical matter. A fund should consider whether adding relevant detail to its disclosure regarding in-kind redemptions, including, for example, whether redemptions in kind will be pro-rata slices of the fund's portfolio or individual securities or a representative basket of securities, or revising its disclosure if the fund would be practically limited in its ability to redeem its shares in kind, would provide more accurate information to investors. [footnotes omitted]

(d) ***Dividends and Distributions.*** Describe the Fund's policy with respect to dividends and distributions, including any options that shareholders may have as to the receipt of dividends and distributions.

(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 ap-

plies 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.

(f) ***Tax Consequences.***

(1) Describe the tax consequences to shareholders of buying, holding, exchanging and selling the Fund's shares, including, as applicable, that:

(i) The Fund intends to make distributions that may be taxed as ordinary income and capital gains (which may be taxable at different rates depending on the length of time the Fund holds its assets). If the Fund expects that its distributions, as a result of its investment objectives or strategies, will consist primarily of ordinary income or capital gains, provide disclosure to that effect.

(ii) The Fund's distributions, whether received in cash or reinvested in additional shares of the Fund, may be subject to federal income tax.

(iii) An exchange of the Fund's shares for shares of another fund will be treated as a sale of the Fund's shares and any gain on the transaction may be subject to federal income tax.

(2) For a Fund that holds itself out as investing in securities generating tax-exempt income:

(i) Modify the disclosure required by paragraph (f)(1) to reflect that the Fund intends to distribute tax-exempt income.

(ii) Also disclose, as applicable, that:

(A) The Fund may invest a portion of its assets in securities that generate income that is not exempt from federal or state income tax;

(B) Income exempt from federal tax may be subject to state and local income tax; and

(C) Any capital gains distributed by the Fund may be taxable.

(3) If the Fund does not expect to qualify as a regulated investment company under Subchapter M of the Internal Revenue Code [I.R.C. 851 *et seq.*], explain the tax consequences. If the Fund expects to pay an excise tax under the Internal Revenue Code [I.R.C. 4982] with respect to its distributions, explain the tax consequences.

(g) ***Exchange-Traded Funds.*** If the Fund is an Exchange-Traded Fund:

(1) The Fund may omit from the prospectus the information required by Items 11(a)(2), (b), and (c) if the Fund issues or redeems Fund shares in creation units of not less than 25,000 shares each; and

(2) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed calendar year, and the most recently completed calendar quarters since that year (or the life of the Fund, if shorter). The Fund may omit this table if the Fund provides an Internet address at the Fund's Web site, which is publicly accessible, free of charge, that investors can use to obtain the premium/discount information required in this Item.

Instructions.

1. Provide the information in tabular form.

2. Express the information as a percentage of the net asset value of the Fund, using separate columns for the number of days the Market Price was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value. Round all percentages to the nearest hundredth of one percent.

3. Adjacent to the table, provide a brief explanation that: shareholders may pay more than net asset value when they buy Fund shares and receive less than net asset value when they sell those shares, because shares are bought and sold at current market prices.

4. Include a statement that the data presented represents past performance and cannot be used to predict future results.

4. Exchange-Traded Funds

c. Premium/Discount Information

We are adopting, as proposed, the amendments to the form to require each ETF to disclose to investors information about the extent and frequency with which market prices of fund shares have tracked the fund's NAV.[309] Each ETF will be required to disclose in its prospectus the number of trading days during the most recently completed calendar year and quarters since that year on which the market price of the ETF shares was greater than the fund's NAV and the number of days it was less than the fund's NAV (premium/discount information).[310] This disclosure is designed to alert investors to the relationship between NAV and the market price of the ETF's shares, and that investors may purchase or sell ETF shares at prices that do not correspond to NAV. In addition, this disclosure will provide historical information regarding the frequency of these deviations.

Commenters on the ETF proposing release were divided as to whether this specific premium/discount information would be useful to investors, although all who commented suggested the information need only be provided on the ETF's Web site.[311] Based on these comments, it appears that specific premium/discount information may not be generally useful to all ETF investors. For that reason, an ETF may omit the disclosure of specific premium/discount information in its prospectus or annual report if the fund provides the information

[309] *Item 11(g)(2) of Form N-1A. See ETF Proposing Release, supra note 14, 73 FR at 14632 nn. 166-169 and accompanying and following text. ETFs currently are required to disclose on their Internet Web sites the prior business day's last determined NAV, the market closing price of the fund's shares or the midpoint of the bid-ask spread at the time of the calculation of NAV ("bid-ask price"), and the premium/discount of that price to NAV. See, e.g., WisdomTree Investments, Inc. et al., Investment Company Act Release Nos. 27324 (May 18, 2006) [71 FR 29995 (May 24, 2006)] (notice) and 27391 (June 12, 2006) (order); PowerShares Exchange Traded Fund Trust et al., Investment Company Act Release Nos. 25961 (Mar. 4, 2003) [68 FR 11598 (Mar. 11, 2003)] (notice) and 25985 (Mar. 28, 2003) (order).*

[310] *Consistent with our proposal, the final amendments require ETFs to present premiums or discounts as a percentage of NAV. Instruction 2 to Item 11(g)(2) of Form N-1A. See ETF Proposing Release, supra note 14, 73 FR at 14632 nn. 166-169 and accompanying and following text. ETFs also will have to explain that shareholders may pay more than NAV when purchasing shares and receive less than NAV when selling, because shares are bought and sold at market prices. Instruction 3 to Item 11(g)(2) of Form N-1A. Consistent with the proposal, the final amendments require ETFs to include a table with premium/discount information in their annual reports for the five recently completed fiscal years. Item 27(b)(7)(iv) of Form N-1A. We are including instructions similar to those in Item 11 to assist funds in meeting this disclosure obligation. Instructions to Item 27(b)(7)(iv) of Form N-1A.*

[311] *See Xshares Letter, supra note 172 ("[W]e believe that the disclosure of [premium/discount] information is useful to investors and support this requirement."); Letter of NYSE Arca (May 28, 2008) (File No. S7-07-08) (asserting generally that disclosure of premium/discount information required on the Web site, together with other available index or portfolio information provides necessary information to investors to assess ETF pricing against the underlying index or portfolio). But see BGFA Letter on ETF Proposing Release, supra note 166 ("[T]he concept of premium/discount may not be an instructive way of thinking about ETF share prices in the secondary market … BGFA's Internet website experience suggests investors do not value this information highly."); ICI Letter on ETF Proposing Release, supra note 167 (premium/discount information is not particularly useful and investors do not regularly seek it).*

on its Internet Web site and discloses in the prospectus or annual report an Internet address where investors can locate the information.[312] Because ETFs may choose to provide this disclosure on their Web sites instead of in their prospectuses, we have added a requirement that the prospectus disclose that ETF shares may trade at a premium or discount.[313] This approach is designed to require disclosure of the information, but avoid duplicative disclosures that may result in additional regulatory burdens. Commenters who addressed the issue strongly supported permitting ETFs to include historical premium/discount information on their Web sites instead of in their prospectuses and annual reports.[314] Our amendments allow ETFs to choose the most cost-effective method of providing this disclosure to their investors.

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[312] *Item 11(g)(2) of Form N-1A; Item 27(b)(7)(iv) of Form N-1A. Although the time period required in the disclosure is different in the prospectus and annual report, ETFs will be able to omit both disclosures by providing on their Internet Web sites only the premium/discount information required by Item 11(g)(2) (the most recently completed fiscal year and quarters since that year). Id. In order to rely on the exemptive orders that permit them to operate, ETFs also must disclose on their Web sites each day the premium and discount of the market closing price or the bid/ask price against the NAV as a percentage of NAV. See supra note 183. Investors in ETFs that choose not to disclose the required premium/discount information in their prospectuses or annual reports would be able to review historic and daily premium/discount information on the ETF's Web site.*

[313] *Item 6(c)(i)(B) of Form N-1A.*

[314] *See, e.g., BGFA Letter on ETF Proposing Release, supra note 166 ("Duplicative disclosure strikes us as unnecessary and burdensome .... Because data in a prospectus speaks of the prospectus date and therefore does not include the most recent information, we believe Internet Web site disclosure is preferable to prospectus disclosure. Accordingly, we believe that it would be sufficient to reference the availability of the information on the Internet Web site in a prospectus.").*

6. Shareholder Information (Item 7)

a. General Purchase and Sale Information

The Proposed Amendments would retain most of the disclosure requirements concerning a fund's purchase and redemption procedures, dividends, and distributions currently required by Form N-1A. The Commission believes that the required information is relevant to a typical investor contemplating an investment in a fund. In the Form N-1A Proposing Release, the Commission acknowledged that disclosure about purchase and redemption procedures is often quite lengthy and may contribute to the perception that prospectuses are too long and complicated and not worth reading.[315] The Commission also observed, however, that much of the purchase and redemption disclosure typically contained in fund prospectuses is not required by Form N-1A, but is included by funds for marketing or other business purposes. The Commission believes that it is appropriate for a fund to have the option to add disclosure to its prospectus for these purposes, and thus the Commission did not propose to limit prospectus disclosure of funds' purchase and sale procedures to that expressly required by Form N-1A. The Commission is adopting the requirements to disclose purchase, redemption, and other shareholder information substantially as proposed with modifications to reflect commenters' suggestions.[316]

Several commenters on the Form N-1A Proposing Release suggested that the Commission specifically acknowledge as consistent with its rules the ability of a fund at its option to place certain information about purchase and redemption procedures in a separate document that would be delivered to an investor no later than with the confirmation of the investor's purchase of the fund's shares. According to the commenters, this separate document, or "owner's manual," can help streamline prospectus disclosure and provide an efficient means for a fund group to provide disclosure about purchase and redemption procedures that is common to all funds in the group. The Commission believes that this sort of disclosure document is consistent with the disclosure principles underlying the revisions to Form N-1A and that investors may find it easier and less confusing to consult and retain a separate document describing certain procedures relating to purchasing and redeeming fund shares, which are typically mechanical in nature. In the Commission's view, as long as the purchase and sale information in a fund's prospectus is not reduced below the minimum required by Form N-1A, the fund would be able to create and use a separate purchase and sale disclosure document as supplemental sales literature.

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[315] *See Form N-1A Proposing Release,* supra *note 8, at 10914.*

[316] *Item 7. The Commission also is adopting, as proposed, the requirement that a fund disclose in its SAI, and not in its prospectus, information about the fund's principal underwriter and service providers. Item 15. Requiring the information in the SAI does not preclude a fund from including it in the prospectus (e.g., for marketing and other business purposes).*

A second way in which a fund could create a separate purchase and sale disclosure document would be for the fund to include in its SAI the information to be contained in the document. A fund could set out this information in a separate section of the SAI and make it available, as a separate document, to investors upon request. To accommodate this option, the Commission is revising Form N-1A to include an instruction in the SAI that permits a fund to provide a separate document with additional purchase and sale information that can be made available to fund investors, along with the SAI or as a stand-alone document, in response to investor requests.[317]

Form N-1A, as amended, provides a third means for developing a purchase and sale manual. As amended, the Form permits a fund to remove all information regarding its purchase and sale procedures from its prospectus and place the information in a separate document. The use of the separate document in this manner, however, would mean that required prospectus disclosure would appear only in the owner's manual. Therefore, the use of this kind of separate document is conditioned on incorporating it by reference into the fund's prospectus and providing it to investors with the prospectus.[318]

b. Valuation of Fund Shares and Net Asset Value

Valuation. The Commission proposed to eliminate an existing requirement of Form N-1A that a fund disclose in its prospectus that the price at which investors' purchase and redemption requests are effected is calculated on the basis of the fund's current net asset value and that the fund identify the methods used to value its portfolio securities (*e.g.*, market price or fair value).[319] The Commission proposed to take this action principally because, in meeting the requirement, funds typically go beyond the required identification of the methods used and repeat the substance of rules under the Investment Company Act specifying the way in which the net asset value of a fund must be calculated. In addition, the information, presented by a fund usually repeats information required to be included in the SAI. This disclosure has tended to be lengthy and technical and, as discussed below, appears not to have been very informative for investors.

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[317] *Instruction to Item 18(a).*

[318] *Item 7(f).*

[319] *Under the Investment Company Act and its rules, funds generally are required to use market quotations to value portfolio securities. If market quotations are not readily available, the fund must value the securities at "fair value as determined in good faith by the board of directors." Section 2(a)(41) [15 U.S.C. 80a-2(a)(41)]; rule 2a-4 [17 CFR 270.2a4].*

The Commission has re-evaluated the disclosure of information in fund prospectuses about the calculation of net asset value in light of numerous complaints from investors that the Commission received recently regarding the manner in which some funds determined their net asset value. In response to volatility in various markets, some funds recently valued certain of their securities on the basis of fair value rather than on the basis of the last market quotations for the securities.[320] In taking this action, the funds appear to have relied on a long-standing position of the Commission's staff that a fund may (but is not required to) value portfolio securities traded on a foreign exchange using fair value, rather than the closing price of the securities on the exchange, when an event occurs after the close of the exchange that is likely to have changed the value of the securities.[321] Many investors complained that they were unaware that their funds could use fair value pricing in such a situation. In response to these complaints, the Division undertook a review of the disclosure documents of funds using such fair value pricing and found that, although the funds disclosed the practice in their prospectuses, the funds' discussions of their pricing procedures would have been enhanced if they had followed the principles of plain English.[322] Investors' recent questions about fund pricing procedures confirm the general importance of this information to at least some investors. Thus, the Commission has determined to continue to require that funds identify the methods used to value their assets in their prospectuses.[323] The Commission is, however, adding an instruction in Form N-1A that will encourage funds to discontinue the use of boilerplate disclosure of the technical aspects of valuation and require them to include a statement about the effect of the fund's use of fair value net asset calculation.

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[320] These funds took this action under circumstances in which stock markets in Asia had closed 13 to 14 hours before the pricing of fund shares in the United States. In that time, several funds identified events that indicated a significant change in the price of securities traded on these markets since the last market quotations. On the basis of this assessment, the funds valued their securities using fair value rather than the market price of the securities. See Barnhart, Asia Aficionados Found Profit in Times of Turmoil, CHICAGO TRIBUNE, Nov. 23, 1997 at C3; Smith, Funds: A Hidden Trick Investors Should Know About, BUSINESS WEEK, Nov. 17, 1997 at 41; Authers, Now The Funds Are Coming Under Fire, FINANCIAL TIMES, Nov. 8, 1997 at 2; Wyatt, The Market Turmoil: Funds; Fidelity Invokes Fine Print and Angers Some Customers, THE NEW YORK TIMES, Oct. 31, 1997 at D6; Gasparino, Pricing System Trips Fidelity, Angers Clients, WALL STREET JOURNAL, Oct. 30, 1997 at C1.

[321] See Putnam Growth Fund (pub. avail. Feb. 23, 1981). Fair value pricing in this context is designed to protect the long-term value of fund shares from the actions of short-term investors who might buy or redeem fund shares in an attempt to profit from short-term market movements.

[322] See "Remembering the Past: Mutual Funds and the Lessons of the Wonder Years," Barry P. Barbash, Director, Division of Investment Management, SEC, at the 1997 ICI Securities Law Procedures Conference, Washington, D.C. (Dec. 4, 1997).

[323] Item 7(a). An instruction to this Item, as adopted, requires a fund to provide a brief explanation of specific policies of the fund concerning use of the fair value method of pricing fund shares. Form N-1A, as amended, requires a fuller explanation of fair value pricing policies in the SAI. Item 18(c).

Time and Frequency of Calculation of Net Asset Value. As proposed, Form N-1A would continue to require a fund to state in its prospectus when calculations of its net asset value are made and to indicate that the fund uses a forward pricing procedure contemplating that the price at which a purchase or redemption order is effected is based on the next calculation of net asset value after the order is placed.[324] In addition, the Proposed Amendments would continue to require a fund to disclose those days on which the fund prices its shares and the holidays on which shares would not be priced. Commenters supported these disclosure requirements, and the Commission is adopting them as proposed.[325]

Meaning of Net Asset Value. In the Form N-1A Proposing Release, the Commission noted that many funds now define the term "net asset value" in their prospectuses (*e.g.*, net asset value means fund assets minus liabilities divided by the number of outstanding shares).[326] The Commission requested comment whether this disclosure should be required in all fund prospectuses. Commenters on this issue were evenly divided between those who believed that the information would be helpful to investors and those who believed the definition of net asset value would not assist investors in making a decision about investing in a fund. While some investors may find information about the meaning of the term net asset value helpful, the Commission is not persuaded that the information is necessary for most investors. Therefore, the Commission is not adopting a requirement that a fund explain the meaning of net asset value in its prospectus. A fund would continue to have the option of including this information in its prospectus or SAI if the fund concluded that such information would be useful to potential investors in the fund.

c. Restrictions on portability

At the time that the Commission issued the Form N-1A Proposing Release, the Commission's staff was considering a number of complaints received from fund investors about restrictions on the "portability" of their fund shares. To better understand the issues raised by these investors, the staff consulted with, among others, a number of industry trade groups and other industry participants.[327] On the basis of the information compiled by the staff, the Commission understands that, in certain cases, an investor who purchases shares of a fund through a broker-dealer or other financial intermediary may be unable to transfer fund shares held in a brokerage account to an account established at another broker-dealer.[328] In their

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[324] *Rule 22c-1 under the Investment Company Act [17 CFR 270.22c-1] requires a fund to adopt "forward pricing" procedures. Under such procedures, a fund must fill an order to buy or redeem its shares based on the net asset value of the shares next calculated after receipt of the order.*

[325] *Item 7(a)(2) and (3). Form N-1A, as amended, allows a fund to identify the days on which the fund will not price its shares through the use of a list of specific days or any other means that effectively communicates the information (e.g., explaining that shares will not be priced on the days on which the New York Stock Exchange is closed for trading).*

[326] *See Form N-1A Proposing Release,* supra *note 8, at 10914.*

[327] *See Letter from Jack W. Murphy, Associate Director, Division of Investment Management, SEC, to Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association, Thomas M. Selman, Director, Advertising/Investment Companies Regulation, NASD Regulation, Inc., and Paul Schott Stevens, Senior Vice President and General Counsel, ICI (Dec. 18, 1996).*

[328] *An investor may seek to transfer such an account, for example, when the registered representative or account executive through which the investor purchased the shares becomes affiliated with a new firm.*

responses to the staff, industry representatives indicated that the lack of portability of an investor's shares in a fund may be attributed to several factors, including limitations on the transfer of shares sold by broker-dealers affiliated with the investment adviser of the fund, the lack of participation by the fund in a computerized transfer system, and the absence of reciprocal agreements between the fund and broker-dealers. The industry participants, however, supported efforts to increase the portability of fund shares.

The Commission understands that some progress has occurred in eliminating portability restrictions. To the extent that restrictions continue to exist, however, the Commission believes that disclosure of the limits on portability of a fund's shares may be of importance to a typical investor. The Commission notes that this type of disclosure would seem to address the relationship between a broker-dealer or other intermediary and a fund shareholder, rather than the relationship between the fund and the shareholder. For that reason, the Commission is not convinced that the disclosure should be required in fund prospectuses.[329] The Commission has asked its staff to continue discussions with the staff of the National Association of Securities Dealers, Inc. ("NASD") to consider means other than the prospectus to alert investors who purchase shares of funds through broker-dealers of restrictions on portability.[330]

d. Tax Consequences

The Proposed Amendments would revise the tax disclosure required in a fund's prospectus to focus that disclosure on the likely tax consequences to the fund and its shareholders if the fund operates as described in the prospectus. In general, the Proposed Amendments were designed to elicit tax disclosure that is far less complicated than that typically included in fund prospectuses today.[331] Commenters strongly agreed with the goal of the proposed provisions relating to prospectus tax disclosure, which the Commission has determined to adopt substantially as proposed. The Commission notes its strong desire that, in revising their documents to comply with Form N-1A, as amended, all funds pay particular attention to simplifying their existing tax disclosures, which the Commission believes are too complicated and discourage the use of fund prospectuses.

The Commission proposed to move disclosure about a fund's qualification under Subchapter M of the Internal Revenue Code[332] to the SAI, unless the fund does not expect to

[329] *Such disclosure would appear to be inconsistent with the fundamental principle underlying Form N-1A that a fund's prospectus should focus on information about the fund.*

[330] *See discussion* infra *Section II.G about other disclosure issues that the Commission is addressing with the NASD.*

[331] *Existing tax-related prospectus disclosure typically includes lengthy and overly technical information about the tax treatment of a fund, and, in some cases, the treatment of specific securities held by a fund. Many prospectuses, for example, include information about the conditions that a fund must meet to qualify for pass-through tax treatment under Subchapter M of the Internal Revenue Code, as well as information about the tax treatment of private activity bonds, foreign currency contracts, and other fund investments. In addition, tax disclosure frequently includes technical jargon in referring, for example, to a fund's status as a "regulated investment company" and the fund's payment of "spillback distributions" and "net investment income." Use of these terms in fund prospectuses would continue to be discouraged. See General Instruction C.1(c), which would continue to instruct a fund not to use technical or legal terminology in its prospectus.*

[332] *I.R.C. 851, et seq.*

qualify for Subchapter M treatment. Commenters supported moving this disclosure to the SAI, agreeing that it does not help investors decide whether to invest in a fund. The Commission is adopting this disclosure requirement as proposed.[333]

The Commission proposed to require a description of the tax consequences to shareholders of buying, holding, exchanging, and selling a fund's shares designed to highlight the tax consequences of investing in the fund. The Proposed Amendments would require a fund to state, as applicable, that the fund intends to make distributions to shareholders that may be taxed as ordinary income or capital gains. Under the Proposed Amendments, a fund that expects that its investment objectives or strategies will result in its distributions primarily consisting of ordinary income (or certain short-term capital gains) or long-term capital gains would be required to provide disclosure to that effect.

Commenters generally supported the proposed tax disclosure, and the Commission is adopting it as proposed with one modification to reflect recent changes to the tax laws.[334] In light of these changes, Form N-1A, as amended, requires a fund to disclose that capital gains may be taxable at different rates depending upon the length of time that the fund holds its assets.[335]

The Proposed Amendments would require a fund to state that it will provide each shareholder by a specified date (typically, January 31 of each year) with information about the amount of ordinary income and capital gains, if any, distributed to the shareholder during the prior calendar year. One commenter questioned the need for this requirement, citing that a fund must send this information to investors by a particular date under Internal Revenue Service-regulations.[336] The Commission agrees that, in light of these regulations, indicating in a prospectus the date by which a fund will deliver certain tax information is unnecessary. Therefore, Form N-1A, as amended, does not adopt this provision of the Proposed Amend ments. The Proposed Amendments would require a tax-exempt fund to inform investors of

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[333] *Item 19(a). Item 7(e)(3) of Form N-1A, as amended, requires a fund that does not expect to qualify for pass-through tax treatment under Subchapter M to explain in its prospectus the tax consequences of not qualifying (e.g., by disclosing that income and gains realized by the fund would be subject to double taxation—that is, both the fund and shareholders could be subject to tax liability). This disclosure would distinguish the fund from other funds and help investors appreciate the tax consequences of investing in the fund. Similarly, a fund that expects to pay an excise tax under the Internal Revenue Code with respect to its distributions is required to disclose in its prospectus the consequences of paying the tax. See I.R.C. 4982.*

[334] *Item 7(e). Funds subject to this requirement would include, for example, those often described as "tax-managed," "tax-sensitive," or "tax-advantaged," which have investment strategies to maximize long-term capital gains and minimize ordinary income. A fund that has a principal investment objective or strategy to achieve tax-managed results (e.g., to maximize long-term capital gains and minimize ordinary income) would need to provide disclosure to that effect in its prospectus risk/return summary. Item 4.*

[335] *Recent changes to the tax laws reduce the maximum rate on the long-term net capital gains on the sale of securities from 28% to 20%, but increase the asset holding period from 12 months to 18 months (except for sales made after May 6, 1997 and before July 29, 1997, which retain long-term gain status). Taxpayer Relief Act of 1997, Pub. L. No. 105-34 (1997). The new laws also classify capital assets held for a period of one year, but less than 18 months, as "mid-term" gains, which are subject to a maximum rate of 28%.*

[336] *The requirement is set forth in I.R.C. 852(b)(3)(c).*

the special tax consequences associated with the fund. Commenters supported the proposed disclosure, and the Commission is adopting it substantially as proposed.[337]

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Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings
[Release Nos. 33-8408; IC-26418; April 16, 2004]

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. 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.

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. 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 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.

[337] *Item 7(e)(2). Form N-1A, as amended, requires a fund to disclose, if applicable, that: (i) the fund may invest a portion of its assets in securities that generate income that is not exempt from federal or state income tax; (ii) income exempt from federal income tax may be subject to state and local income tax; and (iii) any capital gains distributed by the fund may be taxable. The Commission also proposed that a fund disclose that a portion of the tax-exempt income that it distributes may be treated as tax preference items for purposes of determining whether the shareholder is subject to the federal alternative minimum tax. Form N-1A, as amended, does not require disclosure about the preference items in the prospectus. This disclosure is technical in nature and applies only in limited circumstances, and would not appear to help a typical investor make a decision about investing in a fund.*

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. 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.

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.[338] 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. 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

[338] *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).*

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 trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker dealers, transfer agents, third party administrators, and insurance companies.[339] 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.

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. 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

[339] *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.*

arrangements.[340] 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. 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.

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,

[340] *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.*

the commenters noted, shares issued by ETFs are listed for trading on stock exchanges, which allows retail investors to purchase and sell individual ETF shares among themselves at market prices throughout the day. 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.

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. 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 when they are not reliable). 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. 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. The instruction we are adopting will also require a fund to explain the effects of using fair value pricing, similar to the current instruction.[341]

[341] *See Investment Company Act Release No. 23064 (Mar. 13, 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 Release, supra note 5. 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.*

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 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.

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Disclosure of Breakpoint Discounts by Mutual Funds
[Release Nos. 33-8427; 34-49817; IC-26464; June 7, 2004]

…Item 6(g) of Form N-1A currently permits a mutual fund to 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 disclosure document if the fund delivers the document with the prospectus, incorporates the document into the prospectus by reference and files the document with the prospectus, and provides disclosure explaining that the information disclosed in the document is part of, and incorporated into, the prospectus.

Under our amendments, Item 6(g) will continue to permit the breakpoint information required by Item 7(a)(2) to be included in a separate purchase and redemption document. In addition, we are amending Item 6(g) to permit the information about breakpoints required by new Items 7(a)(3), (4), and (5) (*i.e.*, valuation methods, shareholder information and records, and Web site availability) to be included in the separate purchase and redemption document. We are also amending General Instruction C.3.(a) to Form N-1A to make it clear that this information may be disclosed in a separate purchase and redemption document, provided that all the information required by paragraphs 7(a)(2), (3), (4), and (5) is included in the separate document. This instruction will also clarify that if the information required by paragraphs 7(a)(2)-(5) is disclosed in a separate purchase and redemption document, the table of sales loads and breakpoints required by Item 7(a)(1) must be included in the separate purchase and redemption document, as well as the prospectus, in order to comply with the requirement that all disclosure required by Item 7(a) be adjacent to the table of sales loads and breakpoints.

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Item 12. Distribution Arrangements

(a) Sales Loads.

(1) Describe any sales loads, including deferred sales loads, applied to purchases of the Fund's shares. Include in a table any front-end sales load (and each breakpoint in the sales load, if any) as a percentage of both the offering price and the net amount invested.

Instructions.

1. If the Fund's shares are sold subject to a front-end sales load, explain that the term "offering price" includes the front-end sales load.

2. Disclose, if applicable, that sales loads are imposed on shares, or amounts representing shares, that are purchased with reinvested dividends or other distributions.

3. Discuss, if applicable, how deferred sales loads are imposed and calculated, including:

(a) Whether the specified percentage of the sales load is based on the offering price, or the lesser of the offering price or net asset value at the time the sales load is paid.

(b) The amount of the sales load as a percentage of both the offering price and the net amount invested.

(c) A description of how the sales load is calculated (*e.g.*, in the case of a partial redemption, whether or not the sales load is calculated as if shares or amounts representing shares not subject to a sales load are redeemed first, and other shares or amounts representing shares are then redeemed in the order purchased).

(d) If applicable, the method of paying an installment sales load (*e.g.*, by withholding of dividend payments, involuntary redemptions, or separate billing of a shareholder's account).

(2) Unless disclosed in response to paragraph (a)(1), briefly describe any arrangements that result in breakpoints in, or elimination of, sales loads (*e.g.*, letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, redemption reinvestment plans, and waivers for particular classes of investors). Identify each class of individuals or transactions to which the arrangements apply and state each different breakpoint as a percentage of both the offering price and the net amount invested. If applicable, state that additional information concerning sales load breakpoints is available in the Fund's SAI.

Instructions.

1. The description, pursuant to paragraph (a)(1) or (a)(2) of this Item 12, of arrangements that result in breakpoints in, or elimination of, sales loads must include a brief summary of shareholder eligibility requirements, including a description or list of the types of accounts (*e.g.*, retirement accounts, accounts held at other financial intermediaries), account holders (*e.g.*, immediate family members, family trust accounts, solely-controlled business accounts), and fund holdings (*e.g.*, funds held within the same fund complex) that may be aggregated for purposes of determining eligibility for sales load breakpoints.

2. The description pursuant to paragraph (a)(2) of this Item 12 need not contain any information required by Items 17(d) and 23(b).

(3) Describe, if applicable, the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints, including the circumstances in which and the classes of individuals to whom each method applies. Methods that should be described, if applicable, include historical cost, net amount invested, and offering price.

(4)(i) State, if applicable, that, in order to obtain a breakpoint discount, it may be necessary at the time of purchase for a shareholder to inform the Fund or his or her financial intermediary of the existence of other accounts in which there are holdings eligible to be aggregated to meet sales load breakpoints. Describe any information or records, such as account statements, that it may be necessary for a shareholder to provide to the Fund or his or her financial intermediary in order to verify his or her eligibility for a breakpoint discount. This description must include, if applicable:

(A) Information or records regarding shares of the Fund or other funds held in all accounts (*e.g.*, retirement accounts) of the shareholder at the financial intermediary;

(B) Information or records regarding shares of the Fund or other funds held in any account of the shareholder at another financial intermediary; and

(C) Information or records regarding shares of the Fund or other funds held at any financial intermediary by related parties of the shareholder, such as members of the same family or household.

(ii) If the Fund permits eligibility for breakpoints to be determined based on historical cost, state that a shareholder should retain any records necessary to substantiate historical costs because the Fund, its transfer agent, and financial intermediaries may not maintain this information.

(5) State whether the Fund makes available free of charge, on or through the Fund's Web site at a specified Internet address, and in a clear and prominent format, the information required by paragraphs (a)(1) through (a)(4) and Item 23(a), including whether the Web site includes hyperlinks that facilitate access to the information. If the Fund does not make the information required by paragraphs (a)(1) through (a)(4) and Item 23(a) available in this manner, disclose the reasons why it does not do so (including, where applicable, that the Fund does not have an Internet Web site).

Instruction. All information required by paragraph (a) of this Item 12 must be adjacent to the table required by paragraph (a)(1) of this Item 12; must be presented in a clear, concise, and understandable manner; and must include tables, schedules, and charts as expressly required by paragraph (a)(1) of this Item 12 or where doing so would facilitate understanding.

(b) Rule 12b-1 Fees. If the Fund has adopted a plan under rule 12b-1, state the amount of the distribution fee payable under the plan and provide disclosure to the following effect:

(1) The Fund has adopted a plan under rule 12b-1 that allows the Fund to pay distribution fees for the sale and distribution of its shares; and

(2) Because these fees are paid out of the Fund's assets on an on-going basis, over time these fees will increase the cost of your investment and may cost you more than paying other types of sales charges.

Instruction. If the Fund pays service fees under its rule 12b-1 plan, modify this disclosure to reflect the payment of these fees (*e.g.*, by indicating that the Fund pays distribution and other fees for the sale of its shares and for services provided to shareholders). For purposes of this paragraph, service fees have the same meaning given that term under rule 2830(b)(9) of the NASD Conduct Rules [NASD Manual (CCH) 4622].

(c) Multiple Class and Master-Feeder Funds.

(1) Describe the main features of the structure of the Multiple Class Fund or Master-Feeder Fund.

(2) If more than one Class of a Multiple Class Fund is offered in the prospectus, provide the information required by paragraphs (a) and (b) for each of those Classes.

(3) If a Multiple Class Fund offers in the prospectus shares that provide for mandatory or automatic conversions or exchanges from one Class to another Class, provide the in-

formation required by paragraphs (a) and (b) for both the shares offered and the Class into which the shares may be converted or exchanged.

(4) If a Feeder Fund has the ability to change the Master Fund in which it invests, describe briefly the circumstances under which the Feeder Fund can do so.

Instruction. A Feeder Fund that does not have the authority to change its Master Fund need not disclose the possibility and consequences of its no longer investing in the Master Fund.

New Form N-1A Adopting Release; Investment Company Act Release No. 23064 (February 10, 1998)

7. Distribution Arrangements (Item 8)

The Commission proposed changes to Form N-1A to require that all information about a fund's distribution arrangements appear in one section of the fund's prospectus. The Proposed Amendments would require that section to discuss, among other things, sales loads, fees paid under rule 12b-1 plans, and the details of multiple class and master-feeder fund arrangements. The Commission also proposed changes designed to make fund discussions of distribution arrangements less legalistic and more helpful to investors in evaluating and comparing funds.[342] Commenters generally supported the Commission's conclusion that information about distribution arrangements is particularly important to fund investors, and the Commission is adopting the disclosure requirements relating to those arrangements substantially as proposed.

Rule 12b-1 Plans. The Commission proposed to modify Form N-1A's requirements pertaining to plans designed to meet the requirements of rule 12b-1 under the Investment Company Act to focus prospectus disclosure on the amount of fees paid under the plans and to move detailed, technical disclosure about these plans to the SAI. The Commission proposed to require a fund with a rule 12b-1 plan to state the amount of the fee and to disclose that the plan allows the fund to pay fees for the sale and distribution of its shares. The Commission also proposed an additional requirement designed to result in prospectuses that explain more effectively to shareholders that distribution fees are continuous in nature and that these fees, over time, cumulatively may exceed other types of sales loads.[343] The Proposed Amendments would require a fund to add to its prospectus disclosure to the effect that, because distribution fees are paid out of the fund's assets on an ongoing basis, the fees may, over time, increase the cost-of an investment in a fund and cost investors more than other types of sales loads.

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[342] *Typical fund shareholders appear to regard information about fees paid by funds under various distribution arrangements as important information in making investment decisions. See ICI SHAREHOLDER USE STUDY,* supra *note 52, at 21 (1997) (over 70% of survey respondents considered sales charge and fee information before making their most recent purchase).*

[343] *The Commission's proposed disclosure would replace similar disclosure required by the rules of the NASD. Rule 2830(d)(4) of the NASD Conduct Rules,* supra *note 37, at 4624 (requiring a fund with a rule 12b-1 plan to disclose adjacent to the fee table that long-term shareholders may pay more than the maximum front-end sales charge allowed by the NASD). In light of the revisions to Form N-1A contemplated by the Proposed Amendments, the NASD has proposed to eliminate its similar disclosure. NASD Notice to Members 9748, at 393 (Aug. 1997).*

Most commenters supported the proposed disclosure concerning rule 12b-1 plans, although some commenters maintained that disclosure of the amount of rule 12b-1 fees merely duplicated information appearing in the prospectus fee table. The Commission believes that disclosing the amount of the rule 12b-1 fee in connection with other disclosure about the nature of the fees will provide a typical investor with a complete and useful picture of the amounts paid by the fund for distribution. Therefore, the Commission is adopting the disclosure concerning rule 12b-1 fees as proposed.[344]

Sales Loads. The Proposed Amendments would continue to require disclosure of the amount of any sales load charged on an investment in a fund and disclosure indicating when a sales load may be reduced or eliminated (*e.g.*, for larger investments). The Commission proposed to move other technical disclosure about sales loads to the SAI, including disclosure about dealer reallowances, sales load waivers, and breakpoints applicable to the sale of a fund's shares. The Commission believes that this detailed and technical information tends to obscure information about the amount of sales loads charged by a fund and does not help investors evaluate and compare funds. The Commission also proposed to eliminate disclosure about fees charged by third parties (*i.e.*, banks, broker-dealers, or other persons) in connection with the purchase of a fund's shares.[345] Commenters generally supported the proposed approach to disclosure about sales loads, and the Commission is adopting the amendments as proposed.[346]

Multiple Class and Master-Feeder Fund Arrangements. The Commission proposed to combine, in one place in the prospectus, disclosure about the distribution and service arrangements of multiple class and master-feeder funds. Commenters generally supported this treatment of these arrangements, which the Commission is adopting substantially as proposed, with modifications to reflect commenters suggestions.

The Commission proposed to eliminate the requirement that a feeder fund discuss the possibility and consequences of its no longer investing in the master fund. It is the Commission's understanding that distribution arrangements currently used by many funds contemplate feeder funds having the authority to change the master funds in which they are invested. In recognition of this development, the Commission is modifying Form N-1A to require such a feeder fund to describe briefly the circumstances under which it may change its investment in a master fund.[347]

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[344] *Item 8(b); Item 15(g). The Proposed Amendments also would require a fund that pays a service fee outside of a rule 12b-1 plan to disclose the amount and purpose of the fee in the section of its prospectus describing sales loads and rule 12b-1 fees charged by the fund. One commenter questioned the need for this disclosure, asserting that this type of service fee is not appropriately characterized as a distribution fee and would be disclosed in the fee table. The Commission is persuaded that additional disclosure of these fees is unnecessary, and Form N-1A, as amended, does not require prospectus disclosure of them. A fund would disclose service fees paid outside a rule 12b-1 plan in the fee table and in the SAI. Instruction 3(b) to Item 3; Item 20(c).*

[345] *See also Interagency Statement,* supra *note 50; rule 2230 of the NASD Conduct Rules,* supra *note 37, at 4213-14; rule 204-3(a) under the Advisers Act [17 CFR 275.204-3(a)]; Item 1 of Form ADV, Part II [17 CFR 279.1] for fee disclosure requirements applicable to banks, broker-dealers and investment advisers, respectively.*

[346] *Item 8(a); Item 13(e) (sales load arrangements for affiliated persons); and Item 15(f) (dealer reallowances).*

[347] *Item 8(c)(4). A feeder fund that does not have the authority to change its master fund would not need to discuss in its prospectus the possibility and consequences of its no longer investing in the master fund. Instruction to Item 8(c)(4).*

One commenter suggested additional changes to streamline prospectus disclosure about multiple class funds and master-feeder funds. The commenter recommended that the Commission eliminate existing requirements for a fund to disclose information in its prospectus about additional classes or feeders that are not offered in the same prospectus. The commenter also recommended that the Commission modify the proposed disclosure about conversions or exchanges from one class to another to require disclosure only if the conversion or exchange is mandatory or automatic. The Commission agrees that the disclosure about multiple class funds or master-feeder funds in a prospectus should focus on the class or fund offered in that prospectus. Form N-1A, as amended, reflects this position.[348]

[348] *Item 8(c).*

Disclosure of Breakpoint Discounts by Mutual Funds
[Release Nos. 33-8427; 34-49817; IC-26464; June 7, 2004]

The Commission is adopting, with one technical change, amendments to Form N-1A, the registration form for mutual funds, that will require enhanced disclosure regarding breakpoint discounts on front-end sales loads. Nothing in the amendments will eliminate, or diminish in any respect, a broker-dealer's obligations to its customers with respect to mutual fund breakpoints, including its obligations to disclose information about breakpoints.

A. Disclosure of Arrangements that Result in Breakpoints in Sales Loads

We are revising Form N-1A to require a mutual fund to provide a brief description in its prospectus of arrangements that result in sales load breakpoints, including a summary of shareholder eligibility requirements. Currently, Item 7(a)(2) of Form N-1A requires disclosure of arrangements that result in breakpoints in, or elimination of, sales loads, including letters of intent and rights of accumulation. Item 7(a)(2) also requires that each class of individuals or transactions to which the arrangements apply be identified and that each different breakpoint be stated as a percentage of both the offering price and the amount invested. This information may be provided in either the prospectus or the SAI.

The amendments will require that a mutual fund include the description required by Item 7(a)(2) of arrangements that result in breakpoints in, or elimination of, sales loads in its prospectus. Our amendments direct that prospectus disclosure regarding breakpoints be brief in order to avoid overwhelming investors with excessively detailed information. Item 7(a)(2) will not require the prospectus to include the information currently required in the SAI regarding breakpoints for affiliated persons of the fund and breakpoints in connection with a reorganization. This information will continue to be required in the SAI.

We are amending Item 17(a) of Form N-1A to require that information regarding breakpoint arrangements that is not included in the prospectus be included in the SAI. We are also modifying Item 17(a) to conform the enumeration of types of special purchase plans or methods in that Item to the enumeration in Item 7(a)(2) of types of arrangements that result in breakpoints. Specifically, we are adding references to "dividend reinvestment plans," "employee benefit plans," and "redemption reinvestment plans" to Item 17(a) and eliminating "services in connection with retirement plans" from Item 17(a). The amendments also add "waivers for particular classes of investors" to the enumeration in both Items 7(a)(2) and 17(a). To assist investors and financial intermediaries in finding all information about breakpoints, the prospectus will be required to state, if applicable, that additional information concerning sales load breakpoints is available in the SAI.

Our amendments add an instruction to require that the description of arrangements resulting in breakpoints include a brief summary of shareholder eligibility requirements. This summary will be required to include a description or list of the types of accounts (*e.g.*, retirement accounts, accounts held at other financial intermediaries), account holders

(*e.g.*, immediate family members, family trust accounts, solely-controlled business accounts), and fund holdings (*e.g.*, funds held within the same fund complex) that may be aggregated for purposes of determining eligibility for sales load breakpoints.

Several commenters provided recommendations regarding the location of the breakpoint disclosure. For example, two commenters argued that the Commission should require a fund to provide the breakpoint disclosure at the front of its prospectus, such as in the fee table required by Item 3 of Form N-1A, so that the disclosure would be easier to locate. We believe, however, that the amendments strike an appropriate balance between providing enhanced disclosure regarding breakpoint discounts and not overwhelming investors with information. Although important information regarding breakpoint discounts should be included in the prospectus, including this information in the fee table could tend to detract from the presentation of more basic information about fund costs. In addition, some commenters recommended that breakpoint information be provided to investors at the point of sale or in confirmation statements. We note that we recently proposed rules that would require a broker-dealer to provide its customers with information regarding breakpoints at the point of sale and in transaction confirmations.

B. Disclosure of Methods Used to Value Accounts

The amendments also require a mutual fund to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints, including the circumstances in which and the classes of individuals to whom each method applies. The methods required to be disclosed, if applicable, will include historical cost, net amount invested, and offering price.[349]

C. Disclosure Regarding Information and Records Necessary to Aggregate Holdings

Our amendments will also require a mutual fund to state in its prospectus, if applicable, that, in order to obtain a breakpoint discount, it may be necessary at the time of purchase for a shareholder to inform the fund or his or her financial intermediary of the existence of other accounts in which there are holdings eligible to be aggregated to meet sales load breakpoints. In addition, a mutual fund will be required to describe any information or records, such as account statements, that may be necessary for a shareholder to provide to the fund or his or her financial intermediary in order to verify his or her eligibility for a breakpoint discount. The description will be required to include, if applicable:

- information or records regarding shares of the fund or other funds held in all accounts (*e.g.*, retirement accounts) of the shareholder at the financial intermediary;
- information or records regarding shares of the fund or other funds held in any account of the shareholder at another financial intermediary; and

[349] *See Proposing Release, supra note 2, 68 FR at 74733 (discussing net asset value, public offering price, and historical cost methods of valuing accounts). We refer here to "net amount invested" rather than "net asset value," and to "offering price" rather than "public offering price," because these are the terms currently used in Form N-1A. See Instruction 3(a) and (b) to Item 7(a)(1) of Form N-1A.*

- information or records regarding shares of the fund or other funds held at any financial intermediary by related parties of the shareholder, such as members of the same family or household.

In addition, if a mutual fund permits breakpoints to be determined based on historical cost, it will be required to state in its prospectus that a shareholder should retain any records necessary to substantiate historical costs because the fund, its transfer agent, and financial intermediaries may not maintain this information.

D. Disclosure of Availability of Sales Load and Breakpoint Information on Fund's Web Site

The amendments require that a mutual fund state in its prospectus whether it makes available free of charge, on or through its Web site at a specified Internet address, and in a clear and prominent format, the information that is required regarding the fund's sales loads and breakpoints in the prospectus and SAI pursuant to Items 7(a) and 17(a), including whether the Web site includes hyperlinks that facilitate access to the information. A mutual fund that does not make the sales load and breakpoint information available in this manner will be required to disclose the reasons why it does not do so (including, where applicable, that the fund does not have an Internet Web site).

The amendments will require that the disclosure about Web site availability of sales load and breakpoint information indicate whether the information is in a clear and prominent format, including whether the Web site includes hyperlinks that facilitate access to the information. We believe that it is important for Web site disclosure regarding sales loads and breakpoint discounts to be clear and prominent in order to help investors and financial intermediaries find this information easily. Hyperlinks that facilitate access to the information may contribute to a clear and prominent presentation. Thus, Web sites could provide sales load and breakpoint information in a clear and prominent format by, for example, using clear and prominent hyperlinks that provide direct linkage to the relevant portions of the fund's prospectus and SAI or the specific pages on a third-party Web site containing the information.[350]

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E. Presentation Requirements

The amendments will require that the disclosure in Item 7(a)(2) regarding arrangements resulting in breakpoints in, or elimination of, sales loads, and all other sales load disclosure required by Item 7(a), be adjacent to the table of sales loads and breakpoints required by Item 7(a)(1). This will include the description of sales loads required by Item 7(a)(1), as well as the information about breakpoints, including valuation methods, shareholder information and

[350] *See Securities Act Release No. 8128 (Sept. 5, 2002) [67 FR 58480, 58493 (Sept. 16, 2002)] (requiring companies to include disclosure in their annual reports on Form 10-K about availability on company Web sites of reports on Forms 10-K, 10-Q, and 8-K). We direct funds to this release for guidance concerning satisfaction of this requirement through hyperlinking to a third-party Web site.*

records, and Web site availability that will be required by Items 7(a)(3), (4), and (5). The amendments also will require that a mutual fund present the information required by Item 7(a) in a clear, concise, and understandable manner, and include tables, schedules, and charts as expressly required by Item 7(a)(1) or where doing so would facilitate understanding.

General Instruction C.3.(a) to Form N-1A currently requires the information required by Item 7 to be in one place in the prospectus. This includes the information about sales loads and breakpoints required by Item 7(a)(1), information about 12b-1 fees required by Item 7(b), and information about multiple class and master-feeder funds required by Item 7(c). It does not include the information on breakpoints currently required by Item 7(a)(2) because this information may be included in the SAI or in a separate purchase and redemption document pursuant to Item 6(g). Item 6(g) of Form N-1A currently permits a mutual fund to 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 disclosure document if the fund delivers the document with the prospectus, incorporates the document into the prospectus by reference and files the document with the prospectus, and provides disclosure explaining that the information disclosed in the document is part of, and incorporated into, the prospectus.

Under our amendments, Item 6(g) will continue to permit the breakpoint information required by Item 7(a)(2) to be included in a separate purchase and redemption document. In addition, we are amending Item 6(g) to permit the information about breakpoints required by new Items 7(a)(3), (4), and (5) (*i.e.*, valuation methods, shareholder information and records, and Web site availability) to be included in the separate purchase and redemption document. We are also amending General Instruction C.3.(a) to Form N-1A to make it clear that this information may be disclosed in a separate purchase and redemption document, provided that all the information required by paragraphs 7(a)(2), (3), (4), and (5) is included in the separate document. This instruction will also clarify that if the information required by paragraphs 7(a)(2)-(5) is disclosed in a separate purchase and redemption document, the table of sales loads and breakpoints required by Item 7(a)(1) must be included in the separate purchase and redemption document, as well as the prospectus, in order to comply with the requirement that all disclosure required by Item 7(a) be adjacent to the table of sales loads and breakpoints.

General Instruction C.3.(d)(i) to Form N-1A currently permits a fund to modify or omit, if inapplicable, the information required by Items 6(b)-(d) and 7(a)(2) for funds used as investment options for certain defined contribution plans, tax-deferred arrangements, and variable insurance contracts. The Commission is adopting a technical amendment to General Instruction C.3.(d)(i) to extend the instruction to the information required by new Items 7(a)(3), (4), and (5).

F. Omnibus Accounts

Typically, a brokerage firm has one omnibus account with each of the mutual funds with which it does business and through which all of its brokerage customers purchase and redeem

shares of those mutual funds. Consequently, these mutual funds do not have information on the identity of the underlying brokerage customer who is purchasing or redeeming the funds' shares. In the breakpoint context, omnibus accounts make it difficult for funds to track information about the underlying shareholder that could entitle the shareholder to breakpoint discounts.

Although omnibus accounts were not addressed in the proposed amendments, several commenters provided suggestions regarding these accounts. One commenter urged the Commission to end the practice of using omnibus accounts, and in the meantime to require broker-dealers who rely on omnibus accounts and other methods of settling transactions without providing identifying information to show that their methods are as accurate in providing breakpoints as methods that do provide this information. Another commenter argued that the Commission should require financial intermediaries to disclose shareholder identity and transaction information to mutual funds.

We note that the Commission addressed omnibus account issues in our proposed rules regarding mandatory redemption fees. Specifically, we proposed to require that, on at least a weekly basis, a financial intermediary provide to a fund the Taxpayer Identification Number and the amount and dates of all purchases, redemptions, or exchanges for each shareholder within an omnibus account. If the Commission adopts this proposed requirement, the information provided under this requirement may in some cases be helpful to funds that would be able to use it to determine whether shareholders received appropriate breakpoint discounts on purchases of fund shares sold with a front-end sales load.

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Item 13. Financial Highlights Information

(a) Provide the following information for the Fund, or for the Fund and its subsidiaries, audited for at least the latest 5 years and consolidated as required in Regulation S-X [17 CFR 210].

Financial Highlights

The financial highlights table is intended to help you understand the Fund's financial performance for the past 5 years [or, if shorter, the period of the Fund's operations]. Certain information reflects financial results for a single Fund share. The total returns in the table represent the rate that an investor would have earned [or lost] on an investment in the Fund (assuming reinvestment of all dividends and distributions). This information has been audited by , whose report, along with the Fund's financial statements, are included in [the SAI or annual report], which is available upon request.

Net Asset Value, Beginning of Period
Income From Investment Operations
Net Investment Income
Net Gains or Losses on Securities (both realized and unrealized)
Total From Investment Operations
Less Distributions
Dividends (from net investment income)
Distributions (from capital gains)
Returns of Capital
Total Distributions
Capital Adjustments Due to Swing Pricing [**amendment effective November 19, 2018**]

Net Asset Value, End of Period
Net Asset Value, adjusted pursuant to swing pricing, End of Period [**amendment effective November 19, 2018**]

Total Return
- -
Ratios/Supplemental Data

Net Assets, End of Period
Ratio of Expenses to Average Net Assets
Ratio of Net Income to Average Net Assets
Portfolio Turnover Rate

Instructions.

1. General.

(a) Present the information in comparative columnar form for each of the last 5 fiscal years of the Fund (or for such shorter period as the Fund has been in operation), but only for periods subsequent to the effective date of the Fund's registration statement. Also present

the information for the period between the end of the latest fiscal year and the date of the latest balance sheet or statement of assets and liabilities. When a period in the table is for less than a full fiscal year, a Fund may annualize ratios in the table and disclose that the ratios are annualized in a note to the table.

(b) List per share amounts at least to the nearest cent. If the offering price is expressed in tenths of a cent or more, then state the amounts in the table in tenths of a cent. Present the information using a consistent number of decimal places.

(c) Include the narrative explanation before the financial information. A Fund may modify the explanation if the explanation contains comparable information to that shown.

2. Per Share Operating Performance.

(a) Derive net investment income data by adding (deducting) the increase (decrease) per share in undistributed net investment income for the period to (from) dividends from net investment income per share for the period. The increase (decrease) per share may be derived by comparing the per share figures obtained by dividing undistributed net investment income at the beginning and end of the period by the number of shares outstanding on those dates. Other methods of computing net investment income may be acceptable. Provide an explanation in a note to the table of any other method used to compute net investment income.

(b) The amount shown at the Net Gains or Losses on Securities caption is the balancing figure derived from the other amounts in the statement. The amount shown at this caption for a share outstanding throughout the year may not agree with the change in the aggregate gains and losses in the portfolio securities for the year because of the timing of sales and repurchases of the Fund's shares in relation to fluctuating market values for the portfolio.

(c) For any distributions made from sources other than net investment income and capital gains, state the per share amounts separately at the Returns of Capital caption and note the nature of the distributions.

(d) The amount shown at the Capital Adjustments Due to Swing Pricing caption should include the per share impact of any amounts retained by the Fund pursuant to its swing pricing policies and procedures, if applicable. [**amendment effective November 19, 2018**]

(e) The amounts shown at the Net Asset Value, as adjusted pursuant to swing pricing, End of Period caption should be the Fund's net asset value per share as adjusted pursuant to its swing pricing policies and procedures on the last day of the reporting period, if applicable. [**amendment effective November 19, 2018**]

3. Total Return.

(a) Assume an initial investment made at the net asset value calculated on the last business day before the first day of each period shown.

(b) Do not reflect sales loads or account fees in the initial investment, but, if sales loads or account fees are imposed, note that they are not reflected in total return.

(c) Reflect any sales load assessed upon reinvestment of dividends or distributions.

(d) Assume a redemption at the price calculated on the last business day of each period shown.

(e) For a period less than a full fiscal year, state the total return for the period and disclose that total return is not annualized in a note to the table.

4. Ratios/Supplemental Data.

(a) Calculate "average net assets" based on the value of the net assets determined no less frequently than the end of each month.

(b) Calculate the Ratio of Expenses to Average Net Assets using the amount of expenses shown in the Fund's statement of operations for the relevant fiscal period, including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X and reductions resulting from complying with paragraphs 2(a) and (f) of rule 6-07 regarding fee waivers and reimbursements. If a change in the methodology for determining the ratio of expenses to average net assets results from applying paragraph 2(g) of rule 6-07, explain in a note that the ratio reflects fees paid with brokerage commissions and fees reduced in connection with specific agreements only for periods ending after September 1, 1995.

(c) A Fund that is a Money Market Fund may omit the Portfolio Turnover Rate.

(d) Calculate the Portfolio Turnover Rate as follows:

(i) Divide the lesser of amounts of purchases or sales of portfolio securities for the fiscal year by the monthly average of the value of the portfolio securities owned by the Fund during the fiscal year. Calculate the monthly average by totaling the values of portfolio securities as of the beginning and end of the first month of the fiscal year and as of the end of each of the succeeding 11 months and dividing the sum by 13.

(ii) Exclude from both the numerator and the denominator amounts relating to all securities, including options, whose maturities or expiration dates at the time of acquisition were one year or less. Include all long-term securities, including long-term U.S. Government securities. Purchases include any cash paid upon the conversion of one portfolio security into another and the cost of rights or warrants. Sales include net proceeds of the sale of rights and warrants and net proceeds of portfolio securities that have been called or for which payment has been made through redemption or maturity.

(iii) If the Fund acquired the assets of another investment company or of a personal holding company in exchange for its own shares during the fiscal year in a purchase-of-assets

transaction, exclude the value of securities acquired from purchases and securities sold from sales to realign the Fund's portfolio. Adjust the denominator of the portfolio turnover computation to reflect these excluded purchases and sales and disclose them in a footnote.

(iv) Include in purchases and sales any short sales that the Fund intends to maintain for more than one year and put and call options with expiration dates more than one year from the date of acquisition. Include proceeds from a short sale in the value of the portfolio securities sold during the period; include the cost of covering a short sale in the value of portfolio securities purchased during the period. Include premiums paid to purchase options in the value of portfolio securities purchased during the reporting period; include premiums received from the sale of options in the value of the portfolio securities sold during the period.

(e) A Fund may incorporate by reference the Financial Highlights Information from a report to shareholders under rule 30e-1 into the prospectus in response to this Item if the Fund delivers the shareholder report with the prospectus or, if the report has been previously delivered (*e.g.*, to a current shareholder), the Fund includes the statement required by Item 1(b)(1).

PART B

Information Required In A Statement Of Additional Information

Item 14. Cover Page and Table of Contents

(a) *Front Cover Page.* Include the following information on the outside front cover page of the SAI:

(1) The Fund's name and the Class or Classes, if any, to which the SAI relates. If the Fund is a Series, also provide the Registrant's name.

(2) The exchange ticker symbol of the Fund's securities or, if the SAI relates to one or more Classes of the Fund's securities, adjacent to each such Class, the exchange ticker symbol of such Class of the Fund's securities. If the Fund is an Exchange-Traded Fund, also identify the principal U.S. market or markets on which the Fund shares are traded.

(3) A statement or statements:

(i) That the SAI is not a prospectus;

(ii) How the prospectus may be obtained; and

(iii) Whether and from where information is incorporated by reference into the SAI, as permitted by General Instruction D.

Instruction. Any information incorporated by reference into the SAI must be delivered with the SAI unless the information has been previously delivered in a shareholder report (*e.g.*, to a current shareholder), and the Fund states that the shareholder report is available, without charge, upon request. Provide a toll-free (or collect) telephone number to call to request the report.

(4) The date of the SAI and of the prospectus to which the SAI relates.

(b) Table of Contents. Include under appropriate captions (and subcaptions) a list of the contents of the SAI and, when useful, provide cross-references to related disclosure in the prospectus.

Item 15. Fund History

(a) Provide the date and form of organization of the Fund and the name of the state or other jurisdiction in which the Fund is organized.

(b) If the Fund has engaged in a business other than that of an investment company during the past 5 years, state the nature of the other business and give the approximate date on which the Fund commenced business as an investment company. If the Fund's name was changed during that period, state its former name and the approximate date on which it was changed. Briefly describe the nature and results of any change in the Fund's business or name that occurred in connection with any bankruptcy, receivership, or similar proceeding, or any other material reorganization, readjustment or succession.

Item 16. Description of the Fund and Its Investments and Risks

(a) Classification. State that the Fund is an open-end, management investment company and indicate, if applicable, that the Fund is diversified.

(b) Investment Strategies and Risks. Describe any investment strategies, including a strategy to invest in a particular type of security, used by an investment adviser of the Fund in managing the Fund that are not principal strategies and the risks of those strategies.

(c) Fund Policies.

(1) Describe the Fund's policy with respect to each of the following:

(i) Issuing senior securities;

(ii) Borrowing money, including the purpose for which the proceeds will be used;

(iii) Underwriting securities of other issuers;

(iv) Concentrating investments in a particular industry or group of industries;

(v) Purchasing or selling real estate or commodities;

(vi) Making loans; and

(vii) Any other policy that the Fund deems fundamental or that may not be changed without shareholder approval, including, if applicable, the Fund's investment objectives.

Instruction. If the Fund reserves freedom of action with respect to any practice specified in paragraph (c)(1), state the maximum percentage of assets to be devoted to the practice and disclose the risks of the practice.

(2) State whether shareholder approval is necessary to change any policy specified in paragraph (c)(1). If so, describe the vote required to obtain this approval.

(d) Temporary Defensive Position. Disclose, if applicable, the types of investments that a Fund may make while assuming a temporary defensive position described in response to Item 9(b).

(e) Portfolio Turnover. Explain any significant variation in the Fund's portfolio turnover rates over the two most recently completed fiscal years or any anticipated variation in the portfolio turnover rate from that reported for the last fiscal year in response to Item 13.

Instruction. This paragraph does not apply to a Money Market Fund.

(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 16(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 the information will be available.

*[**amendment effective January 17, 2017**. "N-Q" will be replaced by "N-PORT for the last month of the Fund's first or third fiscal quarters". **Note: Funds with assets of $1 billion or more will be required to file Form N-PORT by June 1, 2018. Funds with assets of less than $1 billion will be required to file Form N-PORT by June 1, 2019. Form N-Q will be rescinded on August 1, 2019.**]

(g) *Money Market Fund Material Events.* If the Fund is a Money Market Fund (except any Money Market Fund that is not subject to the requirements of §270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to §270.2a-7(c)(2)(iii) of this chapter, and has not chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §270.2a-7(c)(2)(i) and/or (ii)) disclose, as applicable, the following events:

(1) *Imposition of Liquidity Fees and Temporary Suspensions of Fund Redemptions.*

(i) During the last 10 years, any occasion on which the Fund has invested less than ten percent of its total assets in weekly liquid assets (as provided in §270.2a-7(c)(2)(ii)), and with respect to each such occasion, whether the Fund's board of directors determined to impose a liquidity fee pursuant to §270.2a-7(c)(2)(ii) and/or temporarily suspend the Fund's redemptions pursuant to §270.2a-7(c)(2)(i).

(ii) During the last 10 years, any occasion on which the Fund has invested less than thirty percent, but more than ten percent, of its total assets in weekly liquid assets, (as provided in §270.2a-7(c)(2)(i)) and the Fund's board of directors has determined to impose a liquidity fee pursuant to §270.2a-7(c)(2)(i) and/or temporarily suspend the Fund's redemptions pursuant to §270.2a-7(c)(2)(i).

Instructions.

1. With respect to each such occasion, disclose: the dates and length of time for which the Fund invested less than ten percent (or thirty percent, as applicable) of its total assets in weekly liquid assets; the dates and length of time for which the Fund's board of directors determined to impose a liquidity fee pursuant to §270.2a-7(c)(2)(i) or §270.2a-7(c)(2)(ii), and/or temporarily suspend the Fund's redemptions pursuant to §270.2a-7(c)(2)(i); and the size of any liquidity fee imposed pursuant to §270.2a-7(c)(2)(i) or §270.2a-7(c)(2)(ii).

2. The disclosure required by Item 16(g)(1) should incorporate, as appropriate, any information that the Fund is required to report to the Commission on Items E.1, E.2, E.3, E.4, F.1, F.2, and G.1 of Form N-CR [17 CFR 274.222].

3. The disclosure required by Item 16(g)(1) should conclude with the following statement: "The Fund was required to disclose additional information about this event [or "these events," as appropriate] on Form N-CR and to file this form with the Securities and Exchange Commission. Any Form N-CR filing submitted by the Fund is available on the EDGAR Database on the Securities and Exchange Commission's Internet site at http://www.sec.gov."

(2) *Financial Support Provided to Money Market Funds.* During the last 10 years, any occasion on which an affiliated person, promoter, or principal underwriter of the Fund, or an affiliated person of such a person, provided any form of financial support to the Fund, including a description of the nature of support, person providing support, brief description of the relationship between the person providing support and the Fund, date support provided, amount of support, security supported (if applicable), and the value of security supported on date support was initiated (if applicable).

Instructions.

1. The term "financial support" includes any capital contribution, purchase of security from the Fund in reliance on §270.17a-9, purchase of any defaulted or devalued security at par, execution of letter of credit or letter of indemnity, capital support agreement (whether or not the Fund ultimately received support), performance guarantee, or any other similar action reasonably intended to increase or stabilize the value or liquidity of the Fund's portfolio; excluding, however, any routine waiver of fees or reimbursement of Fund expenses, routine inter-fund lending, routine inter-fund purchases of Fund shares, or any action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the Fund's portfolio.

2. If during the last 10 years, the Fund has participated in one or more mergers with another investment company (a "merging investment company"), provide the information required by Item 16(g)(2) with respect to any merging investment company as well as with respect to the Fund; for purposes of this instruction, the term "merger" means a merger, consolidation, or purchase or sale of substantially all of

the assets between the Fund and a merging investment company. If the person or entity that previously provided financial support to a merging investment company is not currently an affiliated person, promoter, or principal underwriter of the Fund, the Fund need not provide the information required by Item 16(g)(2) with respect to that merging investment company.

3. The disclosure required by Item 16(g)(2) should incorporate, as appropriate, any information that the Fund is required to report to the Commission on Items C.1, C.2, C.3, C.4, C.5, C.6, and C.7 of Form N-CR [17 CFR 274.222].

4. The disclosure required by Item 16(g)(2) should conclude with the following statement: "The Fund was required to disclose additional information about this event [or "these events," as appropriate] on Form N-CR and to file this form with the Securities and Exchange Commission. Any Form N-CR filing submitted by the Fund is available on the EDGAR Database on the Securities and Exchange Commission's Internet site at http://www.sec.gov."

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Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings [Release Nos. 33-8408; IC-26418; April 16, 2004]

II. DISCUSSION

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. We are also adopting parallel amendments to Form N-3 for managed separate accounts that issue variable annuities. 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 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. 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 website (i.e., if the fund posts this description on its website). 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;
- 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;
- 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;
- the individuals or categories of individuals who may authorize disclosure of the fund's portfolio securities;
- 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
- the manner in which the board of directors exercises oversight of disclosure of the fund's portfolio securities.

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.

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. 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. 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 companies or accounts managed by the fund's investment adviser or by any affiliated person of the investment adviser. 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

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 website 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. 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 website; and (ii) discloses in its prospectus the availability of the information on its website. 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. 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 website 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.

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 website.[351] 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.

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

Item 17. Management of the Fund

Instructions.

1. *For purposes of this Item 17, the terms below have the following meanings:*

(a) The term "family of investment companies" means any two or more registered investment companies that:

(1) Share the same investment adviser or principal underwriter; and

(2) Hold themselves out to investors as related companies for purposes of investment and investor services.

(b) The term "fund complex" means two or more registered investment companies that:

(1) Hold themselves out to investors as related companies for purposes of investment and investor services; or

(2) Have a common investment adviser or have an investment adviser that is an affiliated person of the investment adviser of any of the other registered investment companies.

(c) The term "immediate family member" means a person's spouse; child residing in the person's household (including step and adoptive children); and any dependent of the person, as defined in section 152 of the Internal Revenue Code (26 U.S.C. 152).

(d) The term "officer" means the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions.

2. When providing information about directors, furnish information for directors who are interested persons of the Fund separately from the information for directors who are not interested persons of the Fund. For example, when furnishing information in a table, you should provide separate tables (or separate sections of a single table) for directors who are interested persons and for directors who are not interested persons. When furnishing information in narrative form, indicate by heading or otherwise the directors who are interested persons and the directors who are not interested persons.

(a) Management Information.

(1) Provide the information required by the following table for each director and officer of the Fund, and, if the Fund has an advisory board, member of the board. Explain in a footnote to the table any family relationship between the persons listed.

(1)	(2)	(3)	(4)	(5)	(6)
Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years	Number of Portfolios in Fund Complex Overseen by Director	Other Directorships Held by Director

Instructions.

1. For purposes of this paragraph, the term "family relationship" means any relationship by blood, marriage, or adoption, not more remote than first cousin.

2. For each director who is an interested person of the Fund, describe, in a footnote or otherwise, the relationship, events, or transactions by reason of which the director is an interested person.

3. State the principal business of any company listed under column (4) unless the principal business is implicit in its name.

4. Indicate in column (6) directorships not included in column (5) that are held by a director in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Securities Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act, and name the companies in which the directorships are held. Where the other directorships include directorships overseeing two or more portfolios in the same fund complex, identify the fund complex and provide the number of portfolios overseen as a director in the fund complex rather than listing each portfolio separately.

(2) For each individual listed in column (1) of the table required by paragraph (a)(1) of this Item 17, except for any director who is not an interested person of the Fund, describe any positions, including as an officer, employee, director, or general partner, held with affiliated persons or principal underwriters of the Fund.

Instruction. When an individual holds the same position(s) with two or more registered investment companies that are part of the same fund complex, identify the fund complex and provide the number of registered investment companies for which the position(s) are held rather than listing each registered investment company separately.

(3) Describe briefly any arrangement or understanding between any director or officer and any other person(s) (naming the person(s)) pursuant to which he was selected as a director or officer.

Instruction. Do not include arrangements or understandings with directors or officers acting solely in their capacities as such.

(b) Leadership Structure and Board of Directors.

(1) Briefly describe the leadership structure of the Fund's board, including the responsibilities of the board of directors with respect to the Fund's management and whether the chairman of the board is an interested person of the Fund. If the chairman of the board is an interested person of the Fund, disclose whether the Fund has a lead independent director and what specific role the lead independent director plays in the leadership of the Fund. This disclosure should indicate why the Fund has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Fund. In addition, disclose the extent of the board's role in the risk over-

sight of the Fund, such as how the board administers its oversight function and the effect that this has on the board's leadership structure.

(2) Identify the standing committees of the Fund's board of directors, and provide the following information about each committee:

(i) A concise statement of the functions of the committee;

(ii) The members of the committee;

(iii) The number of committee meetings held during the last fiscal year; and

(iv) If the committee is a nominating or similar committee, state whether the committee will consider nominees recommended by security holders and, if so, describe the procedures to be followed by security holders in submitting recommendations.

(3)(i) Unless disclosed in the table required by paragraph (a)(1) of this Item 17, describe any positions, including as an officer, employee, director, or general partner, held by any director who is not an interested person of the Fund, or immediate family member of the director, during the two most recently completed calendar years with:

(A) The Fund;

(B) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a-3(c)(1) and (c)(7)), having the same investment adviser or principal underwriter as the Fund or having an investment adviser or principal underwriter that directly or indirectly controls, is controlled by, or is under common control with an investment adviser or principal underwriter of the Fund;

(C) An investment adviser, principal underwriter, or affiliated person of the Fund; or

(D) Any person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund.

(ii) Unless disclosed in the table required by paragraph (a)(1) of this Item 17 or in response to paragraph (b)(3)(i) of this Item 17, indicate any directorships held during the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Securities Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act, and name the companies in which the directorships were held.

Instruction. When an individual holds the same position(s) with two or more portfolios that are part of the same fund complex, identify the fund complex and provide the number of portfolios for which the position(s) are held rather than listing each portfolio separately.

(4) For each director, state the dollar range of equity securities beneficially owned by the director as required by the following table:

(i) In the Fund; and

(ii) On an aggregate basis, in any registered investment companies overseen by the director within the same family of investment companies as the Fund.

(1)	(2)	(3)
Name of Director	**Dollar Range of Equity Securities in the Fund**	**Aggregate Dollar Range of Equity Securities in All Registered Investment Companies Overseen by Director in Family of Investment Companies**

Instructions.

1. Information should be provided as of the end of the most recently completed calendar year. Specify the valuation date by footnote or otherwise.

2. Determine "beneficial ownership" in accordance with rule 16a-1(a)(2) under the Exchange Act (17 CFR 240.16a-1(a)(2)).

3. If the SAI covers more than one Fund or Series, disclose in column (2) the dollar range of equity securities beneficially owned by a director in each Fund or Series overseen by the director.

4. In disclosing the dollar range of equity securities beneficially owned by a director in columns (2) and (3), use the following ranges: none, $1-$10,000, $10,001-$50,000, $50,001-$100,000, or over $100,000.

(5) For each director who is not an interested person of the Fund, and his immediate family members, furnish the information required by the following table as to each class of securities owned beneficially or of record in:

(i) An investment adviser or principal underwriter of the Fund; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund:

(1)	(2)	(3)	(4)	(5)	(6)
Name of Director	**Name of Owners and Relationships to Director**	**Company**	**Title of Class**	**Value of Securities**	**Percent of Class**

Instructions.

1. Information should be provided as of the end of the most recently completed calendar year. Specify the valuation date by footnote or otherwise.

2. An individual is a "beneficial owner" of a security if he is a "beneficial owner" under either rule 13d-3 or rule 16a-1(a)(2) under the Exchange Act (17 CFR 240.13d-3 or 240.16a-1(a)(2)).

3. Identify the company in which the director or immediate family member of the director owns securities in column (3). When the company is a person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter, describe the company's relationship with the investment adviser or principal underwriter.

4. Provide the information required by columns (5) and (6) on an aggregate basis for each director and his immediate family members.

(6) Unless disclosed in response to paragraph (b)(5) of this Item 17, describe any direct or indirect interest, the value of which exceeds $120,000, of each director who is not an interested person of the Fund, or immediate family member of the director, during the two most recently completed calendar years, in:

(i) An investment adviser or principal underwriter of the Fund; or

(ii) A person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund.

Instructions.

1. A director or immediate family member has an interest in a company if he is a party to a contract, arrangement, or understanding with respect to any securities of, or interest in, the company.

2. The interest of the director and the interests of his immediate family members should be aggregated in determining whether the value exceeds $120,000.

(7) Describe briefly any material interest, direct or indirect, of any director who is not an interested person of the Fund, or immediate family member of the director, in any transaction, or series of similar transactions, during the two most recently completed calendar years, in which the amount involved exceeds $120,000 and to which any of the following persons was a party:

(i) The Fund;

(ii) An officer of the Fund;

(iii) An investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a-3(c)(1) and (c)(7)), having the same investment adviser or principal underwriter as the Fund or having an investment adviser or principal underwriter that directly or indirectly controls, is controlled by, or is under common control with an investment adviser or principal underwriter of the Fund;

(iv) An officer of an investment company, or a person that would be an investment company but for the exclusions provided by sections 3(c)(1) and 3(c)(7) (15 U.S.C. 80a-3(c)(1) and (c)(7)), having the same investment adviser or principal underwriter as the Fund or having an investment adviser or principal underwriter that directly or indirectly controls, is controlled by, or is under common control with an investment adviser or principal underwriter of the Fund;

(v) An investment adviser or principal underwriter of the Fund;

(vi) An officer of an investment adviser or principal underwriter of the Fund;

(vii) A person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund; or

(viii) An officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund.

Instructions.

1. Include the name of each director or immediate family member whose interest in any transaction or series of similar transactions is described and the nature of the circumstances by reason of which the interest is required to be described.

2. State the nature of the interest, the approximate dollar amount involved in the transaction, and, where practicable, the approximate dollar amount of the interest.

3. In computing the amount involved in the transaction or series of similar transactions, include all periodic payments in the case of any lease or other agreement providing for periodic payments.

4. Compute the amount of the interest of any director or immediate family member of the director without regard to the amount of profit or loss involved in the transaction(s).

5. As to any transaction involving the purchase or sale of assets, state the cost of the assets to the purchaser and, if acquired by the seller within two years prior to the transaction, the cost to the seller. Describe the method used in determining the purchase or sale price and the name of the person making the determination.

6. Disclose indirect, as well as direct, material interests in transactions. A person who has a position or relationship with, or interest in, a company that engages in a transaction with one of the persons listed in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 may have an indirect interest in the transaction by reason of the position, relationship, or interest. The interest in the transaction, however, will not be deemed "material" within the meaning of paragraph (b)(7) of this Item 17 where the interest of the director or immediate family member arises solely from the holding of an equity interest (including a limited partnership interest, but excluding a general partnership interest) or a creditor interest in a company that is a party to the transaction with one of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17, and the transaction is not material to the company.

7. The materiality of any interest is to be determined on the basis of the significance of the information to investors in light of all the circumstances of the particular case. The importance of the interest to the person having the interest, the relationship of the parties to the transaction with each other, and the amount involved in the transaction are among the factors to be considered in determining the significance of the information to investors.

8. No information need be given as to any transaction where the interest of the director or immediate family member arises solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 and the director or immediate family member receives no extra or special benefit not shared on a pro rata basis by all holders of the Class of securities.

9. Transactions include loans, lines of credit, and other indebtedness. For indebtedness, indicate the largest aggregate amount of indebtedness outstanding at any time during the period, the nature of the indebtedness and the transaction in which it was incurred, the amount outstanding as of the end of the most recently completed calendar year, and the rate of interest paid or charged.

10. No information need be given as to any routine, retail transaction. For example, the Fund need not disclose that a director has a credit card, bank or brokerage account, residential mortgage, or insurance policy with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 unless the director is accorded special treatment.

(8) Describe briefly any direct or indirect relationship, in which the amount involved exceeds $120,000, of any director who is not an interested person of the Fund, or immediate family member of the director, that existed at any time during the two most recently completed calendar years with any of the persons specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17. Relationships include:

(i) Payments for property or services to or from any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17;

(ii) Provision of legal services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17;

(iii) Provision of investment banking services to any person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17, other than as a participating underwriter in a syndicate; and

(iv) Any consulting or other relationship that is substantially similar in nature and scope to the relationships listed in paragraphs (b)(8)(i) through (b)(8)(iii) of this Item 17.

Instructions.

1. Include the name of each director or immediate family member whose relationship is described and the nature of the circumstances by reason of which the relationship is required to be described.

2. State the nature of the relationship and the amount of business conducted between the director or immediate family member and the person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 as a result of the relationship during the two most recently completed calendar years.

3. In computing the amount involved in a relationship, include all periodic payments in the case of any agreement providing for periodic payments.

4. Disclose indirect, as well as direct, relationships. A person who has a position or relationship with, or interest in, a company that has a relationship with one of the persons listed in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 may have an indirect relationship by reason of the position, relationship, or interest.

5. In determining whether the amount involved in a relationship exceeds $120,000, amounts involved in a relationship of the director should be aggregated with those of his immediate family members.

6. In the case of an indirect interest, identify the company with which a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 has a relationship; the name of the director or immediate family member affiliated with the company and the nature of the affiliation; and the amount of business conducted between the company and the person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 during the two most recently completed calendar years.

7. In calculating payments for property and services for purposes of paragraph (b)(8)(i) of this Item 17, the following may be excluded:

A. Payments where the transaction involves the rendering of services as a common contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority; or

B. Payments that arise solely from the ownership of securities of a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 and no extra or special benefit not shared on a pro rata basis by all holders of the class of securities is received.

8. No information need be given as to any routine, retail relationship. For example, the Fund need not disclose that a director has a credit card, bank or brokerage account, residential mortgage, or insurance policy with a person specified in paragraphs (b)(7)(i) through (b)(7)(viii) of this Item 17 unless the director is accorded special treatment.

(9) If an officer of an investment adviser or principal underwriter of the Fund, or an officer of a person directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund, served during the two most recently completed calendar years, on the board of directors of a company where a director of the Fund who is not an interested person of the Fund, or immediate family member of the director, was during the two most recently completed calendar years, an officer, identify:

(i) The company;

(ii) The individual who serves or has served as a director of the company and the period of service as director;

(iii) The investment adviser or principal underwriter or person controlling, controlled by, or under common control with the investment adviser or principal underwriter where the individual named in paragraph (b)(9)(ii) of this Item 17 holds or held office and the office held; and

(iv) The director of the Fund or immediate family member who is or was an officer of the company; the office held; and the period of holding the office.

(10) For each director, briefly discuss the specific experience, qualifications, attributes, or skills that led to the conclusion that the person should serve as a director for the Fund

at the time that the disclosure is made, in light of the Fund's business and structure. If material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications.

(c) Compensation. For all directors of the Fund and for all members of any advisory board who receive compensation from the Fund, and for each of the three highest paid officers or any affiliated person of the Fund who received aggregate compensation from the Fund for the most recently completed fiscal year exceeding $60,000 ("Compensated Persons"):

(1) Provide the information required by the following table:

COMPENSATION TABLE

(1)	(2)	(3)	(4)	(5)
Name of Person, Position	**Aggregate Compensation From Fund**	**Pension or Retirement Benefits Accrued As Part of Fund Expenses**	**Estimated Annual Benefits Upon Retirement**	**Total Compensation From Fund and Fund Complex Paid to Directors**

Instructions.

1. For column (1), indicate, as necessary, the capacity in which the remuneration is received. For Compensated Persons who are directors of the Fund, compensation is amounts received for service as a director.

2. If the Registrant has not completed its first full year since its organization, furnish the information for the current fiscal year, estimating future payments that would be made pursuant to existing agreement or understanding. Disclose in a footnote to the Compensation Table the period for which the information is furnished.

3. Include in column (2) amounts deferred at the election of the Compensated Person, whether pursuant to a plan established under Section 401(k) of the Internal Revenue Code [26 U.S.C. 401(k)] or otherwise for the fiscal year in which earned. Disclose in a footnote to the Compensation Table the total amount of deferred compensation (including interest) payable to or accrued for any Compensated Person.

4. Include in columns (3) and (4) all pension or retirement benefits proposed to be paid under any existing plan in the event of retirement at normal retirement date, directly or indirectly, by the Registrant, any of its subsidiaries, or other companies in the Fund Complex. Omit column (4) where retirement benefits are not determinable.

5. For any defined benefit or actuarial plan under which benefits are determined primarily by final compensation (or average final compensation) and years of service, provide the information required in column (4) in a separate table showing estimated annual benefits payable upon retirement (including amounts attributable to any defined benefit supplementary or excess pension award plans) in specified compensation and years of service classifications. Also provide the estimated credited years of service for each Compensated Person.

6. Include in column (5) only aggregate compensation paid to a director for service on the board and all other boards of investment companies in a Fund Complex specifying the number of such other investment companies.

(2) Describe briefly the material provisions of any pension, retirement, or other plan or any arrangement, other than fee arrangements disclosed in paragraph (c)(1), under which the Compensated Persons are or may be compensated for services provided, including amounts paid, if any, to the Compensated Person under these arrangements during the most recently completed fiscal year. Specifically include the criteria used to determine amounts payable under the plan, the length of service or vesting period required by the plan, the retirement age or other event that gives rise to payment under the plan, and whether the payment of benefits is secured or funded by the Fund.

(d) Sales Loads. Disclose any arrangements that result in breakpoints in, or elimination of, sales loads for directors and other affiliated persons of the Fund. Identify each class of individuals and transactions to which the arrangements apply and state each different breakpoint as a percentage of both the offering price and the net amount invested of the Fund's shares. Explain, as applicable, the reasons for the difference in the price at which securities are offered generally to the public, and the prices at which securities are offered to directors and other affiliated persons of the Fund.

(e) Codes of Ethics. Provide a brief statement disclosing whether the Fund and its investment adviser and principal underwriter have adopted codes of ethics under rule 17j-1 of the Investment Company Act [17 CFR 270.17j-1] and whether these codes of ethics permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the Fund.

Instruction: A Fund that is not required to adopt a code of ethics under rule 17j-1 of the Investment Company Act is not required to respond to this item.

(f) Proxy Voting Policies. Unless the Fund invests exclusively in non-voting securities, describe the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities, including the procedures that the Fund uses when a vote presents a conflict 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. 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, to determine how to vote proxies relating to portfolio securities. Also, state that information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available (1) without charge, upon request, by calling a specified toll-free (or collect) telephone number; or on or through the Fund's website at a specified Internet address; or both; and (2) on the Commission's website at http://www.sec.gov.

Instructions.

1. A Fund may satisfy the requirement to provide a description of the policies and procedures that it uses to determine how to vote proxies relating to portfolio securities by including a copy of the policies and procedures themselves.

2. If a Fund discloses that the Fund's proxy voting record is available by calling a toll-free (or collect) telephone number, and the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for this information, the Fund (or financial intermediary) must send the information disclosed in the Fund's most recently filed report on Form N-PX, within three business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

3. If a Fund discloses that the Fund's proxy voting record is available on or through its website, the Fund must make available free of charge the information disclosed in the Fund's most recently filed report on Form N-PX on or through its website as soon as reasonably practicable after filing the report with the Commission. The information disclosed in the Fund's most recently filed report on Form N-PX must remain available on or through the Fund's website for as long as the Fund remains subject to the requirements of Rule 30b1-4 (17 CFR 270.30b1-4) and discloses that the Fund's proxy voting record is available on or through its website.

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Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies
[Release Nos. 33-8188, 34-47304, IC-25922; January 31, 2003]

A. Disclosure of Policies and Procedures With Respect To Voting Proxies Relating to Portfolio Securities

The Commission is adopting, with one modification to address commenters' concerns, the requirement that mutual funds that invest in voting securities disclose in their statements of additional information ("SAIs") the policies and procedures that they use to determine how to vote proxies relating to securities held in their portfolios....This disclosure would include the procedures that a fund uses when a vote presents a conflict between the interests of fund shareholders, on the one hand, and those of the fund's investment adviser, principal underwriter, or an affiliated person of the fund, its investment adviser, or principal underwriter, on the other. It also includes any policies and procedures of a fund's investment adviser, or any other third party, that the fund uses, or that are used on the fund's behalf, to determine how to vote proxies relating to portfolio securities. For example, if a fund delegates proxy voting decisions to its investment adviser and the adviser uses its own policies and procedures to vote the fund's proxies, disclosure of the adviser's policies and procedures is required. Or a fund's board may wish to adopt its adviser's policies and procedures, rather than designing its own.

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Commenters generally supported the proposed disclosure requirements regarding proxy voting policies and procedures. A number of commenters, however, objected to certain aspects of the disclosure requirements. Some commenters recommended that we provide additional, more specific guidelines regarding the categories of disclosure that should be included in proxy voting policies and procedures. These commenters, which included many "socially

responsible" fund groups, argued that the absence of specific guidelines could create an incentive for funds to adopt as few policies and procedures as possible, thereby minimizing reporting and disclosure obligations.

We have determined not to prescribe more specific guidelines or requirements for the proxy voting policies and procedures that a fund must disclose in its SAI or Form N-CSR for closed-end funds. The intent of our proposal is to promote transparency with respect to proxy voting information, and not to mandate the content of a fund's policies or procedures. Therefore, we believe that funds should be allowed the flexibility to determine the content that would be appropriate for this disclosure.

We do expect, however, that funds' disclosure of their policies and procedures will include general policies and procedures, as well as policies with respect to voting on specific types of issues. The following are examples of general policies and procedures that some funds include in their proxy voting policies and procedures and with respect to which disclosure would be appropriate:

- The extent to which the fund delegates its proxy voting decisions to its investment adviser or another third party, or relies on the recommendations of a third party;
- Policies and procedures relating to matters that may affect substantially the rights or privileges of the holders of securities to be voted; and
- Policies regarding the extent to which the fund will support or give weight to the views of management of a portfolio company.

The following are examples of specific types of issues that are covered by some funds' proxy voting policies and procedures and with respect to which disclosure would be appropriate:

- Corporate governance matters, including changes in the state of incorporation, mergers and other corporate restructurings, and anti-takeover provisions such as staggered boards, poison pills, and supermajority provisions;
- Changes to capital structure, including increases and decreases of capital and preferred stock issuance;
- Stock option plans and other management compensation issues; and
- Social and corporate responsibility issues.

We are modifying our proposal in one respect, however, to clarify that a fund may satisfy the requirements for a description of its policies and procedures by including a copy of the policies and procedures themselves. A number of commenters recommended that we streamline the disclosure of policies and procedures that would be required in the SAI. Several of these commenters were fund groups that noted that they have funds with multiple sub-advisers, each of which uses its own proxy voting policies and procedures to vote the fund's proxies. Because the proposed rules would require the fund to include a description of

each such sub-adviser's policies and procedures in the fund's SAI, commenters argued, the requirements would add lengthy disclosure to the SAI. Further, because different sub-advisers for a single fund could have policies that vary with respect to a particular issue, this disclosure could confuse investors. These commenters argued that disclosure of policies and procedures was not necessary or appropriate given the lack of genuine shareholder interest in the information.

We have determined that it would not be appropriate to modify the proposal to allow a fund to reduce or eliminate the disclosure regarding its proxy voting policies and procedures. Shareholders have a right to know the policies and procedures that are being used by a fund to vote proxies on their behalf. To the extent that multiple policies are being used by a single fund, shareholders should have access to information about all the policies that are in effect. In order to mitigate the burden of preparing descriptions of policies and procedures, however, we have modified our disclosure requirements to permit a fund to include the actual policies and procedures used to vote proxies in the SAI or N-CSR, rather than a description of the policies.

Some commenters argued that the SAI was not the appropriate location for disclosure of proxy voting policies and procedures because the SAI is not likely to reach a wide base of investors. These commenters argued that the policies and procedures should be required to be distributed to all investors, as part of the fund's prospectus, annual report, or in a separate mailing. We continue to believe, however, that the SAI is the most appropriate and cost-effective location for this disclosure. The disclosure will be readily accessible to shareholders because funds are required to provide an SAI promptly to any investor who requests one. On the other hand, funds and their shareholders will not be forced to bear the costs for printing and mailing this information to every shareholder, without regard to their level of interest in this information.

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Role of Independent Directors of Investment Companies (ICA Release No-24816; January 2, 2001)

[Footnotes omitted except for footnotes 71, 76, 99, & 104]

Disclosure of Information about Fund Directors

We believe that shareholders have a significant interest in knowing who the independent directors are, whether the independent directors' interests are aligned with shareholders' interests, whether the independent directors have any conflicts of interest, and how the directors govern the fund. This information helps a mutual fund shareholder to evaluate whether the independent directors can, in fact, act as an independent, vigorous, and effective force in overseeing fund operations.

In reevaluating our current disclosure requirements, we concluded that, while our fundamental approach has been sound, there are several gaps in the information that shareholders currently receive about directors. We therefore proposed amendments to close these gaps. The proposal would require funds to:

Provide basic information about directors to shareholders annually so that shareholders will know the identity and experience of their representatives;

Disclose to shareholders fund shares owned by directors to help shareholders evaluate whether directors' interests are aligned with their own;

Disclose to shareholders information about directors that may raise conflict of interest concerns; and Provide information to shareholders on the board's role in governing the fund.

We are adopting the disclosure amendments with several modifications designed to tailor the amendments more closely to our goal of providing shareholders with better information to evaluate the independent directors.

Basic Information

We are adopting the requirement to disclose basic information about directors in an easy-to-read tabular format, as proposed. The table will be required in three places: the fund's annual report to shareholders, SAI, and proxy statement for the election of directors. The table will require for each director: (1) name, address, and age; (2) current positions held with the fund; (3) term of office and length of time served; (4) principal occupations during the past five years; (5) number of portfolios overseen within the fund complex; and (6) other directorships held outside of the fund complex.[352] The table also requires for each interested director, as defined in Section 2(a)(19) of the Investment Company Act, a description of the relationship, events, or transactions by reason of which the director is an interested person.

Commenters generally supported the proposal, although several commenters opposed as unnecessary the requirement to describe in the table the relationships, events, or transactions that make certain directors "interested persons." Funds are currently required to disclose this information in the proxy statement for the election of directors, and we are adopting this requirement as proposed. We believe it is important that shareholders be provided with an explanation of why certain directors are "interested persons."

Ownership of Equity Securities in Fund Complex

We are adopting with modifications the requirement to disclose the amount of equity securities of funds in a fund complex owned by each director. Commenters generally agreed with the Commission that disclosure of this information would be useful to shareholders in assessing whether directors' interests are aligned with those of shareholders.

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[352] *In response to privacy concerns raised by several commenters, we wish to clarify that a director may provide the address of the fund or the fund's adviser in the table and need not provide his personal address.*

Disclosure of Amounts Owned by Directors

Many commenters expressed concern about the proposed requirement that funds disclose the exact dollar amount of securities directors own in a fund complex. These commenters argued that this disclosure would discourage potential directors from agreeing to serve, in order to avoid intrusions into their privacy, and might cause existing directors to reduce or sell their holdings to avoid publicity about their investments. As an alternative, many suggested that we require funds to disclose directors' equity ownership using specified dollar ranges, rather than exact dollar amounts. These commenters noted that using dollar ranges would provide shareholders with sufficient information to assess whether directors' interests were aligned with their own, making disclosure of exact dollar amounts unnecessary.

We are persuaded by these comments and have modified the proposal to require disclosure of a director's holdings of securities using dollar ranges rather than an exact dollar amount. Funds will be required to disclose directors' equity ownership using the following ranges: None; $1-$10,000; $10,001-$50,000; $50,001-$100,000; or over $100,000. We believe that disclosure of directors' holdings using these dollar ranges will provide investors with significant information to use in evaluating whether directors' interests are aligned with their own, while protecting directors' legitimate privacy interests.

"Beneficial Ownership"

We received a number of comments requesting clarification about the types of director holdings that would be disclosed under the proposal. Based on these comments, we reevaluated our proposal to require disclosure of securities owned beneficially and of record by each director. Under the proposal, "beneficial ownership" would have been determined in accordance with rule 13d-3 of the Exchange Act, which focuses on a person's voting and investment power. In light of our objective of providing information about the alignment of directors' and shareholders' interests, we believe that disclosure of record holdings should not be required and that the focus of "beneficial ownership" should be on whether a director's economic interests are tied to the securities, rather than his ability to exert voting power or to dispose of the securities. Therefore, we are modifying the proposal to require disclosure of "beneficial ownership" in accordance with the definition contained in rule 16a-1(a)(2) under the Exchange Act.[353] This definition, consistent with our goal, emphasizes the economic incidence of ownership.

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[353] *Rule 16a-1(a)(2). We also have modified the proposal requiring disclosure of securities owned by an independent director and his immediate family members in an investment adviser or principal underwriter and persons controlling, controlled by, or under common control with an investment adviser or principal underwriter. This requirement is intended to illuminate potential conflicts of interest, and we therefore believe that any record or beneficial securities ownership in these entities should be disclosed, whether the beneficial ownership results from voting power, investment power, or economic interests. Therefore, we have revised the proposal to require disclosure of securities owned if covered by the definition of "beneficial ownership" contained in either rule 13d-3 or rule 16a-1(a)(2). Item 22(b)(6) and Instruction 2 to Item 22(b)(6) of Schedule 14A; Item 13(b)(5) and Instruction 2 to Item 13(b)(5) of Form N-1A*

Disclosure of Ownership in Funds the Director Oversees within the Same "Family of Investment Companies"

We proposed to require aggregate disclosure of a director's holdings in a fund complex, rather than separate disclosure of a director's holdings in a particular fund. We were concerned that fund-specific information might have limited meaning because of the many reasons that a director could have for not holding shares of any specific fund, *e.g.*, that its investment objective did not fill a need in the director's portfolio. Several commenters recommended, however, that disclosure of a director's holdings should be made on a fund-by-fund basis, rather than a complex-wide basis, arguing that it would be more relevant to disclose to shareholders a director's ownership of the specific funds on whose board the director serves. Other commenters agreed that disclosure of a director's holdings should be on an aggregate basis as proposed, but recommended that the disclosure be limited to a director's aggregate ownership in the funds overseen by a director within a fund complex. These commenters argued that disclosure in this manner is more useful to investors than complex-wide disclosure in assessing whether a director's interests are aligned with their own.

We are persuaded by these comments and have modified the proposal to require disclosure of: (1) each director's ownership in each fund that he oversees; and (2) each director's aggregate ownership in any funds that he oversees within a fund family. We believe that a director's ownership in a particular fund provides the most direct indication of his alignment with the interests of shareholders in that fund. We continue to believe, however, that disclosure of a director's aggregate ownership will provide shareholders with relevant information about the director's alignment with shareholders. In addition, a director could have many reasons for not holding shares of a specific fund, *e.g.*, that its investment objectives do not match the director's. Disclosure of aggregate ownership will help prevent any inappropriate negative inference about fund management that a fund shareholder could draw from the fact that a director does not hold shares of a particular fund.

For purposes of determining a director's holdings in a fund complex, the Commission proposed to define "fund complex" as two or more funds that (1) hold themselves out to investors as related companies for purposes of investment and investor services; or (2) have a common investment adviser or an investment adviser that is an affiliated person of the investment adviser of any of the other funds. Many commenters argued that this definition would result in disclosure of holdings in funds that are too remotely related to funds on whose board the director serves to demonstrate alignment with fund shareholders (*e.g.*, for a director serving on the board of a fund with a sub-adviser, the director's ownership in any other funds that the sub-adviser serves would be disclosed, regardless of whether the funds are otherwise related). These commenters recommended that the Commission adopt a narrower definition of "family of investment companies," which includes only funds that share the same investment adviser or principal underwriter and hold themselves out to investors as related companies for purposes of investment and investor services. We agree with commenters that the proposed "fund complex" definition could result in disclosure of information having little bearing on a director's alignment with shareholders, and are adopting the narrower definition of "family of investment companies."

Date of Disclosure

The equity ownership information must be included in the SAI and any proxy statement relating to the election of directors. For the proxy statement, the equity ownership information must be provided as of the most recent practicable date, as proposed, in order to ensure that shareholders receive up-to-date information when they are asked to vote to elect directors. For the SAI, we have modified the proposal to require that the equity ownership information be provided as of the end of the last completed calendar year.

We believe that this modified time period requirement facilitates our goal that investors receive equity ownership information to evaluate whether directors' interests are aligned with their own, while imposing less of a burden on directors, especially those who serve multiple funds with staggered fiscal years.

Conflicts of Interest

We are adopting our proposals on conflicts of interest disclosure, with modifications that tailor the requirements more closely to our goals and address commenters' concerns that some aspects of the proposal were overbroad. We proposed to require funds to disclose in the proxy statement and SAI three types of circumstances that could affect the allegiance of fund directors to their shareholders: positions, interests, and transactions and relationships of directors and their immediate family members with the fund and persons related to the fund. The rules we adopt today follow this basic approach.

A number of commenters recommended alternatives to the proposed conflicts of interest disclosure requirements, including: (i) requiring funds to maintain records of potential conflicts of interest of directors; (ii) permitting independent directors to determine for themselves whether or not conflicts of interest exist that affect the "independence" of other independent directors; and (iii) limiting conflicts of interest disclosure to the proxy statement for the election of directors. After careful consideration of these alternatives, we have determined that they would not constitute an adequate substitute for disclosure to shareholders.

We continue to believe that shareholders have a significant interest in information concerning circumstances that may affect the directors' allegiance to shareholders. None of the alternatives suggested by commenters would provide this information to shareholders on a regular basis. The first two alternatives would completely exclude shareholders from the process of evaluating the independence of directors. The third alternative, limiting conflicts of interest disclosure to the proxy statement for the election of directors, ignores the fact that the proxy statement has become an ineffective vehicle for communicating information to fund shareholders on a regular basis because funds generally are no longer required to hold annual meetings.

Modifications to Persons Covered

Interested Directors

We are modifying our proposal to exclude interested directors from the conflicts of interest disclosure requirements in both the SAI and proxy statement. We are persuaded by the

commenters' arguments that if the purpose of the conflicts of interest disclosure is to allow investors and the Commission staff to better evaluate the true independence of independent directors, this goal will not be achieved by requiring disclosure of interested directors' potential conflicts of interest. As previously discussed, however, funds will be required to describe the relationships, events, or transactions that make a director an interested person.

Immediate Family Members

We are narrowing the scope of "immediate family members" covered by the disclosure requirements to a director's spouse, children residing in the director's household, and dependents of the director. As proposed, "immediate family members" also included the director's parents, siblings, children not residing with the director, and in-laws.

We received many comments on this definition, with the overwhelming majority of commenters arguing that the proposed extension of conflicts of interest disclosure to include a director's immediate family members, as defined in the proposal, was overly broad and too burdensome. Commenters noted that the definition, as proposed, would require directors to seek financial information from remote family members with whom they have little or no contact, and that the requirement could impose liabilities on directors without providing the means to enable directors to obtain the required information from reluctant relatives. We are persuaded by the commenters and have addressed their concerns by limiting the definition of "immediate family members" along the lines suggested by many commenters. The narrower definition ensures that disclosure will only be required with respect to family members from whom directors can reasonably be expected to obtain the required information.

Related Persons

The Commission proposed to require disclosure about circumstances involving directors, on the one hand, and the fund and persons related to the fund, on the other. We are modifying the proposal to exclude administrators from the persons related to the fund that are covered by the requirements. Several commenters expressed concern that inclusion of administrators that are not affiliated with the fund's adviser or principal underwriter would produce irrelevant and unnecessary information for shareholders because interactions between directors and unaffiliated administrators would not create conflicts of interest that could affect an independent director's judgment. We are persuaded by these commenters and note that administrators that control, are controlled by, or are under common control with the adviser or principal underwriter will be covered by the conflicts of interest disclosure.

While some commenters also recommended excluding entities "under common control" with the adviser or principal underwriter, we believe that disclosure of interests, positions, and transactions and relationships with entities under common control is important and could highlight circumstances that potentially could affect the judgment of independent directors. We also note that the current proxy rules require disclosure with respect to commonly controlled entities.

Although we are narrowing the scope of immediate family members and related persons in recognition of the overbreadth of our proposal in certain circumstances, we wish to emphasize that a fund's independent directors can vigilantly represent the interests of shareholders only when they are truly independent of those who operate and manage the fund. To that end, we encourage funds to examine any circumstances that could potentially impair the independence of independent directors, whether or not they fall within the scope of our disclosure requirements. There may, for example, be circumstances where an interest of a family member outside the ambit of our rules, or a director's interest in an administrator, impairs the director's ability to represent the interests of shareholders vigilantly.

Other Modifications

Threshold for Disclosure of Interests, Transactions, and Relationships

We are adopting a $60,000 threshold for disclosure of interests, transactions, and relationships. Many commenters requested that the Commission establish a specific dollar threshold that would trigger the disclosure requirements to eliminate the need to make subjective "materiality" determinations. We are persuaded by these comments and are adopting the $60,000 threshold, a level recommended by many commenters and contained in the existing proxy rules.

We have replaced a materiality test with the $60,000 threshold in order to facilitate compliance with the disclosure requirements that we adopt today. This change does not, however, reflect a determination that the $60,000 threshold may be equated with "materiality." We note that the antifraud provisions of the federal securities laws may obligate funds to disclose a material conflict of interest between a director and the fund or its shareholders without regard to the $60,000 threshold. For example, a transaction between a director and a fund's adviser may constitute a material conflict of interest with the fund or its shareholders that is required to be disclosed, regardless of the amount involved, if the terms and conditions of the transaction are not comparable to those that would have been negotiated at "arms-length" in similar circumstances.

Time Periods

We are adopting, as proposed, a five-year time period for disclosure of positions and interests of directors and immediate family members in the proxy statement for the election of directors. We are, however, reducing the time period for disclosure of positions and interests in the SAI to two calendar years. We believe that, when a shareholder is asked to vote to elect directors, he is entitled to information about potential conflicts covering a significant period of time. We recognize, however, that providing five years of information annually in the SAI, would, as suggested by commenters, increase fund compliance burdens without commensurate benefits to shareholders.

We are adopting, as proposed, the requirement to disclose material transactions and relationships since the beginning of the last two completed fiscal years in the proxy statement for

the election of directors. In the SAI, however, we have modified the proposal to require disclosure of transactions and relationships during the two most recently completed calendar years, rather than the last two fiscal years as proposed.

Many commenters noted that a director may serve multiple funds with staggered fiscal years and that a requirement to disclose transactions and relationships for fiscal year time periods could require funds to obtain the information from directors as frequently as monthly, which would be overly burdensome. We have revised the proposal to require two calendar years of disclosure, rather than two fiscal years, in order to reduce this burden for funds with staggered fiscal years, while maintaining the requirement to include two years of disclosure.

Routine, Retail Transactions and Relationships

As proposed, the conflicts of interest disclosure provisions would not have required a fund to disclose routine, retail transactions and relationships, such as a credit card or bank or brokerage account, unless the director is accorded special treatment. At the request of commenters, we are clarifying that the exception for routine, retail transactions and relationships extends to residential mortgages and insurance policies.[354] We also note that the exception for routine, retail transactions and relationships is not limited to the specific transactions and relationships enumerated (credit cards, bank or brokerage accounts, residential mortgages, and insurance policies), but extends to other routine, retail transactions and relationships where the director is not accorded special treatment.

Board's Role in Fund Governance

We are adopting, as proposed, disclosure requirements in the proxy rules and the SAI relating to a fund's committees of the board of directors, which commenters generally supported. We are also adopting, as proposed, the requirement to disclose in the SAI the board's basis for approving an existing investment advisory contract.

A number of commenters argued that information about the board's basis for approving an existing advisory contract is not relevant to an investment decision and disclosure of this information will be "boilerplate" in nature. After careful consideration of these comments, we continue to believe that shareholders should receive information in the SAI to help them evaluate the board's basis for approving the renewal of an existing investment advisory contract. In approving an investment advisory contract, independent directors must review the level of fees charged. Mutual funds fees and expenses, including advisory fees, are extremely important to shareholders. We note that the United States General Accounting Office ("GAO"), in a recent report to Congress on mutual fund fees, stressed the importance of heightening "investors' awareness and understanding of the fees they pay." We believe that the rules we

[354] *...We also note that sales load waivers granted to fund directors generally would not be required to be disclosed as "material" transactions or relationships, provided that such waivers are disclosed as otherwise required. See Instruction 3 to Item 18(c) of Form N-1A...(requiring funds to provide explanations for any differences in the price at which securities are offered generally to the public and the prices at which securities are offered to any class of individuals).*

adopt today, which will ensure that shareholders receive specific information on how directors evaluate and approve fees on a regular basis, will help to address the GAO's concerns. In implementing this disclosure requirement, we remind funds that "boilerplate" disclosure is not appropriate. Funds are required to provide appropriate detail regarding the board's basis for approving an existing investment advisory contract, including the particular factors forming the basis of this determination.

Separate Disclosure

We are adopting, as proposed, the requirement that funds present all disclosure for independent directors separately from disclosure for interested directors in the SAI, proxy statements for the election of directors, and annual reports to shareholders. While several commenters argued that this requirement would confuse shareholders by overemphasizing the differences between independent and interested directors, we believe that the new disclosure format will assist shareholders in understanding information about directors, particularly in evaluating whether the independent directors can, in fact, act as an independent, vigorous, and effective force in overseeing fund operations.[355]

[355] *We reiterate that funds may present information regarding independent and interested directors in a single table or chart, so long as the information for independent and interested directors is provided in separate sections within the table or chart.*

C. New Disclosure about Board Leadership Structure and the Board's Role in Risk Oversight

3. Final Rule

After consideration of the comments, we are adopting the proposals substantially as proposed with a few technical revisions in response to comments. We believe that, in making voting and investment decisions, investors should be provided with meaningful information about the corporate governance practices of companies.[356] As we noted in the Proposing Release, one important aspect of a company's corporate governance practices is its board's leadership structure. Disclosure of a company's board leadership structure and the reasons the company believes that its board leadership structure is appropriate will increase the transparency for investors as to how the board functions.

As stated above, the amendments were designed to provide shareholders with disclosure of, and the reasons for, the leadership structure of a company's board concerning the principal executive officer, the board chairman position and, where applicable, the lead independent director position. We agree with commenters that the phrase "board leadership structure" instead of "company leadership structure" would avoid potential misunderstanding that the amendments require a discussion of the structure of a company's management leadership.[357] We also agree with commenters that the phrase "risk oversight" instead of "risk management" would be more appropriate in describing the board's responsibilities in this area.[358]

Under the amendments, a company is required to disclose whether and why it has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company at the time of the filing. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. In these circumstances, the amendments will require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. As we previously stated in the Proposing Release, these amendments are intended to provide investors with more transparency about the company's corporate governance, but are not intended to influence a company's decision regarding its board leadership structure.

The final rules also require companies to describe the board's role in the oversight of risk. We were persuaded by commenters who noted that risk oversight is a key competence of the

[356] *See, e.g., National Association of Corporate Directors, Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies, (Mar. 2009) ("Every board should explain, in proxy materials and other communications with shareholders, why the governance structures and practices it has developed are best suited to the company.").*

[357] *See letter from Honeywell.*

[358] *See, e.g., letters from Ameriprise Financial and Protective Life Corporation.*

board, and that additional disclosures would improve investor and shareholder understanding of the role of the board in the organization's risk management practices.[359] Companies face a variety of risks, including credit risk, liquidity risk, and operational risk. As we noted in the Proposing Release, similar to disclosure about the leadership structure of a board, disclosure about the board's involvement in the oversight of the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company. This disclosure requirement gives companies the flexibility to describe how the board administers its risk oversight function, such as through the whole board, or through a separate risk committee or the audit committee, for example. Where relevant, companies may want to address whether the individuals who supervise the day-to-day risk management responsibilities report directly to the board as a whole or to a board committee or how the board or committee otherwise receives information from such individuals.

The final rules also require funds to provide disclosure about the board's role in risk oversight. Funds face a number of risks, including investment risk, compliance, and valuation; and we agree with commenters who favored disclosure of board risk oversight by funds.[360] As with corporate issuers, we believe that additional disclosures would improve investor understanding of the role of the board in the fund's risk management practices. Furthermore, the disclosure should provide important information to investors about how a fund perceives the role of its board and the relationship between the board and its advisor in managing material risks facing the fund.

Item 18. Control Persons and Principal Holders of Securities

Provide the following information as of a specified date no more than 30 days prior to the date of filing the registration statement or an amendment.

(a) Control Persons. State the name and address of each person who controls the Fund and explain the effect of that control on the voting rights of other security holders. For each control person, state the percentage of the Fund's voting securities owned or any other basis of control. If the control person is a company, give the jurisdiction under the laws of which it is organized. List all parents of the control person.

Instruction. For purposes of this paragraph, "control" means (i) the beneficial ownership, either directly or through one or more controlled companies, of more than 25% of the voting securities of a company; (ii) the acknowledgment or assertion by either the controlled or controlling party of the existence of control; or (iii) an adjudication under section 2(a)(9), which has become final, that control exists.

(b) Principal Holders. State the name, address, and percentage of ownership of each person who owns of record or is known by the Fund to own beneficially 5% or more of any Class of the Fund's outstanding equity securities.

[359] *See, e.g., letters from Norges Bank and RIMS.*
[360] *See letters from Calvert and MFDF.*

Instructions.

1. Calculate the percentages based on the amount of securities outstanding.

2. If securities are being registered under or in connection with a plan of acquisition, reorganization, readjustment or succession, indicate, as far as practicable, the ownership that would result from consummation of the plan based on present holdings and commitments.

3. Indicate whether the securities are owned of record, beneficially, or both. Show the respective percentage owned in each manner.

(c) Management Ownership. State the percentage of the Fund's equity securities owned by all officers, directors, and members of any advisory board of the Fund as a group. If the amount owned by directors and officers as a group is less than 1% of the Class, provide a statement to that effect.

Item 19. Investment Advisory and Other Services

(a) Investment Advisers. Disclose the following information with respect to each investment adviser:

(1) The name of any person who controls the adviser, the basis of the person's control, and the general nature of the person's business. Also disclose, if material, the business history of any organization that controls the adviser.

(2) The name of any affiliated person of the Fund who also is an affiliated person of the adviser, and a list of all capacities in which the person is affiliated with the Fund and with the adviser.

Instruction. If an affiliated person of the Fund alone or together with others controls the adviser, state that fact. It is not necessary to provide the amount or percentage of the outstanding voting securities owned by the controlling person.

(3) The method of calculating the advisory fee payable by the Fund including:

(i) The total dollar amounts that the Fund paid to the adviser (aggregated with amounts paid to affiliated advisers, if any), and any advisers who are not affiliated persons of the adviser, under the investment advisory contract for the last three fiscal years;

(ii) If applicable, any credits that reduced the advisory fee for any of the last three fiscal years; and

(iii) Any expense limitation provision.

Instructions.

1. If the advisory fee payable by the Fund varies depending on the Fund's investment performance in relation to a standard, describe the standard along with a fee schedule in tabular form. The Fund may include examples showing the fees that the adviser would earn at various levels of

performance as long as the examples include calculations showing the maximum and minimum fee percentages that could be earned under the contract.

2. State separately each type of credit or offset.

3. When a Fund is subject to more than one expense limitation provision, describe only the most restrictive provision.

4. For a Registrant with more than one Series, or a Multiple Class Fund, describe the methods of allocation and payment of advisory fees for each Series or Class.

(b) Principal Underwriter. State the name and principal business address of any principal underwriter for the Fund. Disclose, if applicable, that an affiliated person of the Fund is an affiliated person of the principal underwriter and identify the affiliated person.

(c) Services Provided by Each Investment Adviser and Fund Expenses Paid by Third Parties.

(1) Describe all services performed for or on behalf of the Fund supplied or paid for wholly or in substantial part by each investment adviser.

(2) Describe all fees, expenses, and costs of the Fund that are to be paid by persons other than an investment adviser or the Fund, and identify those persons.

(d) Service Agreements. Summarize the substantive provisions of any other management-related service contract that may be of interest to a purchaser of the Fund's shares, under which services are provided to the Fund, indicating the parties to the contract, and the total dollars paid and by whom for the past three years.

Instructions.

1. The term "management-related service contract" includes any contract with the Fund to keep, prepare, or file accounts, books, records, or other documents required under federal or state law, or to provide any similar services with respect to the daily administration of the Fund, but does not include the following:

(a) Any contract with the Fund to provide investment advice;

(b) Any agreement with the Fund to perform as custodian, transfer agent, or dividend-paying agent for the Fund; and

(c) Any contract with the Fund for outside legal or auditing services, or contract for personal employment entered into with the Fund in the ordinary course of business.

2. No information need be given in response to this paragraph with respect to the service of mailing proxies or periodic reports to the Fund's shareholders.

3. In summarizing the substantive provisions of any management-related service contract, include the following:

(a) The name of the person providing the service;

(b) The direct or indirect relationships, if any, of the person with the Fund, an investment adviser of the Fund or the Fund's principal underwriter; and

(c) The nature of the services provided, and the basis of the compensation paid for the services for the last three fiscal years.

(e) Other Investment Advice. If any person (other than a director, officer, member of an advisory board, employee, or investment adviser of the Fund), through any understanding, whether formal or informal, regularly advises the Fund or the Fund's investment adviser with respect to the Fund's investing in, purchasing, or selling securities or other property, or has the authority to determine what securities or other property should be purchased or sold by the Fund, and receives direct or indirect remuneration, provide the following information:

(1) The person's name;

(2) A description of the nature of the arrangement, and the advice or information provided; and

(3) Any remuneration (including, for example, participation, directly or indirectly, in commissions or other compensation paid in connection with transactions in the Fund's portfolio securities) paid for the advice or information, and a statement as to how the remuneration was paid and by whom it was paid for the last three fiscal years.

Instruction. Do not include information for the following:

1. Persons who advised the investment adviser or the Fund solely through uniform publications distributed to subscribers;

2. Persons who provided the investment adviser or the Fund with only statistical and other factual information, advice about economic factors and trends, or advice as to occasional transactions in specific securities, but without generally advising about the purchase or sale of securities by the Fund;

3. A company that is excluded from the definition of "investment adviser" of an investment company under section 2(a)(20)(iii) [15 U.S.C 80a-2(a)(20)(iii)];

4. Any person the character and amount of whose compensation for these services must be approved by a court; or

5. Other persons as the Commission has by rule or order determined not to be an "investment adviser" of an investment company.

(f) Dealer Reallowances. Disclose any front-end sales load reallowed to dealers as a percentage of the offering price of the Fund's shares.

(g) Rule 12b-1 Plans. If the Fund has adopted a plan under rule 12b-1, describe the material aspects of the plan, and any agreements relating to the implementation of the plan, including:

(1) A list of the principal types of activities for which payments are or will be made, including the dollar amount and the manner in which amounts paid by the Fund under the plan during the last fiscal year were spent on:

(i) Advertising;

(ii) Printing and mailing of prospectuses to other than current shareholders;

(iii) Compensation to underwriters;

(iv) Compensation to broker-dealers;

(v) Compensation to sales personnel;

(vi) Interest, carrying, or other financing charges; and

(vii) Other (specify).

(2) The relationship between amounts paid to the distributor and the expenses that it incurs (*e.g.*, whether the plan reimburses the distributor only for expenses incurred or compensates the distributor regardless of its expenses).

(3) The amount of any unreimbursed expenses incurred under the plan in a previous year and carried over to future years, in dollars and as a percentage of the Fund's net assets on the last day of the previous year.

(4) Whether the Fund participates in any joint distribution activities with another Series or investment company. If so, disclose, if applicable, that fees paid under the Fund's rule 12b-1 plan may be used to finance the distribution of the shares of another Series or investment company, and state the method of allocating distribution costs (*e.g.*, relative net asset size, number of shareholder accounts).

(5) Whether any of the following persons had a direct or indirect financial interest in the operation of the plan or related agreements:

(i) Any interested person of the Fund; or

(ii) Any director of the Fund who is not an interested person of the Fund.

(6) The anticipated benefits to the Fund that may result from the plan.

(h) Other Service Providers.

(1) Unless disclosed in response to paragraph (d), identify any person who provides significant administrative or business affairs management services for the Fund (*e.g.*, an "administrator"), describe the services provided, and the compensation paid for the services.

(2) State the name and principal business address of the Fund's transfer agent and the dividend-paying agent.

(3) State the name and principal business address of the Fund's custodian and independent public accountant and describe generally the services performed by each. If the Fund's portfolio securities are held by a person other than a commercial bank, trust company, or depository registered with the Commission as custodian, state the nature of the business of that person or persons.

(4) If an affiliated person of the Fund, or an affiliated person of the affiliated person, acts as custodian, transfer agent, or dividend-paying agent for the Fund, describe the services that the person performs and the basis for remuneration.

[amendment effective January 17, 2017 with a compliance date of August 1, 2017]

(i) Securities Lending.

(1) Provide the following dollar amounts of income and fees/compensation related to the securities lending activities of each Series during its most recent fiscal year:

(i) Gross income from securities lending activities, including income from cash collateral reinvestment;

(ii) All fees and/or compensation for each of the following securities lending activities and related services: any share of revenue generated by the securities lending program paid to the securities lending agent(s) ("revenue split"); fees paid for cash collateral management services (including fees deducted from a pooled cash collateral reinvestment vehicle) that are not included in the revenue split; administrative fees that are not included in the revenue split; fees for indemnification that are not included in the revenue split; rebates paid to borrowers; and any other fees relating to the securities lending program that are not included in the revenue split, including a description of those other fees;

(iii) The aggregate fees/compensation disclosed pursuant to paragraph (ii); and

(iv) Net income from securities lending activities (i.e., the dollar amount in paragraph (i) minus the dollar amount in paragraph (iii)).

Instruction. If a fee for a service is included in the revenue split, state that the fee is "included in the revenue split."

(2) Describe the services provided to the Series by the securities lending agent in the Series' most recent fiscal year.

Item 20. Portfolio Managers

(a) *Other Accounts Managed.* If a Portfolio Manager required to be identified in response to Item 5(b) is primarily responsible for the day-to-day management of the portfolio of any other account, provide the following information:

(1) The Portfolio Manager's name;

(2) The number of other accounts managed within each of the following categories and the total assets in the accounts managed within each category:

(A) Registered investment companies;

(B) Other pooled investment vehicles; and

(C) Other accounts.

(3) For each of the categories in paragraph (a)(2) of this Item, the number of accounts and the total assets in the accounts with respect to which the advisory fee is based on the performance of the account; and

(4) A description of any material conflicts of interest that may arise in connection with the Portfolio Manager's management of the Fund's investments, on the one hand, and the investments of the other accounts included in response to paragraph (a)(2) of this Item, on the other. This description would include, for example, material conflicts between the investment strategy of the Fund and the investment strategy of other accounts managed by the Portfolio Manager and material conflicts in allocation of investment opportunities between the Fund and other accounts managed by the Portfolio Manager.

Instructions.

1. Provide the information required by this paragraph as of the end of the Fund's most recently completed fiscal year, except that, in the case of an initial registration statement or an update to the Fund's registration statement that discloses a new Portfolio Manager, information with respect to any newly identified Portfolio Manager must be provided as of the most recent practicable date. Disclose the date as of which the information is provided.

2. If a committee, team, or other group of persons that includes the Portfolio Manager is jointly and primarily responsible for the day-to-day management of the portfolio of an account, include the account in responding to paragraph (a) of this Item.

(b) *Compensation.* Describe the structure of, and the method used to determine, the compensation of each Portfolio Manager required to be identified in response to Item 5(b). For each type of compensation (e.g., salary, bonus, deferred compensation, retirement plans and arrangements), describe with specificity the criteria on which that type of compensation is based, for example, whether compensation is fixed, whether (and, if so, how) compensation is based on Fund pre- or after-tax performance over a certain time period, and whether (and, if so, how) compensation is based on the value of assets held in the Fund's portfolio. For example, if compensation is based solely or in part on performance, identify any benchmark used to measure performance and state the length of the period over which performance is measured.

Instructions.

1. Provide the information required by this paragraph as of the end of the Fund's most recently completed fiscal year, except that, in the case of an initial registration statement or an update to the Fund's registration statement that discloses a new Portfolio Manager, information with re-

spect to any newly identified Portfolio Manager must be provided as of the most recent practicable date. Disclose the date as of which the information is provided.

2. Compensation includes, without limitation, salary, bonus, deferred compensation, and pension and retirement plans and arrangements, whether the compensation is cash or non-cash. Group life, health, hospitalization, medical reimbursement, relocation, and pension and retirement plans and arrangements may be omitted, provided that they do not discriminate in scope, terms, or operation in favor of the Portfolio Manager or a group of employees that includes the Portfolio Manager and are available generally to all salaried employees. The value of compensation is not required to be disclosed under this Item.

3. Include a description of the structure of, and the method used to determine, any compensation received by the Portfolio Manager from the Fund, the Fund's investment adviser, or any other source with respect to management of the Fund and any other accounts included in the response to paragraph (a)(2) of this Item. This description must clearly disclose any differences between the method used to determine the Portfolio Manager's compensation with respect to the Fund and other accounts, e.g., if the Portfolio Manager receives part of an advisory fee that is based on performance with respect to some accounts but not the Fund, this must be disclosed.

(c) *Ownership of Securities.* For each Portfolio Manager required to be identified in response to Item 5(b), state the dollar range of equity securities in the Fund beneficially owned by the Portfolio Manager using the following ranges: none, $1-$10,000, $10,001-$50,000, $50,001-$100,000, $100,001-$500,000, $500,001-$1,000,000, or over $1,000,000.

Instructions.

1. Provide the information required by this paragraph as of the end of the Fund's most recently completed fiscal year, except that, in the case of an initial registration statement or an update to the Fund's registration statement that discloses a new Portfolio Manager, information with respect to any newly identified Portfolio Manager must be provided as of the most recent practicable date. Specify the valuation date.

2. Determine "beneficial ownership" in accordance with rule 16a-1(a)(2) under the Exchange Act (17 CFR 240.16a-1(a)(2)).

DISCLOSURE REGARDING PORTFOLIO MANAGERS OF REGISTERED MANAGEMENT INVESTMENT COMPANIES
[Release Nos. 33-8458; IC-26533; August 23, 2004]

II. DISCUSSION

B. Disclosure Regarding Other Accounts Managed and Potential Conflicts of Interest

We are adopting, with several modifications to address commenters' concerns, amendments that require a fund to provide disclosure in its SAI regarding other accounts for which the fund's portfolio manager is primarily responsible for the day-to-day portfolio management. If a committee, team, or other group that includes the portfolio manager is jointly and primarily responsible for the day-to-day management of an account, the fund is required to include that account in responding to the disclosure requirement. Commenters generally supported this disclosure requirement, which is designed to enable investors to assess the conflicts of interest to which a portfolio manager may be subject as a result of managing the fund and other portfolios, such as other registered investment companies and hedge funds.[361]

This disclosure requirement, as well as the disclosure requirements discussed below regarding compensation structure and ownership of fund securities, applies to any portfolio manager who is required to be identified in the prospectus. If a fund identifies more than five persons as portfolio managers in its prospectus, it need only provide the required disclosure regarding other accounts managed, compensation, and securities ownership for the five persons with the most significant responsibility for the day-to-day management of the fund's portfolio.

As adopted, the amendments require a fund to disclose the number of other accounts managed by a portfolio manager, and the total assets in the accounts, within each of the following categories: registered investment companies; other pooled investment vehicles; and other accounts. For each such category, a fund is also required to disclose the number of accounts and the total assets in the accounts with respect to which the advisory fee is based on account performance. We had proposed an additional category of "other investment companies." A commenter suggested, however, that breaking out "other investment companies" as a separate category would not be helpful in enabling investors to assess a portfolio manager's potential conflicts of interest. We agree and are eliminating "other investment companies" as a separate category. Accounts that would have been included in this category will now be included in "other pooled investment vehicles."

The amendments, as adopted, also require a fund to describe any material conflicts of interest that may arise in connection with the portfolio manager's management of the fund's investments, on the one hand, and the investments of the other accounts, on the other. This description would include, for example, material conflicts between the investment strategy of the fund and the investment strategy of the other accounts managed by the portfolio manager

[361] *The disclosure requirement applies to accounts managed in a personal capacity as well as accounts managed in a professional capacity. Conflicts of interest may also arise in connection with the manager's management of such accounts.*

and material conflicts in allocation of investment opportunities between the fund and such other accounts. We have limited the conflicts disclosure requirement to material conflicts of interest in order to address commenters' concerns that the proposed requirement would encourage funds to provide an over inclusive, boilerplate list of potential conflicts. A conflict would be material if there is a substantial likelihood that disclosure of the conflict would be viewed by a reasonable investor as significantly altering the "total mix" of information available about the fund. In our view, this would include, for example, a conflict that a reasonable investor would consider likely to affect the manager's professional judgment with respect to management of the fund.

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C. Disclosure of Portfolio Manager Compensation Structure

We are adopting, with modifications to address commenters' concerns, a requirement that a fund provide disclosure in its SAI regarding the structure of, and the method used to determine, the compensation of its portfolio managers. Commenters supported this proposal and agreed that it may help investors to better understand a portfolio manager's incentives in managing a fund and shed light on possible conflicts of interest that could arise when a portfolio manager manages other accounts.

The amendments require a description of the structure of, and the method used to determine, the compensation received by a fund's portfolio manager from the fund, its investment adviser, or any other source with respect to management of the fund and any other account included by the fund in response to the disclosure requirement described above regarding other accounts managed by the portfolio manager. This disclosure requirement applies to any portfolio manager who is required to be identified in the prospectus. The amendments do not require disclosure of the value of compensation received by a portfolio manager.

For purposes of the disclosure requirement, compensation includes, without limitation, salary, bonus, deferred compensation, and pension and retirement plans and arrangements, whether the compensation is cash or non-cash. We are modifying the proposal to permit funds to omit disclosure regarding group life, health, hospitalization, medical reimbursement, relocation, and pension and retirement plans and arrangements, provided that they do not discriminate in scope, terms, or operation in favor of the portfolio manager or a group of employees that includes the portfolio manager and are available generally to all salaried employees.[362] We agree with several commenters who suggested that, while a portfolio

[362] *Cf. Item 402(a)(7)(ii) of Regulation S-K (permitting operating companies, in disclosing information about executive officers, to omit information regarding group life, health, hospitalization, medical reimbursement, or relocation plans that do not discriminate in scope, terms, or operation in favor of executive officers or directors of the registrant and that are available generally to all salaried employees).*

manager may often receive certain benefits of this type as part of his or her overall compensation, requiring disclosure about these benefits would be of little or no value to investors in assessing whether the manager's interests are aligned with those of investors.

For each type of compensation (e.g., salary, bonus, deferred compensation, retirement plans and arrangements), a fund is required to describe with specificity the criteria on which that type of compensation is based, for example, whether compensation is fixed, whether (and, if so, how) compensation is based on the fund's pre- or after-tax performance over a certain period, and whether (and, if so, how) compensation is based on the value of assets held in the fund's portfolio. This description is required to clearly disclose any differences between the method used to determine the portfolio manager's compensation with respect to the fund and other accounts, e.g., if the portfolio manager receives part of an advisory fee that is based on performance with respect to some accounts but not the fund, this must be disclosed.

We have modified the proposal in order to elicit better disclosure of the basis on which a portfolio manager is compensated. We have made these changes based on commenters' suggestions that a fund should be required to disclose the specific metrics used to measure performance. We believe that where compensation is based on criteria such as performance, requiring more detailed disclosure about the criteria may provide greater insight into a manager's incentives to manage a fund's portfolio in a certain way. First, we are requiring that the criteria on which each type of compensation is based be described with specificity. Second, we are clarifying that a fund must not only describe whether compensation is based on criteria such as fund pre- or after-tax performance over a certain time period, and the value of assets held in the fund's portfolio, but also how compensation is based on these criteria. For example, if compensation is based solely or in part on performance, a fund is required to identify any benchmark used to measure performance and state the length of the period over which performance is measured.

D. Disclosure of Securities Ownership of Portfolio Managers

We are adopting a requirement that a fund disclose in its SAI the securities ownership in the fund of each portfolio manager who is required to be identified in the fund's prospectus. This disclosure is intended to help investors assess the extent to which the portfolio manager's interests are aligned with theirs.

Commenters generally supported the goal of this proposal. Several commenters argued, however, that while the level of a portfolio manager's securities ownership may be an indicator of the manager's confidence in the fund's investment strategy where the manager owns shares in the fund, it does not necessarily follow that a manager who owns few or no securities has any less confidence or is any less concerned about the fund's performance. We continue to believe, however, that a portfolio manager's ownership in a fund provides a direct indication of his or her alignment with the interests of shareholders in that fund. While a manager could have reasons for not holding shares of a specific fund that are unrelated to the manager's lack of confidence in the fund, e.g., that its investment objectives do not match the manager's, we note that a fund is free to include an explanation of these reasons in its disclosure.

We have modified our proposed disclosure requirement with respect to securities ownership significantly, to address concerns raised by commenters. In particular, we have limited the requirement to a portfolio manager's ownership of equity securities in the fund itself.[363] As a result, we are also eliminating the proposed requirements to include the name of the investment company or account in which the manager owns shares and the title of the class of securities owned, as well as the mandatory tabular format. Our proposed amendments would have required a fund to disclose a portfolio manager's ownership not only of the securities of the fund, but also of the securities of other accounts managed by the fund's investment adviser or the portfolio manager. This disclosure requirement was intended, in part, to assist fund investors in assessing potential conflicts between their interests and the interests of other clients or investment vehicles in which the manager has an interest. We were persuaded by commenters who argued that expanding the disclosure requirement to include securities ownership in other accounts would result in overly detailed, complex disclosure that would not help investors assess the extent to which a portfolio manager's interests are aligned with theirs. In addition, commenters noted that the objective of providing investors with information about conflicts of interest is more effectively addressed by the amendments we are adopting that require disclosure of conflicts and the compensation structure of portfolio managers. The commenters also argued that the disclosure would be time-consuming and burdensome to prepare, particularly in the case of funds with one or more subadvisers.

The disclosure requirement we are adopting applies to fund securities beneficially owned by a portfolio manager. For purposes of the requirement to disclose a portfolio manager's beneficial ownership of fund securities, "beneficial ownership" will be determined in accordance with rule 16a-1(a)(2) under the Exchange Act. Our proposal would have required disclosure of securities owned either beneficially or of record, and would have deemed a person to be a "beneficial owner" of a security if he or she is a "beneficial owner" under either rule 13d-3 under the Exchange Act, which focuses on a person's voting and investment power, or rule 16a-1(a)(2) under the Exchange Act, which focuses on a person's economic interests in a security. We had proposed to require disclosure of record ownership, and a broader definition of beneficial ownership, in order to help investors assess potential conflicts of interest. However, in light of our current objective of providing information about the alignment of managers' and shareholders' economic interests, we believe that disclosure of record holdings should not be required and that the focus of "beneficial ownership" should be on whether a manager's economic interests are tied to the securities, rather than his or her ability to exert voting power or to dispose of the securities. This definition is also consistent with the requirements for disclosure of fund securities ownership by fund directors.

[363] *A mutual fund that issues two or more series of preferred or special stock each of which is preferred over all other series in respect of assets specifically allocated to that series is required to disclose a portfolio manager's securities ownership in each series in the statement of additional information for that series.*

…Under the definition of beneficial ownership in rule 16a-1(a)(2) under the Exchange Act that we are adopting, a person is presumed to be a beneficial owner of securities that are held by the person's immediate family members sharing the same household.[364]

We are adopting, as proposed, a requirement that funds disclose portfolio managers' ownership of securities in the fund using the following dollar ranges: none, $1-$10,000, $10,001-$50,000, $50,001-$100,000, $100,001-$500,000, $500,001-$1,000,000, or over $1,000,000. Commenters' views on this proposed approach varied. Several commenters argued that the maximum dollar range of securities owned should be lowered from "over $1,000,000" to "over $100,000," which would be consistent with the requirement for fund directors. These commenters expressed concern that the proposed dollar ranges would require portfolio managers to provide too much information about their net worth and would unduly infringe on their privacy interests. Another commenter, by contrast, argued that any maximum dollar range chosen should accurately reflect the likely value of shares owned by a representative cross section of managers in the mutual fund industry. This commenter suggested that if a lower maximum range of $100,000 were used, an overwhelming majority of managers would likely exceed that threshold. Finally, other commenters suggested that we require disclosure of the precise number of shares of the fund owned by a portfolio manager.

We continue to believe, on balance, that requiring disclosure of securities owned using a maximum dollar range of "over $1,000,000" is appropriate. Disclosure of the dollar range of securities owned by a portfolio manager, rather than precise dollar holdings, is intended to provide shareholders with significant information to use in evaluating whether a manager's interests are aligned with their own, while protecting managers' legitimate privacy interests. The maximum range of "over $1,000,000" is intended to reflect a level of investment that would be significant. At the same time, we are not persuaded that requiring disclosure of the precise dollar holdings of securities owned is necessary.

Item 21. Brokerage Allocation and Other Practices

(a) Brokerage Transactions. Describe how transactions in portfolio securities are effected, including a general statement about brokerage commissions, markups, and markdowns on principal transactions and the aggregate amount of any brokerage commissions paid by the Fund during its three most recent fiscal years. If, during either of the two years preceding the Fund's most recent fiscal year, the aggregate dollar amount of brokerage commissions paid by the Fund differed materially from the amount paid during the most recent fiscal year, state the reason(s) for the difference(s).

[364] *See Rule 16a-1(a)(2)(ii)(A) under the Exchange Act (indirect pecuniary interest in securities includes securities held by any member of a person's immediate family sharing the same household). "Immediate family" is defined for purposes of rule 16a-1 as any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, and includes adoptive relationships. Rule 16a-1(e) under the Exchange Act.*

(b) Commissions.

(1) Identify, disclose the relationship, and state the aggregate dollar amount of brokerage commissions paid by the Fund during its three most recent fiscal years to any broker:

(i) That is an affiliated person of the Fund or an affiliated person of that person; or

(ii) An affiliated person of which is an affiliated person of the Fund, its investment adviser, or principal underwriter.

(2) For each broker identified in response to paragraph (b)(1), state:

(i) The percentage of the Fund's aggregate brokerage commissions paid to the broker during the most recent fiscal year; and

(ii) The percentage of the Fund's aggregate dollar amount of transactions involving the payment of commissions effected through the broker during the most recent fiscal year.

(3) State the reasons for any material difference in the percentage of brokerage commissions paid to, and the percentage of transactions effected through, a broker disclosed in response to paragraph (b)(1).

(c) Brokerage Selection. Describe how the Fund will select brokers to effect securities transactions for the Fund and how the Fund will evaluate the overall reasonableness of brokerage commissions paid, including the factors that the Fund will consider in making these determinations.

Instructions.

1. If the Fund will consider the receipt of products or services other than brokerage or research services in selecting brokers, specify those products and services.

2. If the Fund will consider the receipt of research services in selecting brokers, identify the nature of those research services.

3. State whether persons acting on the Fund's behalf are authorized to pay a broker a higher brokerage commission than another broker might have charged for the same transaction in recognition of the value of (a) brokerage or (b) research services provided by the broker.

4. If applicable, explain that research services provided by brokers through which the Fund effects securities transactions may be used by the Fund's investment adviser in servicing all of its accounts and that not all of these services may be used by the adviser in connection with the Fund. If other policies or practices are applicable to the Fund with respect to the allocation of research services provided by brokers, explain those policies and practices.

(d) Directed Brokerage. If, during the last fiscal year, the Fund or its investment adviser, through an agreement or understanding with a broker, or otherwise through an internal allocation procedure, directed the Fund's brokerage transactions to a broker because of research services provided, state the amount of the transactions and related commissions.

(e) Regular Broker-Dealers. If the Fund has acquired during its most recent fiscal year or during the period of time since organization, whichever is shorter, securities of its regular brokers or dealers as defined in rule 10b-1 [17 CFR 270.10b-1] or of their parents, identify those brokers or dealers and state the value of the Fund's aggregate holdings of the securities of each issuer as of the close of the Fund's most recent fiscal year.

Instruction. The Fund need only disclose information about an issuer that derived more than 15% of its gross revenues from the business of a broker, a dealer, an underwriter, or an investment adviser during its most recent fiscal year.

Item 22. Capital Stock and Other Securities

(a) Capital Stock. For each Class of capital stock of the Fund, provide:

(1) The title of each Class; and

(2) A full discussion of the following provisions or characteristics of each Class, if applicable:

(i) Restrictions on the right freely to retain or dispose of the Fund's shares;

(ii) Material obligations or potential liabilities associated with owning the Fund's shares (not including investment risks);

(iii) Dividend rights;

(iv) Voting rights (including whether the rights of shareholders can be modified by other than a majority vote);

(v) Liquidation rights;

(vi) Preemptive rights;

(vii) Conversion rights;

(viii) Redemption provisions;

(ix) Sinking fund provisions; and

(x) Liability to further calls or to assessment by the Fund.

Instructions.

1. If any class described in response to this paragraph possesses cumulative voting rights, disclose the existence of those rights and explain the operation of cumulative voting.

2. If the rights evidenced by any Class described in response to this paragraph are materially limited or qualified by the rights of any other Class, explain those limitations or qualifications.

(b) Other Securities. Describe the rights of any authorized securities of the Fund other than capital stock. If the securities are subscription warrants or rights, state the title and amount of securities called for, and the period during which and the prices at which the warrants or rights are exercisable.

Item 23. Purchase, Redemption, and Pricing of Shares

(a) Purchase of Shares. To the extent that the prospectus does not do so, describe how the Fund's shares are offered to the public. Include any special purchase plans or methods not described in the prospectus or elsewhere in the SAI, including letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, redemption reinvestment plans, and waivers for particular classes of shareholders.

(b) *Fund Reorganizations.* Disclose any arrangements that result in breakpoints in, or elimination of, sales loads in connection with the terms of a merger, acquisition, or exchange offer made under a plan of reorganization. Identify each class of individuals to which the arrangements apply and state each different sales load available as a percentage of both the offering price and the net amount invested.

(c) *Offering Price.* Describe the method followed or to be followed by the Fund in determining the total offering price at which its shares may be offered to the public and the method(s) used to value the Fund's assets.

Instructions.

1. Describe the valuation procedure(s) that the Fund uses in determining the net asset value and public offering price of its shares.

2. Explain how the excess of the offering price over the net amount invested is distributed among the Fund's principal underwriters or others and the basis for determining the total offering price.

3. Explain the reasons for any difference in the price at which securities are offered generally to the public, and the prices at which securities are offered for any class of transactions or to any class of individuals.

4. Unless provided as a continuation of the balance sheet in response to Item 27, include a specimen price-make-up sheet showing how the Fund calculates the total offering price per unit. Base the calculation on the value of the Fund's portfolio securities and other assets and its outstanding securities as of the date of the balance sheet filed by the Fund.

(d) *Redemption in Kind.* If the Fund has received an order of exemption from section 18(f) or has filed a notice of election under rule 18f-1 that has not been withdrawn, describe the nature, extent, and effect of the exemptive relief or notice.

(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 23(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.

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SEC Q&A Letter on New Form N-1A (October 2, 1998)

Purchase and Sale Information

7) Q: The Form N-lA Adopting Release states that "as long as the purchase and sale information in a fund's prospectus is not reduced below the minimum [disclosure] required by Form N-1A, the fund would be able to create and use a separate purchase and sale disclosure document as supplemental sales literature. "What is the minimum disclosure required in the prospectus?

A: The minimum disclosure required in a prospectus depends upon the facts and circumstances specific to a particular fund. The following types of disclosures, however, are examples of those that would not be required to appear in the prospectus: (1) a description of every possible way to purchase or redeem fund shares; (2) a description of every restriction or process related to purchasing or redeeming fund shares (*e.g.*, requirements that checks be drawn in U.S. dollars, and disclosure about share certificates); and (3) detailed information about various types of accounts, such as different types of tax-deferred accounts. Among the information that would be required is disclosure of any material restrictions that a fund imposes on the right of redemption and disclosure of minimum investment requirements.

8) Q: Item 18(a) of Form N-lA provides that a fund may incorporate purchase and redemption information required by Item 18(a) into its Statement of Additional Information ("SAI") by reference to a separate disclosure document that may be provided to investors with the SAI or separately. If a fund elects to provide purchase and redemption information in a separate disclosure document that it incorporates by reference into the SAI, can the SAI, in turn, be incorporated by reference into the fund's prospectus without violating the Commission's rule that restricts double incorporation by reference? Are the delivery requirements for this separate document the same as for the complete SAI?

A: Rule 10(d) generally prohibits double incorporation by reference—an incorporation by reference that is twice removed from the primary document. Funds that choose to incorporate the SAI into the prospectus should include, rather than incorporate, the information

required by Item 18(a) in a separate section of the SAI and provide that section individually and apart from the SAI to investors who request additional purchase and redemption information. Since the purchase and redemption information would be a separable section of the SAI and not a separate document, the fund would avoid double incorporation by reference when the SAI is incorporated by reference into the prospectus.

Item 1 of Form N-lA requires a fund that receives a request for the SAI or the shareholder report to send the requested document within 3 business days of receipt of the request. The same delivery requirement would apply to a request for a separate section of the SAI containing additional information on purchase and redemption procedures. We note that a fund that chooses to use these SAI disclosure options must provide a complete SAI to investors who request the SAI and do not limit their request to information on purchase and redemption procedures.

Three-Day Mailing Requirement

10) Q: Must a fund ensure that a third-party intermediary selling its shares complies with the requirement to send the SAI, annual or semi-annual report (and, in the case of the profile, the prospectus) to an investor within 3 business days of receipt of a request?

A: Yes, if the third-party intermediary is named in the prospectus (or profile) or otherwise acts as an agent of the fund. In the Form N-lA Adopting Release and the release adopting the profile rule ("Profile Adopting Release"),[433] the Commission stated that funds are required to mail SAIs and prospectuses to investors within 3 days of a request because prompt delivery of those documents to investors is essential to the disclosure formats contemplated by Form N-lA and the profile. Recognizing that many funds are distributed through financial intermediaries and that investors may look to those intermediaries to provide information, the Commission allowed a fund to indicate in its prospectus or profile that an investor may obtain an SAI or shareholder report (or, in the case of the profile, the prospectus) from a financial intermediary. When a financial intermediary is named in the prospectus (or profile) as a party to contact in order to obtain information or when a financial intermediary otherwise acts as an agent for a fund, the fund remains obligated to ensure that the information is sent to investors within 3 business days of receipt of a request. In those cases, the fund can contract with intermediaries to ensure their compliance with the 3-day mailing requirement.

A fund, however, is not responsible for ensuring that a third-party intermediary complies with the 3-day mailing requirement if: (1) the third-party intermediary is not an agent of the fund; (2) the prospectus or profile provides the fund's toll-free (or collect) telephone number for investors to call to obtain a copy of the specified documents from the fund; (3) the prospectus or profile does not mention that intermediary as a source for obtaining these documents and does not generally instruct investors to contact an intermediary to obtain documents; and (4) an investor directly contacts the third-party intermediary to request one or more of these documents.

1994 Comment III.B—Disclaimers of Liability for Losses Resulting from Unauthorized Telephone Transactions

In the 1992 generic comment letter, the Division of Investment Management advised investment company registrants that the Divisions of Market Regulation and Investment Management were reviewing the practice of some investment companies to disclaim liability for following instructions for telephone exchange or redemption transactions that prove to be fraudulent.

In a recent letter to the Investment Company Institute, the Division stated its position that it is misleading for a fund to attempt to disclaim all liability for losses resulting from unauthorized or fraudulent telephone transactions regardless of the precautions the fund takes to avoid such losses. See Letter to Matthew P. Fink, President, Investment Company Institute from Max Berueffy, Senior Special Counsel, Division of Investment Management (April 19, 1993) [See Letter in Appendix II]. In our view, such disclaimers do not accurately state the obligation of a fund, or its servicing or transfer agents, to exercise due care to determine that instructions communicated by telephone are genuine and thus avoid fraudulent transfers.

The letter stated that a fund permitting investments to engage in transactions by telephone may advise investors that it will not be liable for following instructions communicated by telephone that it reasonably believes to be genuine. The letter also states that, whether or not it includes such a statement, a fund should include the following information in its prospectus or in any other document describing transactions initiated by telephone:

1. A statement whether the privilege to initiate transactions by telephone will be made available to shareholders automatically or whether the shareholder must first elect the privilege.

2. A statement to the effect that the fund will employ reasonable procedures to confirm that instructions communicated by telephone are genuine, and that if it does not, it may be liable for any losses due to unauthorized or fraudulent instructions.

3. A description of the procedures the fund follows for transactions initiated by telephone.

Certain questions have arisen regarding this position. First, the letter indicates that a fund may state that it "will not be liable for following instructions communicated by telephone that it reasonably believes to be genuine" if the fund includes the three other statements specified in the letter. One of these statements is that the fund may be liable for any losses due to unauthorized or fraudulent instructions if it fails to follow reasonable procedures. A fund need not include both the negative statement (when the fund will not be liable) as well as the positive (when the fund will be liable). One or the other is sufficient.

Second, some funds have expressed concern that describing the procedures they use to confirm the identity of shareholders over the telephone will make it easier for impostors to defeat those procedures. Therefore, funds may describe, in the Statement of Additional Information, the general types of procedures (*e.g.*, a password or other form of personal identification) they will employ, rather than the specific requirements (*e.g.*, the shareholder's social security number).

Item 24. Taxation of the Fund

(a) If applicable, state that the Fund is qualified or intends to qualify under Subchapter M of the Internal Revenue Code. Disclose the consequences to the Fund if it does not qualify under Subchapter M.

(b) Disclose any special or unusual tax aspects of the Fund, such as taxation resulting from foreign investment or from status as a personal holding company, or any tax loss carry-forward to which the Fund may be entitled.

Item 25. Underwriters

(a) Distribution of Securities. For each principal underwriter distributing securities of the Fund, state:

(1) The nature of the obligation to distribute the Fund's securities;

(2) Whether the offering is continuous; and

(3) The aggregate dollar amount of underwriting commissions and the amount retained by the principal underwriter for each of the Fund's last three fiscal years.

(b) Compensation. Provide the information required by the following table with respect to all commissions and other compensation received by each principal underwriter, who is an affiliated person of the Fund or an affiliated person of that affiliated person, directly or indirectly, from the Fund during the Fund's most recent fiscal year:

(1)	(2)	(3)	(4)	(5)
Name of Principal Underwriter	Net Underwriting Discounts and Commissions	Compensation on Redemptions and Repurchases	Brokerage Commissions	Other Compensation

Instruction. Disclose in a footnote to the table the type of services rendered in consideration for the compensation listed under column (5).

(c) Other Payments. With respect to any payments made by the Fund to an underwriter or dealer in the Fund's shares during the Fund's last fiscal year, disclose the name and address of the underwriter or dealer, the amount paid and basis for determining that amount, the circumstances surrounding the payments, and the consideration received by the Fund. Do not include information about:

(1) Payments made through deduction from the offering price at the time of sale of securities issued by the Fund;

(2) Payments representing the purchase price of portfolio securities acquired by the Fund;

(3) Commissions on any purchase or sale of portfolio securities by the Fund; or

(4) Payments for investment advisory services under an investment advisory contract.

Instructions.

1. Do not include in response to this paragraph information provided in response to paragraph (b) or with respect to service fees under the Instruction to Item 12(b)(2). Do not include any payment for a service excluded by Instructions 1 and 2 to Item 19(d) or by Instruction 2 to Item 34.

2. If the payments were made under an arrangement or policy applicable to dealers generally, describe only the arrangement or policy.

Item 26. Calculation of Performance Data

(a) *Money Market Funds.* Yield quotation(s) for a Money Market Fund included in the prospectus should be calculated according to paragraphs (a)(1)—(4).

(1) *Yield Quotation.* Based on the 7 days ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's yield by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one share at the beginning of the period, subtracting a hypothetical charge reflecting deductions from shareholder accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then multiplying the base period return by (365/7) with the resulting yield figure carried to at least the nearest hundredth of one percent.

(2) *Effective Yield Quotation.* Based on the 7 days ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's effective yield, carried to at least the nearest hundredth of one percent, by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one share at the beginning of the period, subtracting a hypothetical charge reflecting deductions from shareholder accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then compounding the base period return by adding 1, raising the sum to a power equal to 365 divided by 7, and subtracting 1 from the result, according to the following formula:

$$\text{EFFECTIVE YIELD} = [(\text{BASE PERIOD RETURN} + 1)^{365/7}] - 1.$$

(3) *Tax Equivalent Current Yield Quotation.* Calculate the Fund's tax equivalent current yield by dividing that portion of the Fund's yield (as calculated under paragraph (a)(1)) that is tax-exempt by 1 minus a stated income tax rate and adding the quotient to that portion, if any, of the Fund's yield that is not tax-exempt.

(4) *Tax Equivalent Effective Yield Quotation.* Calculate the Fund's tax equivalent effective yield by dividing that portion of the Fund's effective yield (as calculated under paragraph (a)(2)) that is tax-exempt by 1 minus a stated income tax rate and adding the quotient to that portion, if any, of the Fund's effective yield that is not tax-exempt.

Instructions.

1. When calculating yield or effective yield quotations, the calculation of net change in account value must include:

(a) The value of additional shares purchased with dividends from the original share and dividends declared on both the original shares and additional shares; and

(b) All fees, other than non-recurring account or sales charges, that are imposed on all shareholder accounts in proportion to the length of the base period. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size.

2. Exclude realized gains and losses from the sale of securities and unrealized appreciation and depreciation from the calculation of yield and effective yield. Exclude income other than investment income.

3. Disclose the amount or specific rate of any nonrecurring account or sales charges not included in the calculation of the yield.

4. If the Fund holds itself out as distributing income that is exempt from federal, state, or local income taxation, in calculating yield and effective yield (but not tax equivalent yield or tax equivalent effective yield), reduce the yield quoted by the effect of any income taxes on the shareholder receiving dividends, using the maximum rate for individual income taxation. For example, if the Fund holds itself out as distributing income exempt from federal taxation and the income taxes of State A, but invests in some securities of State B, it must reduce its yield by the effect of state income taxes that must be paid by the residents of State A on that portion of the income attributable to the securities of State B.

(b) *Other Funds*. Performance information included in the prospectus should be calculated according to paragraphs (b)(1)—(6).

(1) *Average Annual Total Return Quotation.* For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet included in the registration statement (or for the periods the Fund has been in operation), calculate the Fund's average annual total return by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods (or for the periods of the Fund's operations) that would equate the initial amount invested to the ending redeemable value, according to the following formula:

$$P(1+T)^n = ERV$$

Where:

P = a hypothetical initial payment of $1,000.

T = average annual total return.

n = number of years

ERV = ending redeemable value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion).

Instructions.

1. Assume the maximum sales load (or other charges deducted from payments) is deducted from the initial $1,000 payment.

2. Assume all distributions by the Fund are reinvested at the price stated in the prospectus (including any sales load imposed upon reinvestment of dividends) on the reinvestment dates during the period.

3. Include all recurring fees that are charged to all shareholder accounts. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size. Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

4. Determine the ending redeemable value by assuming a complete redemption at the end of the 1-, 5-, or 10-year periods and the deduction of all nonrecurring charges deducted at the end of each period. If shareholders are assessed a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus.

5. State the average annual total return quotation to the nearest hundredth of one percent.

6. Total return information in the prospectus need only be current to the end of the Fund's most recent fiscal year.

(2) Average Annual Total Return (After Taxes on Distributions) Quotation.

For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet included in the registration statement (or for the periods the Fund has been in operation), calculate the Fund's average annual total return (after taxes on distributions) by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods (or for the periods of the Fund's operations) that would equate the initial amount invested to the ending value, according to the following formula:

$$P(1+T)^n = ATV_D$$

Where:

P = a hypothetical initial payment of $1,000.

T = average annual total return (after taxes on distributions).

n = number of years.

ATV_D = ending value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion), after taxes on fund distributions but not after taxes on redemption.

Instructions.

1. Assume the maximum sales load (or other charges deducted from payments) is deducted from the initial $1,000 payment.

2. Assume all distributions by the Fund, less the taxes due on such distributions, are reinvested at the price stated in the prospectus (including any sales load imposed upon reinvestment of dividends) on the reinvestment dates during the period.

3. Calculate the taxes due on any distributions by the Fund by applying the tax rates specified in Instruction 4 to each component of the distributions on the reinvestment date (e.g., ordinary income, short-term capital gain, long-term capital gain). The taxable amount and tax character of each distribution should be as specified by the Fund on the dividend declaration date, but may be adjusted to reflect subsequent recharacterizations of distributions. Distributions should be adjusted to reflect the federal tax impact the distribution would have on an individual taxpayer on the reinvestment date. For example, assume no taxes are due on the portion of any distribution that would not result in federal income tax on an individual, e.g., tax-exempt interest or non-taxable returns of capital. The effect of applicable tax credits, such as the foreign tax credit, should be taken into account in accordance with federal tax law.

4. Calculate the taxes due using the highest individual marginal federal income tax rates in effect on the reinvestment date. The rates used should correspond to the tax character of each component of the distributions (e.g., ordinary income rate for ordinary income distributions, short-term capital gain rate for short-term capital gain distributions, long-term capital gain rate for long-term capital gain distributions). Note that the required tax rates may vary over the measurement period. Disregard any potential tax liabilities other than federal tax liabilities (e.g., state and local taxes); the effect of phaseouts of certain exemptions, deductions, and credits at various income levels; and the impact of the federal alternative minimum tax.

5. Include all recurring fees that are charged to all shareholder accounts. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size. Assume that no additional taxes or tax credits result from any redemption of shares required to pay such fees. Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

6. Determine the ending value by assuming a complete redemption at the end of the 1-, 5-, or 10-year periods and the deduction of all nonrecurring charges deducted at the end of each period. If shareholders are assessed a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus. Assume that the redemption has no tax consequences.

7. State the average annual total return (after taxes on distributions) quotation to the nearest hundredth of one percent.

(3) Average Annual Total Return (After Taxes on Distributions and Redemption) Quotation.

For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet included in the registration statement (or for the periods the Fund has been in operation), calculate the Fund's average annual total return (after taxes on distributions and redemption) by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods (or for the periods of the Fund's operations) that would equate the initial amount invested to the ending value, according to the following formula:

$P(1 + T)^n = ATV_{DR}$

Where:

P = a hypothetical initial payment of $1,000.

T = average annual total return (after taxes on distributions and redemption).

n = number of years.

ATV_{DR} = ending value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion), after taxes on fund distributions and redemption.

Instructions.

1. Assume the maximum sales load (or other charges deducted from payments) is deducted from the initial $1,000 payment.

2. Assume all distributions by the Fund, less the taxes due on such distributions, are reinvested at the price stated in the prospectus (including any sales load imposed upon reinvestment of dividends) on the reinvestment dates during the period.

3. Calculate the taxes due on any distributions by the Fund by applying the tax rates specified in Instruction 4 to each component of the distributions on the reinvestment date (e.g., ordinary income, short-term capital gain, long-term capital gain). The taxable amount and tax character of each distribution should be as specified by the Fund on the dividend declaration date, but may be adjusted to reflect subsequent recharacterizations of distributions. Distributions should be adjusted to reflect the federal tax impact the distribution would have on an individual taxpayer on the reinvestment date. For example, assume no taxes are due on the portion of any distribution that would not result in federal income tax on an individual, e.g., tax-exempt interest or non-taxable returns of capital. The effect of applicable tax credits, such as the foreign tax credit, should be taken into account in accordance with federal tax law.

4. Calculate the taxes due using the highest individual marginal federal income tax rates in effect on the reinvestment date. The rates used should correspond to the tax character of each component of the distributions (e.g., ordinary income rate for ordinary income distributions, short-term capital gain rate for short-term capital gain distributions, long-term capital gain rate for long-term capital gain distributions). Note that the required tax rates may vary over the measurement period. Disregard any potential tax liabilities other than federal tax liabilities (e.g., state and local taxes); the effect of phaseouts of certain exemptions, deductions, and credits at various income levels; and the impact of the federal alternative minimum tax.

5. Include all recurring fees that are charged to all shareholder accounts. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size. Assume that no additional taxes or tax credits result from any redemption of shares required to pay such fees. Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

6. Determine the ending value by assuming a complete redemption at the end of the 1-, 5-, or 10-year periods and the deduction of all nonrecurring charges deducted at the end of each period. If shareholders are assessed a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus.

7. Determine the ending value by subtracting capital gains taxes resulting from the redemption and adding the tax benefit from capital losses resulting from the redemption.

(a) Calculate the capital gain or loss upon redemption by subtracting the tax basis from the redemption proceeds (after deducting any nonrecurring charges as specified by Instruction 6).

(b) The Fund should separately track the basis of shares acquired through the $1,000 initial investment and each subsequent purchase through reinvested distributions. In determining the basis for a reinvested distribution, include the distribution net of taxes assumed paid from the distribution, but not net of any sales loads imposed upon reinvestment. Tax basis should be adjusted for any distributions representing returns of capital and any other tax basis adjustments that would apply to an individual taxpayer, as permitted by applicable federal tax law.

(c) The amount and character (e.g., short-term or long-term) of capital gain or loss upon redemption should be separately determined for shares acquired through the $1,000 initial investment and each subsequent purchase through reinvested distributions. The Fund should not assume that shares acquired through reinvestment of distributions have the same holding period as the initial $1,000 investment. The tax character should be determined by the length of the measurement period in the case of the initial $1,000 investment and the length of the period between reinvestment and the end of the measurement period in the case of reinvested distributions.

(d) Calculate the capital gains taxes (or the benefit resulting from tax losses) using the highest federal individual capital gains tax rate for gains of the appropriate character in effect on the redemption date and in accordance with federal tax law applicable on the redemption date. For example, applicable federal tax law should be used to determine whether and how gains and losses from the sale of shares with different holding periods should be netted, as well as the tax character (e.g., short-term or long-term) of any resulting gains or losses. Assume that a shareholder has sufficient capital gains of the same character from other investments to offset any capital losses from the redemption so that the taxpayer may deduct the capital losses in full.

8. State the average annual total return (after taxes on distributions and redemption) quotation to the nearest hundredth of one percent.

(4) Yield Quotation. Based on a 30-day (or one month) period ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's yield by dividing the net investment income per share earned during the period by the maximum offering price per share on the last day of the period, according to the following formula:

$$\text{YIELD} = 2\left[\left(\frac{a - b}{cd} + 1\right)^6 - 1\right]$$

Where:

a = dividends and interest earned during the period.

b = expenses accrued for the period (net of reimbursements).

c = the average daily number of shares outstanding during the period that were entitled to receive dividends.

d = the maximum offering price per share on the last day of the period.

Instructions.

1. To calculate interest earned on debt obligations for purposes of "a" above:

(a) Calculate the yield to maturity of each obligation held by the Fund based on the market value of the obligation (including actual accrued interest) at the close of business on the last business day of each month or, with respect to obligations purchased during the month, the purchase price (plus actual accrued interest). The maturity of an obligation with a call provision(s) is the next call date on which the obligation reasonably may be expected to be called, or if none, the maturity date.

(b) Divide the yield to maturity by 360 and multiply the quotient by the market value of the obligation (including actual accrued interest) to determine the interest income on the obligation for each day of the subsequent month that the obligation is in the portfolio. Assume that each month has 30 days.

(c) Total the interest earned on all debt obligations and all dividends accrued on all equity securities during the 30-day (or one month) period. Although the period for calculating interest earned is based on calendar months, a 30-day yield may be calculated by aggregating the daily interest on the portfolio from portions of 2 months. In addition, a Fund may recalculate daily interest income on the portfolio more than once a month.

(d) For a tax-exempt obligation issued without original issue discount and having a current market discount, use the coupon rate of interest in lieu of the yield to maturity. For a tax-exempt obligation with original issue discount in which the discount is based on the current market value and exceeds the then-remaining portion of original issue discount (market discount), base the yield to maturity on the imputed rate of the original issue discount calculation. For a tax-exempt obligation with original issue discount, where the discount based on the current market value is less than the then-remaining portion of original issue discount (market premium), base the yield to maturity on the market value.

2. For discount and premium on mortgage or other receivables-backed obligations that are expected to be subject to monthly payments of principal and interest ("paydowns"):

(a) Account for gain or loss attributable to actual monthly paydowns as an increase or decrease to interest income during the period; and

(b) The Fund may elect:

(i) To amortize the discount and premium on the remaining securities, based on the cost of the securities, to the weighted average maturity date, if the information is available, or to the remaining term of the securities, if the weighted average maturity date is not available; or

(ii) Not to amortize the discount or premium on the remaining securities.

3. Solely for the purpose of calculating yield, recognize dividend income by accruing 1/360 of the stated dividend rate of the security each day that the security is in the portfolio.

4. Do not use equalization accounting in calculating yield.

5. Include expenses accrued under a plan adopted under rule 12b-1 in the expenses accrued for the period. Reimbursement accrued under the plan may reduce the accrued expenses, but only to the extent the reimbursement does not exceed expenses accrued for the period.

6. Include in the expenses accrued for the period all recurring fees that are charged to all shareholder accounts in proportion to the length of the base period. For any account fees that vary with the size of the account, assume an account size equal to the Fund's mean (or median) account size.

7. If a broker-dealer or an affiliate of the broker-dealer (as defined in rule 1-02(b) of Regulation S-X [17 CFR 210.1-02(b)], has, in connection with directing the Fund's brokerage transactions to the broker-dealer, provided, agreed to provide, paid for, or agreed to pay for, in whole or in part, services provided to the Fund (other than brokerage and research services as those terms are used in section 28(e) of the Securities Exchange Act [15 U.S.C. 78bb(e)], add to expenses accrued for the period an estimate of additional amounts that would have been accrued for the period if the Fund had paid for the services directly in an arm's length transaction.

8. Undeclared earned income, calculated in accordance with generally accepted accounting principles, may be subtracted from the maximum offering price. Undeclared earned income is the net investment income that, at the end of the base period, has not been declared as a dividend, but is reasonably expected to be and is declared as a dividend shortly thereafter.

9. Disclose the amount or specific rate of any nonrecurring account or sales charges.

10. If, in connection with the sale of the Fund's shares, a deferred sales load payable in installments is imposed, the "maximum public offering price" includes the aggregate amount of the installments ("installment load amount").

(5) Tax Equivalent Yield Quotation. Based on a 30-day (or one month) period ended on the date of the most recent balance sheet included in the registration statement, calculate the Fund's tax equivalent yield by dividing that portion of the Fund's yield (as calculated under paragraph (b)(2)) that is tax-exempt by 1 minus a stated income tax rate and adding the quotient to that portion, if any, of the Fund's yield that is not tax-exempt.

(6) Non-Standardized Performance Quotation. A Fund may calculate performance using any other historical measure of performance (not subject to any prescribed method of computation) if the measurement reflects all elements of return.

Disclosure of Mutual Fund After-Tax Returns Adopting Release IC-24832 (January 18, 2001)

[Note footnotes omitted except for footnotes 69, 70, & 79]

Formulas for Computing After-Tax Return

We are adopting, with the modifications discussed below, the requirement that funds compute after-tax returns using standardized formulas that are based largely on the current standardized formula for computing before-tax average annual total return. After-tax returns will be computed assuming a hypothetical $1,000 one-time initial investment and the deduction of the maximum sales load and other charges from the initial $1,000 payment. Also, after-tax returns will be calculated for 1-, 5-, and 10-year periods.

1. Tax Bracket

We are requiring, as proposed, that standardized after-tax returns be calculated assuming that distributions by the fund and gains on a sale of fund shares are taxed at the highest applicable individual federal income tax rate. Comment was divided on this issue. Some commenters supported the highest tax rate as providing investors with the full range of historical after-tax returns, as well as being the simplest rate to use to compute after-tax returns.

Other commenters, however, recommended that we require funds to calculate after-tax returns using an intermediate tax rate in addition to, or in lieu of, the highest tax rate. These commenters observed that the typical mutual fund investor is not in the highest tax bracket, and argued that after-tax returns calculated using tax rates to which the typical mutual fund investor is subject would be more useful.

After careful consideration of these comments, we continue to believe that it is most appropriate to use the highest tax rate, rather than an intermediate rate. Computing after-tax returns with maximum tax rates will provide investors with the "worst-case" federal income tax scenario. Coupled with before-tax return, which reflects the imposition of taxes at a 0 percent rate, this "worst-case" scenario will effectively provide investors with the full range of historical after-tax returns. We believe that providing the full range of federal income tax outcomes provides investors the most complete information.

In addition, we concluded that any benefits of using an intermediate tax rate would be outweighed by the complexity of determining the appropriate intermediate rate from one year to the next as tax rates and the income of a typical mutual fund investor change. Most of the commenters who recommended that after-tax returns be calculated using an intermediate rate suggested that we either use a specific rate (*e.g.*, 28 percent) or select a specific income level (*e.g.*, $55,000) that would be used to identify the appropriate tax rate. If we were to adopt either of these approaches, we would be required to make ongoing modifications to respond to changes in tax rates and income levels. One commenter suggested that we determine the intermediate rate by reference to the median United States household income reported by the

U.S. Census Bureau. This approach would be predicated on assumptions about the "typical" mutual fund investor and the past, present, and future income of that investor.

In any case, a requirement that funds calculate after-tax returns using an intermediate rate would effectively require that we continually monitor the changing demographics of mutual fund investors, as well as changing tax laws, and update our rules accordingly. The use of an intermediate rate also would require that funds include complex narrative disclosure in the risk/return summary about how the intermediate rate had been selected or what intermediate rate had been used from year to year.

While we are not adopting a requirement that funds calculate after-tax returns using an intermediate rate, we encourage funds to provide their investors with additional information that is tailored to a particular fund's typical investor, or to make available to investors after-tax returns calculated using multiple tax rate assumptions. Funds can supply this information in a variety of ways (*e.g.*, calculators on their websites or disclosure elsewhere in the prospectus of returns calculated based on different tax rate assumptions).

2. Capital Gains and Losses Upon a Sale of Fund Shares

We are adopting, substantially as proposed, amendments requiring that return, after taxes on distributions and redemption, be computed assuming a complete sale of fund shares at the end of the 1-, 5-, or 10-year measurement period, resulting in capital gains taxes or a tax benefit from any resulting capital losses.[365] As proposed, a fund will be required to track the actual holding periods of reinvested distributions and may not assume that they have the same holding period as the initial $1,000 investment.[366] We have made technical changes to clarify that applicable federal tax law should be used to determine whether and how gains and losses from the sale of shares with different holding periods should be netted, as well as the tax character (*e.g.*, short-term or long-term) of any resulting gains or losses.

Several commenters suggested that we permit funds to calculate taxes on gains realized upon a sale of shares at the end of the one-year period (i.e., short-term capital gains) as if the shares had been held for one year and one day (i.e., long-term capital gains). These commenters argued that a reasonable shareholder would hold the shares for the extra day in order to qualify for the more advantageous tax treatment, and that it is inappropriate to assume that shares would be sold at the end of the one-year period. We are not modifying the pro-

[365] *Instructions 6 and 7 to Item 21(b)(3) of Form N-1A. In order to simplify the computation of returns after taxes on distributions and sale of fund shares, funds may assume that a taxpayer has sufficient capital gains of the same character to offset any capital losses on a sale of fund shares and therefore that the taxpayer may deduct the entire capital loss. Instruction 7(d) to Item 21(b)(3) of Form N-1A.*

[366] *Instruction 7(c) to Item 21(b)(3) of Form N-1A.*

A fund would also be required to separately track the basis of shares acquired though the $1,000 initial investment and each subsequent purchase through reinvested distributions. We wish to clarify that a distribution representing a return of capital will reduce the basis of an existing lot of shares and be included in the basis of the shares acquired upon reinvestment, which may have the effect of shifting the amount of basis allocated to shares with various holding periods.

posal to reflect this comment. A shareholder who redeems his or her shares at any time during the one-year period is subject to taxation of gains at short-term rates. We believe that it is important for the after-tax return calculation to accurately reflect the fact that redeeming shares within the one-year period may have significant adverse tax consequences. In addition, we are providing that the tax consequences of a sale of fund shares should be determined in accordance with applicable federal tax law on the redemption date. If we were, instead, to prescribe a special rule for one-year returns, we would have to reevaluate this special rule in light of subsequent changes in tax law, such as increases to the holding period required for long-term gain treatment.

A number of commenters suggested other modifications to the proposal regarding the tracking of holding periods, such as treating the holding period of all reinvested distributions as beginning on the date of the original investment, and treating all gains on redemption as qualifying for long-term capital gains treatment. We are not adopting these recommended modifications, each of which would have the effect of reclassifying short-term gains as long-term gains, as they would minimize the impact of short-term gains on fund returns, in a manner inconsistent with federal tax law. One of our purposes in requiring the disclosure of after-tax returns is to provide investors with information about the differential impact that taxes have on the before-tax returns of various funds, and we believe that ignoring the effect of short-term gains would tend to minimize these differences inappropriately.

3. Other Assumptions

Commenters generally supported the other assumptions that the Commission proposed to require in the computation of after-tax returns, and we are adopting those requirements as proposed. Specifically, after-tax returns:

- Will be calculated using historical tax rates;
- Will be based on calendar-year periods, consistent with the before-tax return disclosure that currently appears in the risk/return summary;
- Will exclude state and local tax liability;
- Will not take into account the effect of either the alternative minimum tax or phase-outs of certain tax credits, exemptions, and deductions for taxpayers whose adjusted gross income is above a specified amount;
- Will assume that any taxes due on a distribution are paid out of that distribution at the time the distribution is reinvested and reduce the amount reinvested; and
- Will be calculated assuming that the taxable amount and tax character (*e.g.*, ordinary income, short-term capital gain, long-term capital gain) of each distribution are as specified by the fund on the dividend declaration date, adjusted to reflect subsequent recharacterizations.

Tax Treatment of Distributions

As proposed, we are not specifying in detail the tax consequences of fund distributions. Funds generally should determine the tax consequences of distributions by applying the tax law in effect on the date the distribution is reinvested. However, because a number of commenters expressed concern about whether a fund that has elected to pass through foreign tax credits to its shareholders may reflect the foreign tax credit in after-tax returns, we are providing that the effect of applicable tax credits, such as the foreign tax credit, should be taken into account in accordance with federal tax law.[367]

Narrative Disclosure

We are adopting, with modifications, the requirement that funds include a short, explanatory narrative adjacent to the performance table in the risk/return summary. This is intended to facilitate investor understanding of the table. We are not mandating specific language for the narrative, but it must be in plain English.

Commenters generally agreed that the proposed narrative disclosure would help investors understand information in the performance table. Several commenters, however, recommended streamlining the narrative by combining some of the proposed items with the narrative currently required for before-tax returns and by eliminating technical items unnecessary for investor understanding of performance information. We agree and have modified the narrative disclosure to require the following information:

- After-tax returns are calculated using the historical highest individual federal marginal income tax rates, and do not reflect the impact of state and local taxes; and
- Actual after-tax returns depend on the investor's tax situation and may differ from those shown, and the after-tax returns shown are not relevant to investors who hold their fund shares through tax-deferred arrangements such as 401(k) plans or individual retirement accounts.
- In addition, a fund will be required to provide a statement to the effect that the fund's past performance, before and after taxes, is not necessarily an indication of how the fund will perform in the future.

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[367] *Instruction 3 to Item 21(b)(2) of Form N-1A; Instruction 3 to Item 21(b)(3) of Form N-1A. A fund may elect to pass through to shareholders foreign tax credits if more than 50 percent of the value of the fund's total assets at the close of the taxable year consists of stock or securities in foreign corporations and the fund otherwise qualifies for favorable tax treatment as a regulated investment company for the taxable year. I.R.C. 853. In computing after-tax returns, a fund that elects to pass foreign tax credits through to shareholders may assume that the shareholders use those credits. We would not object if a fund adjusts after-tax returns to reflect the impact of distributions of up to $600 of foreign tax credits, the amount of credit that may be taken by a married couple filing jointly without regard to limits on the foreign tax credit. I.R.C. 904(a) and (j)(2). If a fund makes distributions of foreign tax credits in excess of $600, the fund must take into account the limits in the federal tax law on the ability of shareholders to use foreign tax credits.*

Relevant Portion of SEC Generic Comment Letters

2001 ANNUAL INVESTMENT COMPANY CFO LETTER (February 14, 2001)

AIMR Performance Verification and Auditor Consents

An increasing number of registrants include certain private account performance information of investment advisers in their registration statements and disclose that this information is presented in accordance with the Association for Investment Management & Research Performance Presentation Standards ("AIMR-PPS"). We have noted that a number of these presentations do not fully comply with the requirements of AIMR-PPS. For example, many presentations do not include the standard compliance statement required by AIMR-PPS.[368] If registrants choose to disclose that performance information is prepared and presented in accordance with AIMR-PPS, then we remind registrants that it may be misleading to not comply with all of the performance and presentation standards required by the AIMR standards. Additionally, when a third party, such as an independent public accountant, is named in a registration statement as having performed a verification in accordance with AIMR-PPS, the written consent of that third party is required to be filed as an exhibit to the registration statement.

Item 27. Financial Statements

(a) *Registration Statement*. Include, in a separate section following the responses to the preceding Items, the financial statements and schedules required by Regulation S-X. The specimen price-make-up sheet required by Instruction 4 to Item 23(c) may be provided as a continuation of the balance sheet specified by Regulation S-X.

Instructions.

1. The statements of any subsidiary that is not a majority-owned subsidiary required by Regulation S-X may be omitted from Part B and included in Part C.

2. In addition to the requirements of rule 3-18 of Regulation S-X [17 CFR 210.3-18], any Fund registered under the Investment Company Act that has not previously had an effective registration statement under the Securities Act must include in its initial registration statement under the Securities Act any additional financial statements and condensed financial information (which need not

[368]*For current AIMR standards, see Association of Investment Management and Research, AIMR Performance Presentation Standards Handbook (2d Ed. 1996). In addition to a number of other presentation requirements required by AIMR, investment advisers seeking to comply with the AIMR-PPS must include a compliance statement to accompany all performance presentations: "[insert firm name] has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS). AIMR has not been involved with the preparation or review of this report."*

be audited) necessary to make the financial statements and condensed financial information included in the registration statement current as of a date within 90 days prior to the date of filing.

(b) **Annual Report.** Every annual report to shareholders required by rule 30e-1 must contain the following:

(1) **Financial Statements.** The audited financial statements required, and for the periods specified, by Regulation S-X.

Instructions.

1. *Schedule VI—Summary schedule of investments in securities of unaffiliated issuers* [17 CFR 210.12-12C] [**amendment effective January 17, 2017, with a compliance date of August 1, 2017:** "Schedule VI—Summary schedule of investments in securities of unaffiliated issuers [17 CFR 210.12-12C]" will be amended to state "Schedule IX—Summary schedule of investments in securities of unaffiliated issuers [17 CFR 210.12-12B]"] may be included in the financial statements in lieu of Schedule I—Investments in securities of unaffiliated issuers [17 CFR 210.12-12] if: (a) the Fund states in the report that the Fund's complete schedule of investments in securities of unaffiliated issuers is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; (ii) on the Fund's website, if applicable; and (iii) on the Commission's website at http://www.sec.gov; and (b) whenever the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for the Fund's schedule of investments in securities of unaffiliated issuers, the Fund (or financial intermediary) sends a copy of Schedule I—Investments in securities of unaffiliated issuers within 3 business days of receipt by first-class mail or other means designed to ensure equally prompt delivery.

2. In the case of a Money Market Fund, *Schedule I—Investments in securities of unaffiliated issuers* [17 CFR 210.12-12C] [**amendment effective January 17, 2017, with a compliance date of August 1, 2017:** "[17 CFR 210.12-12C]" will be amended to state "[17 CFR 210.12-12B]"] may be omitted from its financial statements, provided that: (a) the Fund states in the report that the Fund's complete schedule of investments in securities of unaffiliated issuers is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; (ii) on the Fund's website, if applicable; and (iii) on the Commission's website at http://www.sec.gov; and (b) whenever the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for the Fund's schedule of *investments in securities of unaffiliated issuers, the Fund (or financial intermediary) sends a copy of Schedule I—Investments in securities of unaffiliated issuers within 3 business days of receipt by first-class mail or other means designed to ensure equally prompt delivery.*

(2) *Condensed Financial Information.* The condensed financial information required by Item 13(a) with at least the most recent fiscal year audited.

(3) *Remuneration Paid to Directors, Officers, and Others*. Unless shown elsewhere in the report as part of the financial statements required by paragraph (b)(1), the aggregate remuneration paid by the Fund during the period covered by the report to:

(i) All directors and all members of any advisory board for regular compensation;

(ii) Each director and each member of an advisory board for special compensation;

(iii) All officers; and

(iv) Each person of whom any officer or director of the Fund is an affiliated person.

(4) *Changes in and Disagreements with Accountants*. The information concerning changes in and disagreements with accountants and on accounting and financial disclosure required by Item 304 of Regulation S-K [17 CFR 229.304].

(5) *Management Information*. The management information required by Item 17(a)(1).

(6) *Availability of Additional Information about Fund Directors*. A statement that the SAI includes additional information about Fund directors and is available, without charge, upon request, and a toll-free (or collect) telephone number for shareholders to call to request the SAI.

(7) *Management's Discussion of Fund Performance*. Disclose the following information unless the Fund is a Money Market Fund:

(i) Discuss the factors that materially affected the Fund's performance during the most recently completed fiscal year, including the relevant market conditions and the investment strategies and techniques used by the Fund's investment adviser.

(ii) (A) Provide a line graph comparing the initial and subsequent account values at the end of each of the most recently completed 10 fiscal years of the Fund (or for the life of the Fund, if shorter), but only for periods subsequent to the effective date of the Fund's registration statement. Assume a $10,000 initial investment at the beginning of the first fiscal year in an appropriate broad-based securities market index for the same period.

(B) In a table placed within or next to the graph, provide the Fund's average annual total returns for the 1-, 5-, and 10-year periods as of the end of the last day of the most recent fiscal year (or for the life of the Fund, if shorter), but only for periods subsequent to the effective date of the Fund's registration statement. Average annual total returns should be computed in accordance with Item 26(b)(1). Include a statement accompanying the graph and table to the effect that past performance does not predict future performance and that the graph and table do not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares.

Instructions.

1. *Line Graph Computation.*

   (a) Assume that the initial investment was made at the offering price last calculated on the business day before the first day of the first fiscal year.

   (b) Base subsequent account values on the net asset value of the Fund last calculated on the last business day of the first and each subsequent fiscal year.

   (c) Calculate the final account value by assuming the account was closed and redemption was at the price last calculated on the last business day of the most recent fiscal year.

   (d) Base the line graph on the Fund's required minimum initial investment if that amount exceeds $10,000.

2. *Sales Load.* Reflect any sales load (or any other fees charged at the time of purchasing shares or opening an account) by beginning the line graph at the amount that actually would be invested (i.e., assume that the maximum sales load, and other charges deducted from payments, is deducted from the initial $10,000 investment). For a Fund whose shares are subject to a contingent deferred sales load, assume the deduction of the maximum deferred sales load (or other charges) that would apply for a complete redemption that received the price last calculated on the last business day of the most recent fiscal year. For any other deferred sales load, assume that the deduction is in the amount(s) and at the time(s) that the sales load actually would have been deducted.

3. *Dividends and Distributions.* Assume reinvestment of all of the Fund's dividends and distributions on the reinvestment dates during the period, and reflect any sales load imposed upon reinvestment of dividends or distributions or both.

4. *Account Fees. Reflect recurring fees that are charged to all accounts.*

   (a) For any account fees that vary with the size of the account, assume a $10,000 account size.

   (b) Reflect, as appropriate, any recurring fees charged to shareholder accounts that are paid other than by redemption of the Fund's shares.

   (c) Reflect an annual account fee that applies to more than one Fund by allocating the fee in the following manner: divide the total amount of account fees collected during the year by the Funds' total average net assets, multiply the resulting percentage by the average account value for each Fund and reduce the value of each hypothetical account at the end of each fiscal year during which the fee was charged.

5. *Appropriate Index.* For purposes of this Item, an "appropriate broad-based securities market index" is one that is administered by an organization that is not an affiliated person of the Fund, its investment adviser, or principal underwriter, unless the index is widely recognized and used. Adjust the index to reflect the reinvestment of dividends on securities in the index, but do not reflect the expenses of the Fund.

6. *Additional Indexes*. A Fund is encouraged to compare its performance not only to the required broad-based index, but also to other more narrowly based indexes that reflect the market sectors in which the Fund invests. A Fund also may compare its performance to an additional broad-based index, or to a non-securities index (e.g., the Consumer Price Index), so long as the comparison is not misleading.

7. *Change in Index*. If the Fund uses an index that is different from the one used for the immediately preceding fiscal year, explain the reason(s) for the change and compare the Fund's annual change in the value of an investment in the hypothetical account with the new and former indexes.

8. *Other Periods*. The line graph may cover earlier fiscal years and may compare the ending values of interim periods (e.g., monthly or quarterly ending values), so long as those periods are after the effective date of the Fund's registration statement.

9. *Scale*. The axis of the graph measuring dollar amounts may use either a linear or a logarithmic scale.

10. *New Funds*. A New Fund (as defined in Instruction 6 to Item 3) is not required to include the information specified by this Item in its prospectus (or annual report), unless Form N-1A (or the annual report) contains audited financial statements covering a period of at least 6 months.

11. *Change in Investment Adviser*. If the Fund has not had the same investment adviser for the previous 10 fiscal years, the Fund may begin the line graph on the date that the current adviser began to provide advisory services to the Fund so long as:

(a) Neither the current adviser nor any affiliate is or has been in "control" of the previous adviser under section 2(a)(9) [15 U.S.C. 80a-2(a)(9)];

(b) The current adviser employs no officer(s) of the previous adviser or employees of the previous adviser who were responsible for providing investment advisory or portfolio management services to the Fund; and

(c) The graph is accompanied by a statement explaining that previous periods during which the Fund was advised by another investment adviser are not shown.

(iii) Discuss the effect of any policy or practice of maintaining a specified level of distributions to shareholders on the Fund's investment strategies and per share net asset value during the last fiscal year. Also discuss the extent to which the Fund's distribution policy resulted in distributions of capital.

(iv) Provide a table showing the number of days the Market Price of the Fund shares was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value (i.e., premium or discount) for the most recently completed five fiscal years (or the life of the Fund, if shorter). The Fund may omit this table from the annual report if the Fund provides an Internet address at the Fund's Web site, which is publicly accessible, free of charge, that investors can use to obtain the premium/discount information required in Item 11(g)(2).

Instructions.

1. Provide the information in tabular form.
2. Express the information as a percentage of the net asset value of the Exchange-Traded Fund, using separate columns for the number of days the Market Price was greater than the Fund's net asset value and the number of days it was less than the Fund's net asset value. Round all percentages to the nearest hundredth of one percent.
3. Adjacent to the table, provide a brief explanation that: shareholders may pay more than net asset value when they buy Fund shares and receive less than net asset value when they sell those shares, because shares are bought and sold at current market prices.
4. Include a statement that the data presented represents past performance and cannot be used to predict future results.

(c) *Semi-Annual Report*. Every semi-annual report to shareholders required by rule 30e-1 must contain the following, which need not be audited:

(1) *Financial Statements*. The financial statements required by Regulation S-X for the period commencing either with:

(i) The beginning of the Fund's fiscal year (or date of organization, if newly organized); or

(ii) A date not later than the date after the close of the period included in the last report under rule 30e-1 and the most recent preceding fiscal year.

Instruction. Instructions 1 and 2 to Item 27(b)(1) also apply to this Item 27(c)(1).

(2) *Condensed Financial Information*. The condensed financial information required by Item 13(a), for the period of the report as specified by paragraph (c)(1), and the most recent preceding fiscal year.

(3) *Remuneration Paid to Directors, Officers, and Others*. Unless shown elsewhere in the report as part of the financial statements required by paragraph (c)(1), the aggregate remuneration paid by the Fund during the period covered by the report to the persons specified under paragraph (b)(3).

(4) *Changes in and Disagreements with Accountants*. The information concerning changes in and disagreements with accountants and on accounting and financial disclosure required by Item 304 of Regulation S-K [17 CFR 229.304].

(d) *Annual and Semi-Annual Reports*. Every annual and semi-annual report to shareholders required by rule 30e-1 must contain the following:

(1) *Expense Example*. The following information regarding expenses for the period:

Example

As a shareholder of the Fund, you incur two types of costs: (1) transaction costs, including sales charges (loads) on purchase payments, reinvested dividends, or other distributions; redemption fees; and exchange fees; and (2) ongoing costs, including management fees; distribution

[and/or service] (12b-1) fees; and other Fund expenses. This Example is intended to help you understand your ongoing costs (in dollars) of investing in the Fund and to compare these costs with the ongoing costs of investing in other mutual funds. The Example is based on an investment of $1,000 invested at the beginning of the period and held for the entire period [insert dates].

Actual Expenses

The first line of the table below provides information about actual account values and actual expenses. You may use the information in this line, together with the amount you invested, to estimate the expenses that you paid over the period. Simply divide your account value by $1,000 (e.g., an $8,600 account value divided by $1,000 = 8.6), then multiply the result by the number in the first line under the heading entitled "Expenses Paid During Period" to estimate the expenses you paid on your account during this period. [If the Fund charges any account fees or other recurring fees that are not included in the expenses shown in the table, for example, because they are not charged to all investors, disclose the amounts of these fees, describe the accounts that are charged these fees, and explain how an investor would use this information to estimate the total ongoing expenses paid over the period and the impact of these fees on ending account value.]

Hypothetical Example for Comparison Purposes

The second line of the table below provides information about hypothetical account values and hypothetical expenses based on the Fund's actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Fund's actual return. The hypothetical account values and expenses may not be used to estimate the actual ending account balance or expenses you paid for the period. You may use this information to compare the ongoing costs of investing in the Fund and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds. [If the Fund charges any account fees or other recurring fees that are not included in the expenses shown in the table, for example, because they are not charged to all investors, disclose the amounts of these fees, describe the accounts that are charged these fees, and explain how an investor would use this information in making the foregoing comparison.]

Please note that the expenses shown in the table are meant to highlight your ongoing costs only and do not reflect any transactional costs, such as sales charges (loads), redemption fees, or exchange fees. Therefore, the second line of the table is useful in comparing ongoing costs only, and will not help you determine the relative total costs of owning different funds. In addition, if these transactional costs were included, your costs would have been higher.

	Beginning Account Value [Date]	Ending Account Value [Date]	Expenses Paid During Period* [Dates]
Actual	$1,000		
Hypothetical (5% return before expenses)	$1,000		

* Expenses are equal to the Fund's annualized expense ratio of [%], multiplied by the average account value over the period, multiplied by [number of days in most recent fiscal half-year/365 [or 366]] (to reflect the one-half year period).

Instructions.

1. *General.*

(a) Round all figures in the table to the nearest cent.

(b) Include the narrative explanations in the order indicated. A Fund may modify the narrative explanations if the explanation contains comparable information to that shown, and is required to make any modifications necessary to reflect accurately the Fund's circumstances. A Fund may eliminate any parts of the narrative explanations that are inapplicable. For example, a Fund that does not charge loads need not include the statement that the Example does not reflect loads or that costs would be higher if loads were included.

(c) The Fund's expense ratio shown in the footnote to the table should be calculated in the manner required by Instruction 4(b) to Item 13(a) using the expenses for the Fund's most recent fiscal half-year (the Fund's second fiscal half-year in the case of an annual report). Express the expense ratio on an annualized basis.

(d)(i) If the Fund is a Feeder Fund, reflect the aggregate expenses of the Feeder Fund and the Master Fund. In a footnote to the Example, state that the Example reflects the expenses of both the Feeder and Master Funds.

(ii) If the report covers more than one Class of a Multiple Class Fund or more than one Feeder Fund that invests in the same Master Fund, provide a separate Example for each Class or Feeder Fund.

(e) If the Fund is an Exchange-Traded Fund:

(i) Modify the narrative explanation to state that investors may pay brokerage commissions on their purchases and sales of Exchange-Traded Fund shares, which are not reflected in the example; and

(ii) If the Fund issues or redeems shares in creation units of not less than 25,000 shares each, exclude any fees charged for the purchase and redemption of the Fund's creation units.

2. *Computation.*

(a)(i) In determining the Fund's "actual expenses" for purposes of this example, include all expenses that are deducted from the Fund's assets or charged to all shareholder accounts, including "Management Fees," "Distribution [and/or Service] (12b-1) Fees," and "Other Expenses" as those terms are defined in Instruction 3 to Item 3 of this form as modified by Instructions 2(a)(ii) and (c)(i) to this Item. Reflect recurring and non-recurring fees charged to all investors other than any exchange fees, sales charges (loads), or fees charged upon redemption of the Fund's shares. The amount of expenses deducted from the Fund's assets are the amounts shown as expenses in the Fund's statement of operations (including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X [17 CFR 210.6-07]).

(ii) For purposes of this Item 27 (d) (1), "Other Expenses" include extraordinary expenses as determined under generally accepted accounting principles (see FASB ASC Subtopic 225-20, Income Statement—Extraordinary and Unusual Items). If extraordinary expenses were incurred that materially affected the Fund's "Other Expenses," the Fund may disclose in a footnote to the Example what "actual expenses" would have been had the extraordinary expenses not been included.

(b) Assume reinvestment of all dividends and distributions.

(c)(i) Base the percentages of "actual expenses" on amounts incurred during the Fund's most recent fiscal half-year (the Fund's second fiscal half-year in the case of an annual report). "Actual expenses" should reflect actual expenses after expense reimbursement or fee waiver arrangements that reduced expenses during the most recent fiscal half-year.

(ii) If there have been any increases or decreases in Fund expenses that occurred during the Fund's most recent fiscal half-year (or that have occurred or are expected to occur during the current fiscal year) that would have materially affected the information in the Example had those changes been in place throughout the most recent fiscal half-year, restate in a footnote to the Example the expense information using the current fees as if they had been in effect throughout the entire most recent fiscal half-year. A change in Fund expenses does not include a decrease in expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in the Fund's assets.

(d) Reflect any shareholder account fees collected by more than one Fund by allocating the total amount of the fees collected during the Fund's most recent fiscal half-year (the Fund's second fiscal half-year in the case of an annual report) for all such Funds to each Fund in proportion to the relative average net assets of the Fund. A Fund that charges account fees based on a minimum account requirement exceeding $1,000 may adjust its account fees based on the amount of the fee in relation to the Fund's minimum account requirement.

3. *Graphical Representation of Holdings*. One or more tables, charts, or graphs depicting the portfolio holdings of the Fund by reasonably identifiable categories (e.g., type of security, industry sector, geographic regions, credit quality, or maturity) showing the percentage of net asset value or total investments attributable to each. The categories and the basis of presentation should be formatted, in a manner reasonably designed to depict clearly the types of investments made by the Fund, given its investment objectives. If the Fund depicts portfolio holdings according to the credit quality, it should include a description of how the credit quality of the holdings were determined, and if credit ratings, as defined in section 3(a)(60) of the Securities Exchange Act [15 U.S.C. 78(c)(a)(60)], assigned by a credit rating agency, as defined in section 3(a)(61) of the Securities Exchange Act [15 U.S.C. 78(c)(a)(61)], are used, explain how they were identified and selected. This description should be included near, or as part of, the graphical representation.

4. *Statement Regarding Availability of Quarterly Portfolio Schedule*. A statement that: (i) the Fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year on Form N-Q; (ii) the Fund's Forms N-Q are available on the Commission's website at http://www.sec.gov; (iii) the Fund's Forms N-Q may be reviewed and copied at the Commission's Public Reference Room in Washington, DC, and that information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330; and (iv) if

the Fund makes the information on Form N-Q available to shareholders on its website or upon request, a description of how the information may be obtained from the Fund.

[effective January 17, 2017 Instruction 4 above will be amended to state the following:

4. Statement Regarding Availability of Quarterly Portfolio Schedule. A statement that: (i) the Fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year as an exhibit to its reports on Form N-PORT; (ii) the Fund's Form N-PORT reports are available on the Commission's website at http://www.sec.gov; and (iii) if the Fund makes the information on Form N-PORT available to shareholders on its website or upon request, a description of how the information may be obtained from the Fund.]

[Note Regarding Replacement of Form N-Q by Form N-PORT: Funds with assets of $1 billion or more will be required to file Form N-PORT by June 1, 2018. Funds with assets of less than $1 billion will be required to file Form N-PORT by June 1, 2019. Form N-Q will be rescinded on August 1, 2019.]

5. *Statement Regarding Availability of Proxy Voting Policies and Procedures*. A statement that a description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; (ii) on the Fund's website, if applicable; and (iii) on the Commission's website at http://www.sec.gov.

> ***Instruction.*** When a Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for a description of the policies and procedures that the Fund uses to determine how to vote proxies, the Fund (or financial intermediary) must send the information disclosed in response to Item 17(f) of this Form, within three business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

6. *Statement Regarding Availability of Proxy Voting Record*. A statement that information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available (i) without charge, upon request, by calling a specified toll-free (or collect) telephone number; or on or through the Fund's website at a specified Internet address; or both; and (ii) on the Commission's website at http://www.sec.gov.

Instructions.

1. If a Fund discloses that the Fund's proxy voting record is available by calling a toll-free (or collect) telephone number, and the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for this information, the Fund (or financial intermediary) must send the information disclosed in the Fund's most recently filed report on Form N-PX, within three business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery.

2. If a Fund discloses that the Fund's proxy voting record is available on or through its website, the Fund must make available free of charge the information disclosed in the Fund's most recently filed report on Form N-PX on or through its website as soon as reasonably practicable

after filing the report with the Commission. The information disclosed in the Fund's most recently filed report on Form N-PX must remain available on or through the Fund's website for as long as the Fund remains subject to the requirements of Rule 30b1-4 [17 CFR 270.30b1-4], and discloses that the Fund's proxy voting record is available on or through its website.

7. *Statement Regarding Basis for Approval of Investment Advisory Contract.* If the board of directors approved any investment advisory contract during the Fund's most recent fiscal half-year, discuss in reasonable detail the material factors and the conclusions with respect thereto that formed the basis for the board's approval. Include the following in the discussion:

(i) Factors relating to both the board's selection of the investment adviser and approval of the advisory fee and any other amounts to be paid by the Fund under the contract. This would include, but not be limited to, a discussion of the nature, extent, and quality of the services to be provided by the investment adviser; the investment performance of the Fund and the investment adviser; the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the Fund; the extent to which economies of scale would be realized as the Fund grows; and whether fee levels reflect these economies of scale for the benefit of Fund investors. Also indicate in the discussion whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (*e.g.*, pension funds and other institutional investors). If the board relied upon such comparisons, describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved; and

(ii) If applicable, any benefits derived or to be derived by the investment adviser from the relationship with the Fund such as soft dollar arrangements by which brokers provide research to the Fund or its investment adviser in return for allocating Fund brokerage.

Instructions.

1. Board approvals covered by this Item include both approvals of new investment advisory contracts and approvals of contract renewals. Investment advisory contracts covered by this Item include subadvisory contracts.

2. Conclusory statements or a list of factors will not be considered sufficient disclosure. Relate the factors to the specific circumstances of the Fund and the investment advisory contract and state how the board evaluated each factor. For example, it is not sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its decision to approve the contract.

3. If any factor enumerated in paragraph (d)(6)(i) of this Item is not relevant to the board's evaluation of an investment advisory contract, note this and explain the reasons why that factor is not relevant.

Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies [Release Nos. 33-8188, 34-47304, IC-25922; January 31, 2003]

A. Disclosure of Policies and Procedures With Respect To Voting Proxies Relating to Portfolio Securities

The Commission is adopting, with one modification to address commenters' concerns, the requirement that mutual funds that invest in voting securities disclose in their statements of additional information ("SAIs") the policies and procedures that they use to determine how to vote proxies relating to securities held in their portfolios....This disclosure would include the procedures that a fund uses when a vote presents a conflict between the interests of fund shareholders, on the one hand, and those of the fund's investment adviser, principal underwriter, or an affiliated person of the fund, its investment adviser, or principal underwriter, on the other. It also includes any policies and procedures of a fund's investment adviser, or any other third party, that the fund uses, or that are used on the fund's behalf, to determine how to vote proxies relating to portfolio securities. For example, if a fund delegates proxy voting decisions to its investment adviser and the adviser uses its own policies and procedures to vote the fund's proxies, disclosure of the adviser's policies and procedures is required. Or a fund's board may wish to adopt its adviser's policies and procedures, rather than designing its own.

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Commenters generally supported the proposed disclosure requirements regarding proxy voting policies and procedures. A number of commenters, however, objected to certain aspects of the disclosure requirements. Some commenters recommended that we provide additional, more specific guidelines regarding the categories of disclosure that should be included in proxy voting policies and procedures. These commenters, which included many "socially responsible" fund groups, argued that the absence of specific guidelines could create an incentive for funds to adopt as few policies and procedures as possible, thereby minimizing reporting and disclosure obligations.

We have determined not to prescribe more specific guidelines or requirements for the proxy voting policies and procedures that a fund must disclose in its SAI or Form N-CSR for closed-end funds. The intent of our proposal is to promote transparency with respect to proxy voting information, and not to mandate the content of a fund's policies or procedures. Therefore, we believe that funds should be allowed the flexibility to determine the content that would be appropriate for this disclosure.

We do expect, however, that funds' disclosure of their policies and procedures will include general policies and procedures, as well as policies with respect to voting on specific types of issues. The following are examples of general policies and procedures that some funds

include in their proxy voting policies and procedures and with respect to which disclosure would be appropriate:

- The extent to which the fund delegates its proxy voting decisions to its investment adviser or another third party, or relies on the recommendations of a third party;
- Policies and procedures relating to matters that may affect substantially the rights or privileges of the holders of securities to be voted; and
- Policies regarding the extent to which the fund will support or give weight to the views of management of a portfolio company.

The following are examples of specific types of issues that are covered by some funds' proxy voting policies and procedures and with respect to which disclosure would be appropriate:

- Corporate governance matters, including changes in the state of incorporation, mergers and other corporate restructurings, and anti-takeover provisions such as staggered boards, poison pills, and supermajority provisions;
- Changes to capital structure, including increases and decreases of capital and preferred stock issuance;
- Stock option plans and other management compensation issues; and
- Social and corporate responsibility issues.

We are modifying our proposal in one respect, however, to clarify that a fund may satisfy the requirements for a description of its policies and procedures by including a copy of the policies and procedures themselves. A number of commenters recommended that we streamline the disclosure of policies and procedures that would be required in the SAI. Several of these commenters were fund groups that noted that they have funds with multiple sub-advisers, each of which uses its own proxy voting policies and procedures to vote the fund's proxies. Because the proposed rules would require the fund to include a description of each such sub-adviser's policies and procedures in the fund's SAI, commenters argued, the requirements would add lengthy disclosure to the SAI. Further, because different sub-advisers for a single fund could have policies that vary with respect to a particular issue, this disclosure could confuse investors. These commenters argued that disclosure of policies and procedures was not necessary or appropriate given the lack of genuine shareholder interest in the information.

We have determined that it would not be appropriate to modify the proposal to allow a fund to reduce or eliminate the disclosure regarding its proxy voting policies and procedures. Shareholders have a right to know the policies and procedures that are being used by a fund to vote proxies on their behalf. To the extent that multiple policies are being used by a single fund, shareholders should have access to information about all the policies that are in effect. In order to mitigate the burden of preparing descriptions of policies and procedures, however,

we have modified our disclosure requirements to permit a fund to include the actual policies and procedures used to vote proxies in the SAI or N-CSR, rather than a description of the policies.

Some commenters argued that the SAI was not the appropriate location for disclosure of proxy voting policies and procedures because the SAI is not likely to reach a wide base of investors. These commenters argued that the policies and procedures should be required to be distributed to all investors, as part of the fund's prospectus, annual report, or in a separate mailing. We continue to believe, however, that the SAI is the most appropriate and cost-effective location for this disclosure. The disclosure will be readily accessible to shareholders because funds are required to provide an SAI promptly to any investor who requests one. On the other hand, funds and their shareholders will not be forced to bear the costs for printing and mailing this information to every shareholder, without regard to their level of interest in this information.

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DISCLOSURE REGARDING APPROVAL OF INVESTMENT ADVISORY CONTRACTS BY DIRECTORS OF INVESTMENT COMPANIES [Release Nos. 33-8433; 34-49909; IC-26486; June 23, 2004]

II. DISCUSSION

B. Disclosure Enhancements

We are adopting several enhancements to the existing proxy statement disclosure requirements and are including these same enhancements in the new shareholder reports disclosure requirement. These enhancements clarify and reinforce a fund's obligation under the existing proxy disclosure requirement to discuss the material factors and the conclusions with respect thereto that formed the board's basis for recommending that the shareholders approve an advisory contract. They are intended to address our concerns that some funds do not provide adequate specificity regarding the board's basis for its decision. We are adopting the enhancements substantially as proposed, with some modifications to address commenters' concerns.

Selection of Adviser and Approval of Advisory Fee. The amendments clarify that the fund's discussion must include factors relating to both the board's selection of the investment adviser, and its approval of the advisory fee and any other amounts to be paid under the advisory contract. Two commenters objected to the use of the phrase "selection of the investment adviser," arguing that this language suggests that the annual review and approval of the advisory contract is an annual opportunity to replace the investment adviser, and that it is not the role of the directors, except in the most egregious circumstances, to override the investors' choice of an adviser. We note, however, that although we would not expect that fund boards would routinely replace investment advisers, the board does have a duty to monitor the adviser's performance of its duties under the advisory contract, and to consider replacing the adviser if necessary. The directors' decision to renew an investment advisory contract, in effect, constitutes the selection of the investment adviser.

Specific Factors. The amendments will require a fund to include a discussion including, but not limited to, the following: (1) the nature, extent, and quality of the services to be pro vided by the investment adviser; (2) the investment performance of the fund and the investment adviser; (3) the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the fund; (4) the extent to which economies of scale would be realized as the fund grows; and (5) whether fee levels reflect these economies of scale for the benefit of fund investors.

We are adding an instruction to clarify that if any of the enumerated factors is not relevant to the board's evaluation of an investment advisory contract, the discussion must note this and explain the reasons why that factor is not relevant. This instruction is intended to address the concerns of commenters who argued that the proposal should be modified to allow for less or different disclosure with respect to advisory contracts with "non-sponsor advisers" (i.e., investment advisers, including subadvisers, to funds that are sponsored by third parties unaffiliated with the adviser). …

The instruction we are adding will permit a fund, including a fund with a non-sponsor adviser, to tailor its disclosure to its particular circumstances. At the same time, it will require each fund to address each of the enumerated factors, either substantively or by explaining why the factor is not relevant. This degree of uniformity in the discussion is designed to facilitate investor understanding of board approvals of investment advisory contracts. We emphasize that it is important that a fund disclose how a board evaluated and approved all investment advisory contracts, including contracts with non-sponsor advisers, such as unaffiliated subadvisers. Under the Investment Company Act, a fund's board plays an important role in the selection and oversight of the fund's adviser and subadvisers, and the fact that these contracts are the result of "arm's length" negotiations does not remove the need for board oversight. Unaffiliated subadvisers may, for example, have other material business arrangements with the fund's adviser or principal underwriter, which the board should consider in the course of evaluating a subadviser's contract.[369]

We note that the amendments are not intended to require disclosure of the amount of the fee paid to an unaffiliated subadviser if that information would not otherwise be required to be disclosed. For example, if a manager of managers fund is not otherwise required to disclose separately the fee paid to each subadviser, the amendments would not require this disclosure.

Under the amendments, a fund's discussion is required to state how the board evaluated the costs of the services to be provided and the profits to be realized by the investment adviser and its affiliates from the relationship with the fund. One commenter argued that, to the extent that actual operating cost and profit information is required, such disclosure could have harmful competitive effects on investment advisers, and that in any event disclosure of specific

[369] *See Manager of Managers Proposing Release, , (noting that, in carrying out its obligations under Section 15(c) of the Investment Company Act, a board should consider any material business arrangements between the adviser or principal underwriter and the subadviser, including the involvement of the subadviser in the distribution of the fund's shares).*

cost and profit figures is not necessary to help investors understand the board's evaluation of this factor. We wish to clarify that disclosure of specific proprietary information about the operating costs and profits of the investment adviser and its affiliates is not necessary to meet this requirement.

Comparison of Fees and Services Provided by Adviser. The fund's discussion will be required to indicate whether the board relied upon comparisons of the services to be rendered and the amounts to be paid under the contract with those under other investment advisory contracts, such as contracts of the same and other investment advisers with other registered investment companies or other types of clients (e.g., pension funds and other institutional investors). If the board relied upon such comparisons, the discussion will be required to describe the comparisons that were relied on and how they assisted the board in concluding that the contract should be approved.

....We are adopting the requirement as proposed because we believe that information concerning whether and, if so, how the board relies on comparisons is important in understanding the board's decision. As adopted, the amendment requires a description of the comparisons upon which the board relied and how they assisted the board in concluding that the contract should be approved, and does not require an enumeration of the types of comparisons that the board did not use.

Evaluation of Factors. The existing SAI and proxy statement requirements state that conclusory statements or a list of factors will not be considered sufficient disclosure, and that a fund's discussion must relate the factors to the specific circumstances of the fund and the investment advisory contract. We are clarifying this by requiring that the fund's discussion state how the board evaluated each factor. For example, it will not be sufficient to state that the board considered the amount of the investment advisory fee without stating what the board concluded about the amount of the fee and how that affected its determination that the contract should be approved.

Commenters' views on this proposed requirement were divided. On the one hand, some commenters agreed that the requirement that the discussion state how the board evaluated each factor would be useful in ensuring that the discussion has reasonable detail and does not rely on boilerplate disclosure. On the other hand, some commenters argued that detailed information regarding the factors that the board considered and the conclusions it reached is not of interest to most shareholders, and that, as a factual matter, boards typically determine whether to approve an advisory contract based on the totality of the factors considered. We believe that the proposed requirement will elicit more useful information than the existing requirement. It would be difficult for a board to reach a final conclusion as to whether to approve an advisory contract without reaching conclusions as to each material factor that forms the basis for the board's approval. Therefore, a discussion of the board's evaluation of the individual factors is important in order to help investors understand how the board reached its decision on whether to approve such a contract.

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Relevant Portion of Accountants SEC Generic Comment Letters

2001 ANNUAL INVESTMENT COMPANY CFO LETTER (February 14, 2001)

Updating Requirements for Financial Highlights Included in a Registration Statement Subsequent to a Stock Split

Several registrants have asked whether retroactive adjustment to the financial highlights and financial statements is required after an investment company issues a stock split.[370] Staff Accounting Bulletin Topic 4C requires that a change in capital structure be presented retroactively if such change occurs before the release of the financial statements or the effective date of the registration statement, whichever is later.[371] When a stock split occurs after the effective date of the registration statement, some registrants make a supplemental filing pursuant to Rule 497 ("sticker") to provide investors with information about the transaction, including an updated financial highlights table showing the effect of the stock split on a per share basis. Since the supplemental filing under Rule 497 does not update the registration statement, this information does not need to be audited. When a registrant files its annual update or any other post-effective amendment to the registration statement, however, the registrant is required to include an audited retroactively adjusted financial highlights table.

Pro Forma Financial Statements and Filings Pursuant to Rule 488 of the Securities Act of 1933

Typically, management investment companies file a registration statement on Form N-14 when merging investment companies and may elect to file pursuant to Rule 488 under the 1933 Act requesting automatic effectiveness.[372] As a condition to Rule 488, the filing must be materially complete. We have seen a growing number of registration statements filed pursuant to Rule 488 that do not include the required pro forma, audited annual, or unaudited semi-annual financial statements. When an open-end investment company files pursuant to Rule 488 and excludes this information, the staff considers the filing materially incomplete, and will suspend the automatic effectiveness by notifying the registrant in writing.[373]

Financial Highlights and Financial Statements During Reorganizations When Performance is being Carried Over

The staff receives numerous inquiries each year on the financial statements and financial highlights requirement for "shell" investments companies who utilize the historical performance of a predecessor entity subsequent to reorganization. In August, the Division granted

[370] *A fund must provide its financial highlights pursuant to either Item 9 of Form N-1A, or Item 4 of Form N-2.*

[371] *See Topic 4-C of the Staff Accounting Bulletin Series ("Change in Capital Structure").*

[372] *Rule 488(a) under the 1933 Act states: "A registration statement filed on Form N-14 by a registered open-end management investment company . . . shall become effective on the thirtieth day after the date upon which it is filed with the Commission . . .." 17 C.F.R. § 230.488(a) (2000).*

[373] *Rule 488(b) under the 1933 Act states: "No registration statement shall become effective pursuant to paragraph (a) of this section if, prior to the effective date of the registration statement, it should appear to the Commission that the registration statement may be incomplete or inaccurate in any material respect and the Commission furnishes to the registrant written notice that the effective date is to be suspended." 17 C.F.R. § 230.488(b) (2000).*

no-action relief to Janus Adviser Series, permitting the Adviser Series to use the historical performance information of the predecessor entities (in this case several classes) in their initial registration statement provided that, among other things, Adviser Series represented it would carry forward the financial statements and financial highlights of the predecessor entities and report their historical financial information as their own.[374] When investment companies reorganize existing funds or classes into new "shell" entities and carry over past performance information, the new "shell" entities should also carryover the prior financial highlights and financial statements.

1999 ANNUAL INVESTMENT COMPANY CFO LETTER (December 30, 1999)

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Financial Highlights and Fee Table Disclosures

We have reviewed a number of financial highlights tables where registrants have incorrectly calculated the ratio of expenses to average net assets ("the expense ratio"). The expense ratio is calculated by dividing total expenses by average net assets. We have noted that a number of registrants are incorrectly reducing total expenses by brokerage offsets, custodial credits and/or other expense reductions. Certain registrants also are excluding interest and dividend expenses, attributable to securities sold short, from total expenses Registrants are reminded that total expenses may be reduced only by fee waivers or reimbursements.

In our review of prospectuses, we have noted that some registrants are reducing the fee table expense percentages with custodial credits and/or other third-party offset arrangements. We remind registrants that the use of these credits and offsets to reduce fund expense ratios is inconsistent with the requirements of the form. Only contractual waivers or reimbursements may be used to reduce expense percentages in the fee table.[375]

[374] *See Janus Adviser Series (pub. avail. Aug. 28, 2000).*

[375] *See Letter from Barry D. Miller, Associate Director, Division of Investment Management, to Craig S. Tyle, Esq., General Counsel, Investment Company Institute (Oct. 2, 1998).*

PART C
Other Information

Item 28. Exhibits

Subject to General Instruction D regarding incorporation by reference and rule 483 under the Securities Act [17 CFR 230.483], file the exhibits listed below as part of the registration statement. Letter or number the exhibits in the sequence indicated and file copies rather than originals, unless otherwise required by rule 483. Reflect any exhibit incorporated by reference in the list below and identify the previously filed document containing the incorporated material.

(a) **Articles of Incorporation.** The Fund's current articles of incorporation, charter, declaration of trust or corresponding instruments and any related amendment.

(b) **By-laws.** The Fund's current by-laws or corresponding instruments and any related amendment.

(c) **Instruments Defining Rights of Security Holders.** Instruments defining the rights of holders of the securities being registered, including the relevant portion of the Fund's articles of incorporation or by-laws.

(d) **Investment Advisory Contracts.** Investment advisory contracts relating to the management of the Fund's assets.

(e) **Underwriting Contracts.** Underwriting or distribution contracts between the Fund and a principal underwriter, and agreements between principal underwriters and dealers.

(f) **Bonus or Profit Sharing Contracts.** Bonus, profit sharing, pension, or similar contracts or arrangements in whole or in part for the benefit of the Fund's directors or officers in their official capacity. Describe in detail any plan not included in a formal document.

(g) **Custodian Agreements.** Custodian agreements and depository contracts under section 17(f) [15 U.S.C. 80a-17(f)] concerning the Fund's securities and similar investments, including the schedule of remuneration.

(h) **Other Material Contracts.** Other material contracts not made in the ordinary course of business to be performed in whole or in part on or after the filing date of the registration statement.

(i) **Legal Opinion.** An opinion and consent of counsel regarding the legality of the securities being registered, stating whether the securities will, when sold, be legally issued, fully paid, and nonassessable.

(j) **Other Opinions.** Any other opinions, appraisals, or rulings, and related consents relied on in preparing the registration statement and required by section 7 of the Securities Act [15 U.S.C. 77g].

(k) **Omitted Financial Statements.** Financial statements omitted from Item 27.

(l) **Initial Capital Agreements.** Any agreements or understandings made in consideration for providing the initial capital between or among the Fund, the underwriter, adviser, promoter or

initial shareholders and written assurances from promoters or initial shareholders that purchases were made for investment purposes and not with the intention of redeeming or reselling.

(m) **Rule 12b-1 Plan.** Any plan entered into by the Fund under rule 12b-1 and any agreements with any person relating to the plan's implementation.

(n) **Rule 18f-3 Plan.** Any plan entered into by the Fund under rule 18f-3, any agreement with any person relating to the plan's implementation, and any amendment to the plan or an agreement.

(o) *Reserved*

(p) **Codes of Ethics.** Any codes of ethics adopted under rule 17j-1 of the Investment Company Act [17 CFR 270.17j-1] and currently applicable to the Fund (*i.e.*, the codes of the Fund and its investment advisers and principal underwriters). If there are no codes of ethics applicable to the Fund, state the reason (*e.g.*, that the Fund is a Money Market Fund).

Instruction: A Fund that is a Feeder Fund also must file a copy of all codes of ethics applicable to the Master Fund.

Relevant Portions of SEC Generic Comment Letters

1996 Comment II.A—Multiple Class Funds

In addition, Item 24(b) [**Current Item 28**] of Form N-1A requires copies of any plan entered into by the registrant under Rule 18f-3, including any implementing agreement and plan amendments, to be filed as exhibits to the registration statement. A post-effective amendment for the purpose of filing exhibits and agreements pertaining to the Rule 18f-3 plan may be filed under Rule 485(b) under the Securities Act of 1933 (the "1933 Act").[376]

1993 Comment VI—Financial Statements of Series Companies

Registered management investment companies are required to update financial statements in accordance with Rule 3-18 of Regulation S-X. Series company registrants are reminded that this requirement applies where series are added to prospectuses and/or Statements of Additional Information which already include data of other series. For example, if a prospectus or Statement of Additional Information adds information about a new series, the financial information for the existing series will be required to meet the updating requirement in such prospectus or Statement of Additional Information. This requirement also applies to registrants using prospectuses that combine disclosure relating to funds that are registered separately under the Investment Company Act.

[376] *When the Commission adopted amendments to Rule 485 in 1994, it delegated authority to the Division to determine appropriate uses of Rule 485(b) in contexts other than those specifically enumerated in the rule. This comment and Comment II.B dealing with Form N-14 filings authorize registrants to file post-effective amendments under Rule 485(b) in accordance with that authority. See Investment Company Act Release No. 20486 (Aug. 17, 1994). Registrants availing themselves of this procedure should ensure that their post-effective amendments otherwise meet the conditions for filing under Rule 485(b).*

Item 29. Persons Controlled by or Under Common Control with the Fund

Provide a list or diagram of all persons directly or indirectly controlled by or under common control with the Fund. For any person controlled by another person, disclose the percentage of voting securities owned by the immediately controlling person or other basis of that person's control. For each company, also provide the state or other sovereign power under the laws of which the company is organized.

Instructions.

1. Include the Fund in the list or diagram and show the relationship of each company to the Fund and to the other companies named, using cross-references if a company is controlled through direct ownership of its securities by two or more persons.

2. Indicate with appropriate symbols subsidiaries that file separate financial statements, subsidiaries included in consolidated financial statements, or unconsolidated subsidiaries included in group financial statements. Indicate for other subsidiaries why financial statements are not filed.

Item 30. Indemnification

State the general effect of any contract, arrangements or statute under which any director, officer, underwriter or affiliated person of the Fund is insured or indemnified against any liability incurred in their official capacity, other than insurance provided by any director, officer, affiliated person, or underwriter for their own protection.

Item 31. Business and Other Connections of Investment Adviser

Describe any other business, profession, vocation or employment of a substantial nature that each investment adviser, and each director, officer or partner of the adviser, is or has been engaged within the last two fiscal years for his or her own account or in the capacity of director, officer, employee, partner, or trustee.

Instructions.

1. Disclose the name and principal business address of any company for which a person listed above serves in the capacity of director, officer, employee, partner, or trustee, and the nature of the relationship.

2. The names of investment advisory clients need not be given in answering this Item.

Item 32. Principal Underwriters

(a) State the name of each investment company (other than the Fund) for which each principal underwriter currently distributing the Fund's securities also acts as a principal underwriter, depositor, or investment adviser.

(b) Provide the information required by the following table for each director, officer, or partner of each principal underwriter named in the response to Item 25:

(1) Name and Principal Business Address	(2) Positions and Offices with Underwriter	(3) Positions and Offices with Fund

(c) Provide the information required by the following table for all commissions and other compensation received, directly or indirectly, from the Fund during the last fiscal year by each principal underwriter who is not an affiliated person of the Fund or any affiliated person of an affiliated person:

(1) Name of Principal Underwriter	(2) Net Underwriting Discounts and Commissions	(3) Compensation on Redemption and Repurchases	(4) Brokerage Commissions	(5) Other Compensation

Instructions.

1. Disclose the type of services rendered in consideration for the compensation listed under column (5).

2. Instruction 1 to Item 25(c) also applies to this Item.

Item 33. Location of Accounts and Records

State the name and address of each person maintaining physical possession of each account, book, or other document required to be maintained by section 31(a) [15 U.S.C. 80a-30(a)] and the rules under that section.

Instructions.

1. The instructions to Item 20.4 also apply to this item.

2. Information need not be provided for any service provided for which total payments of less than $5,000 during each of the last three fiscal years.

[amendment effective January 17, 2017, with a compliance date of August 1, 2017:

3. A Fund may omit this information to the extent it is provided in its most recent report on Form N-CEN [17 CFR 274.101].

Item 34. Management Services

Provide a summary of the substantive provisions of any management-related service contract not discussed in Part A or B, disclosing the parties to the contract and the total amount paid and by whom for the Fund's last three fiscal years.

Instructions.

1. The instructions to Item 19 also apply to this Item.

2. Exclude information about any service provided for payments totaling less than $5,000 during each of the last three fiscal years.

Item 35. Undertakings

In initial registration statements filed under the Securities Act, provide an undertaking to file an amendment to the registration statement with certified financial statements showing the initial capital received before accepting subscriptions from more than 25 persons if the Fund intends to raise its initial capital under section 14(a)(3) [15 U.S.C. 80a-14(a)(3)].

SIGNATURES

Pursuant to the requirements of (the Securities Act of 1933 and) the Investment Company Act of 1940, the Fund (certifies that it meets all of the requirement for effectiveness of this registration statement under rule 485(b) under the Securities Act and) has duly caused this registration statement to be signed on its behalf by the undersigned, duly authorized, in the City of _____, and State of _____ on the __ day of _____, _____.
(Year)

_____
Fund

By _____
(Signature and Title)

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed below by the following persons in the capacities and on the dates indicated.

_____	_____	_____
(Signature)	(Title)	(Date)

APPENDIX I

ADOPTING RELEASES AND SEC Q & A LETTERS

ENHANCED DISCLOSURE AND NEW PROSPECTUS DELIVERY OPTION FOR REGISTERED OPEN-END MANAGEMENT INVESTMENT COMPANIES
[EXCERPTED AND FOOTNOTES OMITTED]
Release Nos. 33-8998; IC-28584
(January 13, 2009)

SUMMARY: The Securities and Exchange Commission is adopting amendments to the form used by mutual funds to register under the Investment Company Act of 1940 and to offer their securities under the Securities Act of 1933 in order to enhance the disclosures that are provided to mutual fund investors. The amendments require key information to appear in plain English in a standardized order at the front of the mutual fund statutory prospectus. The Commission is also adopting rule amendments that permit a person to satisfy its mutual fund prospectus delivery obligations under Section 5(b)(2) of the Securities Act by sending or giving the key information directly to investors in the form of a summary prospectus and providing the statutory prospectus on an Internet Web site. Upon an investor's request, mutual funds are also required to send the statutory prospectus to the investor. These amendments are intended to improve mutual fund disclosure by providing investors with key information in plain English in a clear and concise format, while enhancing the means of delivering more detailed information to investors. Finally, the Commission is adopting additional amendments that are intended to result in the disclosure of more useful information to investors who purchase shares of exchange-traded funds on national securities exchanges.

DATES: Effective date: March 31, 2009. Compliance Date: *See* Part III.D. of this release for information on compliance dates.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting amendments to rules 159A, 482, 485, 497, and 498 under the Securities Act of 1933 ("Securities Act") and rules 304 and 401 of Regulation S-T. The Commission is also adopting amendments to Form N-1A, the form used by open-end management investment companies to register under the Investment Company Act of 1940 ("Investment Company Act") and to offer securities under the Securities Act; Form N-4, the form used by insurance company separate accounts organized as unit investment trusts and offering variable annuity contracts to register under the Investment Company Act and to offer securities under the Securities Act; and Form N-14, the form used by registered management investment companies and business development companies to register under the Securities Act securities to be issued in business combinations.

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I. EXECUTIVE SUMMARY

Today, the Commission is adopting an improved mutual fund disclosure framework that it originally proposed in November 2007. This improved disclosure framework is intended to provide investors with information that is easier to use and more readily accessible, while retaining the comprehensive quality of the information that is available today. The foundation of the improved disclosure framework is the provision to all investors of streamlined and user-friendly information that is key to an investment decision.

To implement the new disclosure framework, we are adopting amendments to Form N-1A that will require every prospectus to include a summary section at the front of the prospectus, consisting of key information about the fund, including investment objectives and strategies, risks, costs, and performance. We are also adopting a new option for satisfying prospectus delivery obligations with respect to mutual fund securities under the Securities Act. Under the option, key information will be sent or given to investors in the form of a summary prospectus ("Summary Prospectus"), and the statutory prospectus will be provided on an Internet Web site. Funds that select this option will also be required to send the statutory prospectus to the investor upon request.

In addition, the Commission is adopting amendments to Form N-1A relating to exchange-traded funds ("ETFs") that we proposed in a separate release in March 2008. These amendments are intended to result in the disclosure of more useful information to investors who purchase shares of exchange-traded funds on national securities exchanges.

II. BACKGROUND

Millions of individual Americans invest in shares of open-end management investment companies ("mutual funds"), relying on mutual funds for their retirement, their children's education, and their other basic financial needs. These investors face a difficult task in choosing among the more than 8,000 available mutual funds. Fund prospectuses, which have been criticized by investor advocates, representatives of the fund industry, and others as being too long and complicated, often prove difficult for investors to use efficiently in comparing their many choices. Current Commission rules require mutual fund prospectuses to contain key information about investment objectives, risks, and expenses that, while important to investors, can be difficult for investors to extract. Prospectuses are often long, both because they contain a wealth of detailed information, which our rules require, and because prospectuses for multiple funds are often combined in a single document. Too frequently, the language of prospectuses is complex and legalistic, and the presentation formats make little use of graphic design techniques that would contribute to readability.

Numerous commentators have suggested that investment information that is key to an investment decision should be provided in a streamlined document with other more detailed information provided elsewhere. Furthermore, recent investor surveys indicate that investors prefer to receive information in concise, user-friendly formats.

Similar opinions were voiced at a roundtable held by the Commission in June 2006, at which representatives from investor groups, the mutual fund industry, analysts, and others discussed how the Commission could change the mutual fund disclosure framework so that investors would be provided with better information. Significant discussion at the roundtable concerned the importance of providing mutual fund investors with access to key fund data in a shorter, more easily understandable format. The participants focused on the importance of providing mutual fund investors with shorter disclosure documents, containing key information, with more detailed disclosure documents available to investors and others who choose to review additional information. There was consensus among the roundtable participants that the key information that investors need to make an investment decision includes information about a mutual fund's investment objectives and strategies, risks, costs, and performance.

The roundtable participants also discussed the potential benefits of increased Internet availability of fund disclosure documents, which include, among other things, facilitating comparisons among funds and replacing "one-size-fits-all" disclosure with disclosure that each investor can tailor to his or her own needs. In recent years, access to the Internet has greatly expanded, and significant strides have been made in the speed and quality of Internet connections. The Commission has already harnessed the power of these technological advances to provide better access to information in a number of areas. Recently, for example, we created a program that permits issuers, on a voluntary basis, to submit to the Commission financial information and, in the case of mutual funds, key prospectus information, in an interactive data format that facilitates automated retrieval, analysis, and comparison of the information. More recently, we proposed rules that would require mutual funds to provide the risk/return summary section of their prospectuses, and companies to provide their financial statements, to the Commission in interactive data format. In addition, we recently adopted rules that provide all shareholders with the ability to choose whether to receive proxy materials in paper or via the Internet. As suggested by the participants at the June 2006 roundtable, advances in technology also offer a promising means to address the length and complexity of mutual fund prospectuses by streamlining the key information that is provided to investors, ensuring that access to the full wealth of information about a fund is immediately and easily accessible, and providing the means to present all information about a fund online in an interactive format that facilitates comparisons of key information, such as expenses, across different funds and different share classes of the same fund. Technology has the potential to replace the current one-size-fits-all mutual fund prospectus with an approach that allows investors, their financial intermediaries, third-party analysts, and others to tailor the wealth of available information to their particular needs and circumstances.

In November 2007, the Commission proposed an improved mutual fund disclosure framework that was intended to address the concerns that have been raised about mutual fund prospectuses and to make use of technological advances to enhance the provision of information to mutual fund investors. The Commission received approximately 155 comment submissions. The commenters generally supported the proposals, with some commenters suggesting specific changes to the proposals. Commission staff also arranged for investor focus group testing of the proposed Summary Prospectus. Today, the Commission is adopting the proposed amendments with modifications to respond to the focus group testing and to address commenters' recommendations.

We are adopting amendments to Form N-1A that will require every prospectus to include a summary section at the front of the prospectus, consisting of key information about the fund, including investment objectives and strategies, risks, costs, and performance. This key information is required to be presented in plain English in a standardized order. Our intent is that this information will be presented succinctly, in three or four pages, at the front of the prospectus.

We are also adopting a new option for satisfying prospectus delivery obligations with respect to mutual fund securities under the Securities Act. Under the option, key information will be sent or given to investors in the form of a Summary Prospectus, and the statutory prospectus will be provided on an Internet Web site. Upon an investor's request, funds will also be required to send the statutory prospectus to the investor. Our intent in providing this option is that funds take full advantage of the Internet's search and retrieval capabilities in order to enhance the provision of information to mutual fund investors.

The disclosure framework that we are adopting has the potential to revolutionize the provision of information to the millions of investors who rely on mutual funds for their most basic financial needs. It is intended to help investors who are overwhelmed by the choices among thousands of available funds described in lengthy and legalistic documents to access readily key information that is important to an informed investment decision. At the same time, by harnessing the power of technology to deliver information in better, more useable formats, the disclosure framework can help those investors, their intermediaries, third-party analysts, the financial press, and others to locate and compare facts and data from the wealth of more detailed disclosures that are available.

III. DISCUSSION

A. Amendments to Form N-1A

The Commission is adopting, with modifications to address commenters' suggestions, amendments to Form N-1A that will require the statutory prospectus of every mutual fund to include a summary section at the front of the prospectus consisting of key information presented in plain English in a standardized order. Commenters and investors participating in focus groups arranged by Commission staff generally supported the proposed summary presentation and agreed that it will address investors' preferences for concise, user-friendly information. The summary section will provide investors with key information about the fund that investors can use to evaluate and compare the fund. This summary will be located in a standardized, easily accessible place and will be available to all investors, regardless of whether the fund uses a Summary Prospectus and whether the investor is reviewing the prospectus in a paper or electronic format.

As in our proposal, the information required in the summary section of the prospectus will be the same as that required in the new Summary Prospectus, and it is key information that is important to an investment decision. We believe, and commenters generally agreed, that the key

information that is important to an investment decision is the same, whether an investor is reviewing the summary section of a statutory prospectus or a short-form disclosure document. For that reason, we are requiring the same information in the summary section of the statutory prospectus and in the Summary Prospectus. In each case, our intent is that funds prepare a concise summary (on the order of three or four pages) that will provide key information.

In addition, with the exception of some information that is common to multiple funds, we are requiring, as proposed, that the summary section be presented separately for each fund covered by a multiple fund prospectus and that the information for multiple funds not be integrated. This requirement is intended to assist investors in finding important information regarding the particular fund in which they are interested. Multiple fund prospectuses contribute substantially to prospectus length and complexity, which act as barriers to understanding. We have concluded that requiring a self-contained summary section for each fund will significantly aid investors' ability to use multiple fund prospectuses effectively.

The Commission is committed to encouraging statutory prospectuses that are simpler, clearer, and more useful to investors. The prospectus summary section is intended to provide investors with streamlined disclosure of key mutual fund information at the front of the statutory prospectus, in a standardized order that facilitates comparisons across funds. We are adopting the following amendments to Form N-1A in order to implement the summary section.

1. General Instructions to Form N-1A

We are adopting, substantially as proposed, amendments to the General Instructions to Form N-1A to address the new summary section of the statutory prospectus. These amendments address plain English and organizational requirements.

Plain English

We are amending, as proposed, the General Instructions to state that the summary section of the prospectus must be provided in plain English under rule 421(d) under the Securities Act. Rule 421(d) requires an issuer to use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors sections of its prospectus. The amended instruction will serve as a reminder that the new prospectus summary section is subject to rule 421(d). The use of plain English principles in the new summary section will further our goal of encouraging its entirety, also will remain subject to the requirement that the information be presented in a clear, concise, and understandable manner.

Organizational Requirements

We are also adopting amendments to the organizational requirements of the General Instructions, with one modification to address commenters' suggestions. The amendments will require mutual funds to disclose the summary information in numerical order at the front of the prospectus and not to precede this information with any information other than the cover page

or table of contents. Commenters generally supported standardizing the order and content of the summary section, agreeing that a standardized summary section will enhance investor understanding and the ability to compare funds. Information included in the summary section need not be repeated elsewhere in the prospectus. While a fund may continue to include information in the prospectus that is not required, a fund may not include any such additional information in the summary section of the prospectus.

As noted above, we are, with one exception, requiring as proposed that a multiple fund prospectus present the summary information for each fund sequentially and not integrate the information for more than one fund. That is, a multiple fund prospectus will be required to present all of the summary information for a particular fund together, followed by all of the summary information for each additional fund. For example, a multiple fund prospectus will not be permitted to present the investment objectives for several funds followed by the fee tables for several funds. A multiple fund prospectus will also be required to identify clearly the name of the particular fund at the beginning of the summary information for that fund.

Many commenters agreed that multiple fund prospectuses should present the summary information for each fund separately. Some commenters stated that requiring a separate summary for each fund will better achieve the Commission's goal of keeping summaries short which should help facilitate comparisons across funds. Commenters also stated that multiple fund prospectuses often confuse investors and make reviewing key information for a single fund more difficult.

A number of commenters, however, expressed reservations about the Commission's proposal to prohibit multiple fund summary sections, requesting that the Commission permit integrated summaries for multiple funds in at least some circumstances. Some commenters suggested that integrated summary information would allow investors to better compare all funds within a fund family, or at least certain categories of funds within a fund family. Categories of funds cited included international funds, asset allocation funds, and U.S. Treasury Funds. In addition, some commenters argued that prohibiting multiple fund summaries would lead to unnecessary duplication of information and longer statutory prospectuses. A number of investors in our focus groups expressed the view that multiple fund presentations of mutual fund information could be helpful in facilitating useful comparisons among funds. Some of these investors stated that multiple fund presentations could be used as a screening tool to determine which funds to research in more detail. Some investors in our focus groups, however, indicated that combining too many funds within a single summary can result in confusing complexity. The investors in our focus groups did not express a consensus on a specific limit on the number of funds or page length that would be appropriate in multiple fund presentations.

While we believe that multiple fund presentations can, in limited circumstances, be useful in helping investors to compare funds, we have determined that prohibiting multiple fund summary sections is more consistent with the goal of achieving concise, readable summaries for investors. The requirement that summary information be separately presented for each fund in a multiple fund prospectus is intended to address the problem of lengthy and complex multiple fund pro-

spectuses in the least intrusive manner possible. Multiple fund prospectuses contribute substantially to prospectus length and complexity, which act as barriers to investor understanding. We have concluded that permitting information for multiple funds to be integrated in the summary section would undermine our goal of providing mutual fund investors with concise and readable key information.

We note, however, that our rules do not restrict in any way the use of multiple fund presentations in advertising and sales materials, whether those materials are provided along with the Summary Prospectus or separately. Funds have complete flexibility to prepare and present comparative information to investors regarding any grouping of multiple funds that they believe is useful, and also to provide automated tools on their Web sites permitting investors to choose which funds to compare. As a result, we do not believe that the prohibition on multiple fund summaries in the statutory prospectus will impair in any significant manner funds' ability to provide useful, comparative information to investors.

We are adopting one exception to the requirement that multiple fund prospectuses not integrate the summary information for more than one fund in order to eliminate duplicative information and reduce prospectus length. Two commenters recommended that the Commission permit summary information that is identical for multiple funds to be presented once, at the end of all the individual summaries within a multiple fund statutory prospectus. We agree with these commenters that permitting integration of information that is likely to be uniform for multiple funds will further our goal of concise, user-friendly summary sections. Therefore, a multiple fund prospectus will be permitted to integrate the information required by any of new Item 6 (purchase and sale of fund shares), Item 7 (tax information), and Item 8 (financial intermediary compensation) if it is identical for all funds covered in the prospectus. This information is often uniform across multiple funds unlike, for example, information about investment objectives, costs, performance, or portfolio managers. If the information required by any of Items 6 through 8 is integrated, the integrated information will be required to immediately follow the separate individual fund summaries containing the other non-integrated information. In addition, a statement containing the following information will be required in each individual fund summary section in the location where the information that is integrated, and presented later, would have appeared.

> "For important information about [purchase and sale of fund shares,] [tax information,] and [financial intermediary compensation], please turn to [identify section heading and page number of prospectus]."

As proposed, the instructions will permit a fund with multiple share classes, each with its own cost structure, to present the summary information separately for each class, to integrate the information for multiple classes, or to use another presentation that is consistent with disclosing the summary information in a standard order at the beginning of the prospectus. Commenters generally supported, or did not express a view with respect to, allowing multiple class summary sections; and some commenters noted that such sections would assist investors in choosing the class most appropriate for their circumstances. We are not requiring the integration

of information for multiple classes of a fund, which two commenters argued was important to facilitate cost comparisons. We are retaining flexibility in this area because we believe that whether a multiple class presentation is helpful or overwhelming depends on the particular circumstances. We note, however, that our ongoing interactive data initiative is intended, among other things, to facilitate cost comparisons by investors across multiple classes of a single fund, as well as across different funds.

Page Limits

As proposed, we are not imposing page limits on the summary section. We emphasize, however, that it is our intent that funds prepare a concise summary (on the order of three or four pages) that will provide key information. Commenters differed regarding whether the Commission should impose page limits on the summary.

Several commenters supported page limits. One commenter expressed concern that, in the absence of a page limit, the summary section would tend to expand over time, which would undermine its usefulness. Another commenter noted that, absent page limits, lengths of summary sections would vary widely, hindering investors' ability to compare funds. While we share these commenters' concerns, especially with respect to the possibility of summary sections getting longer over time, we believe that these concerns are outweighed by the concerns of other commenters that page limits could constrain appropriate disclosure and lead funds to omit material information. We also agree with a commenter who noted that the prohibition of multiple fund summary sections should help to limit their length.

Elimination of Separate Purchase and Redemption Document

As proposed, we are eliminating the provisions of Form N-1A that permit a fund to omit detailed information about purchase and redemption procedures from the prospectus and to provide this information in a separate document that is incorporated into and delivered with the prospectus, as well as a similar provision in the requirements for the statement of additional information ("SAI"). We have concluded that this option is unnecessary in light of the new Summary Prospectus which could be used, at a fund's option, along with any additional sales materials, including a document describing purchase and redemption procedures. The elimination of these provisions does not otherwise alter the information about purchase and redemption procedures that must appear in the fund's prospectus and SAI, and this information will continue to be required in those documents.

Variable Contract and Retirement Plan Funds

Finally, we are modifying the proposal to permit funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit certain information required in the new summary section. This modification addresses commenters' concerns that certain information is not relevant to those funds. Specifically, we are amending the General Instructions to Form N-1A to permit funds that are used as investment options for retirement

plans and variable insurance contracts to modify or omit the information required by new summary section Item 6 (purchase and sale of fund shares). Existing Form N-1A permits funds that are used as investment options for retirement plans and variable insurance contracts to modify or omit certain information regarding the purchase and sale of fund shares that is not relevant in these contexts. The amendment we are making extends the same treatment to the purchase and sale information in the new summary section.

2. Exchange Ticker Symbols

We requested comment on whether we should require or permit a fund to include its ticker symbol in the summary, or on the front or back cover page of the statutory prospectus or SAI or elsewhere. Many commenters suggested that the Commission should require or permit funds to disclose their exchange ticker symbols. We agree with these commenters that requiring exchange ticker symbols to be included in fund disclosure documents would make it easier for investors to find information about particular funds and share classes of funds. Accordingly, we are requiring that a fund include its exchange ticker symbol on the cover pages of the statutory prospectus and SAI. Specifically, a fund will be required to disclose the exchange ticker symbol of the fund's shares or, if the prospectus or SAI relate to one or more classes of the fund's shares, adjacent to each such class, the exchange ticker symbol of that class.

3. Information Required in Summary Section

We are adopting the required content of the summary section substantially as proposed, except that, having considered commenters' concerns and the views of investors expressed in focus groups, we have determined not to require disclosure of a fund's portfolio holdings. The summary section of a mutual fund statutory prospectus will consist of the following information: (1) investment objectives; (2) costs; (3) principal investment strategies, risks, and performance; (4) investment advisers and portfolio managers; (5) brief purchase and sale and tax information; and (6) financial intermediary compensation. These items will appear in the same order that we proposed. We have modified the requirements for some items to address comments and views expressed in the focus groups.

a. Elimination of Proposed Portfolio Holdings Requirement

The Commission has determined not to require the summary section to include the list of the fund's 10 largest holdings which we proposed. As proposed, the top 10 holdings list would have been updated in the statutory prospectus on an annual basis and in the Summary Prospectus on a quarterly basis.

Commenters were split regarding whether the top 10 portfolio holdings should be required in the summary section. We are persuaded by the commenters who pointed out the limited utility of the proposed top 10 holdings list. Commenters expressed the view that top 10 holdings information may mislead investors because the top 10 holdings may not accurately represent a fund's overall holdings and because the top 10 holdings information may become stale. Com-

menters also pointed out that portfolio holdings information is already widely available through other sources, such as shareholder reports and other Commission filings, as well as fund Web sites and sales materials.

We continue to believe that information concerning a fund's portfolio holdings may provide investors with a greater understanding of a fund's stated investment objectives and strategies and may assist investors in making more informed asset allocation decisions. In light of the limited utility of top 10 holdings information, however, and the widespread availability of portfolio holdings information from other sources, we have determined not to require this information in the summary section. Some commenters and investors in our focus groups suggested that we instead require disclosure about the current allocation of a fund's portfolio by asset type, such as a pie chart that would graphically display this information. We have determined not to require this information because we have concluded that it is subject to the same concerns about staleness as top 10 holdings information and because of the widespread availability of portfolio holdings information from other sources. Nonetheless, where a fund's asset allocation strategy is a principal investment strategy of the fund, the fund should clearly disclose this strategy, and we would encourage the use of graphical representations as a potentially helpful communications tool.

In reaching our determination with respect to portfolio holdings information, we carefully considered the views of investors expressed in our focus groups. Many investors in the focus groups expressed significant interest in portfolio holdings information. At the same time, like the commenters, a number of the investors participating in our focus groups pointed out that top 10 portfolio holdings information changes frequently and can quickly become outdated, and some participants acknowledged that the top 10 holdings information can sometimes account for a relatively small portion of a fund's holdings. We concluded that investors' interest in this information is outweighed by its potential to mislead and confuse in the context of the summary section of a prospectus. Because this information is widely available through other sources, we are persuaded that investors' interest in this information can be satisfied through these other sources.

b. Order of Information

We are adopting the order of the information required in the summary section, as proposed. This includes moving the fee table forward from its current location, which follows information about investment strategies, risks, and past performance. We continue to believe that the change to the location of the fee table will enhance the prominence of this information, which is important to address continuing concerns about investor understanding of mutual fund costs. Several commenters agreed that relocation of the fee table will place fee information in a more prominent location and encourage investors to give greater attention to costs and cost comparisons. While several commenters suggested alternative orders for the information in the summary section, there was no consensus by commenters regarding any alternative.

A number of commenters, largely from the fund industry, opposed relocating the fee table. These commenters argued that moving the fee table forward inappropriately overemphasizes

costs over other more important information and that the fee table should not come between investment objectives and principal investment strategies and risks. Some of these commenters argued that the fee table should not be moved forward, because it is important for investors to first and foremost understand a fund and its risks, and that a fund's objectives, strategies, and risks provide necessary context for fees. Some commenters also argued that moving the fee table forward is unnecessary because the short length of the summary section will make the fee table sufficiently prominent.

We are not persuaded by these commenters. We continue to believe, along with a number of commenters, that placement of the fee table in a more prominent location will encourage investors to give greater attention to costs. The fee table and example are designed to help investors understand the costs of investing in a fund and compare those costs with the costs of other funds. Placing the fee table and example at the front of the summary section reflects the importance of costs to an investment decision. Moving the fee table forward also eliminates the possibility that the fee table could be obscured by other information.

c. Investment Objectives and Goals

We are adopting, as proposed, the requirement that the summary section begin with disclosure of a fund's investment objectives or goals, which commenters generally supported. As proposed, a fund also will be permitted to identify its type or category (*e.g.*, that it is a money market fund or balanced fund).

d. Fee Table

We are adopting, with modifications to address commenters' concerns and views expressed by investors in the focus groups, the fee table and example. The fee table and example disclose the costs of investing and immediately follow the fund's investment objectives.

Breakpoint Discounts

We are requiring, substantially as proposed, that mutual funds that offer discounts on front-end sales charges for volume purchases (so-called "breakpoint discounts") include brief narrative disclosure alerting investors to the availability of those discounts. Commenters generally supported the disclosure about breakpoint discounts, although many commenters, as well as focus group investors, provided suggestions for revising the narrative proposed. We are modifying the proposal in two ways to address these comments.

First, we are adding to the required narrative a description of where investors can find additional information regarding breakpoint discounts. Specifically, the narrative will be required to state that further information is available from the investor's financial professional, as well as identify the section heading and page number of the fund's prospectus and SAI where more information can be found. This information is intended to address the views of both commenters and investors in the focus groups that it would be helpful for more detailed information about

breakpoint discounts to be readily available to investors. Second, we are clarifying the instruction that the dollar level at which investors may qualify for breakpoint discounts that is required to be disclosed in the new item is the minimum level of investment required to qualify for a discount as disclosed in the table required by current Item 7(a)(1) of Form N-1A. This change makes clear that the required dollar threshold to be disclosed is the same as disclosure that is already required in Form N-1A. This change, together with the added narrative about additional information, addresses commenters' concerns that the breakpoints disclosure does not capture the complexity and variety of policies regarding breakpoint discounts.

Parenthetical to "Annual Fund Operating Expenses"

We are adopting, substantially as proposed, revisions to the heading "Annual Fund Operating Expenses" in the fee table. Specifically, we are revising the parenthetical following the heading to read "expenses that you pay each year as a percentage of the value of your investment" in place of "expenses that are deducted from Fund assets." In recent years, we have taken significant steps to address concerns that investors do not understand that they pay costs every year when they invest in mutual funds, including requiring disclosure of these costs in shareholder reports. Our revision further addresses those concerns by making clear that the expenses in question are paid by investors as a percentage of the value of their investments in the fund.

Many commenters supported the Commission's proposed revision. We have deleted the word "ongoing" from the beginning of the parenthetical language to address commenters' concerns that this term incorrectly suggests that fund operating expenses are the same each year. We are not modifying the parenthetical to address the views of some industry commenters that the statement incorrectly implies that shareholders directly pay fund expenses, when in fact expenses are paid out of fund assets. The purpose of the revision is to make clear to investors that they, in fact, bear these expenses, and the proposed language conveys this fact. Our conclusion is supported by commenters representing investor groups.

Portfolio Turnover Rate

We are adopting, with two modifications, the requirement that funds, other than money market funds, include brief disclosure regarding portfolio turnover immediately following the fee table example. A fund will be required to disclose its portfolio turnover rate for the most recent fiscal year as a percentage of the average value of its portfolio. This numerical disclosure will be accompanied by a brief explanation of the effect of portfolio turnover on transaction costs and fund performance. Some concerns have been expressed in recent years regarding the degree to which investors understand the effect of portfolio turnover, and the resulting transaction costs, on fund expenses and performance. The requirement to provide brief portfolio turnover disclosure in the summary section of the prospectus is intended to address these concerns, and the proposed disclosure received support from a significant number of commenters. Because we believe that it is important to address investors' lack of understanding of the effect of portfolio turnover and transaction costs on fund expenses and performance, we disagree with commenters opposing the disclosure of portfolio turnover rate on the grounds that such information is too complicated or unnecessary for the summary section.

We are modifying the proposed required explanation of the effect of portfolio turnover to require that the explanation also address the adverse tax consequences that may result from a higher portfolio turnover rate when fund shares are held in a taxable account. We agree with commenters who suggested that adverse tax consequences, as well as higher transaction costs, should be expressly addressed by the explanation. We are also making a technical revision to the final sentence of the proposed required explanation.

We have determined not to adopt two significant suggestions that were made by commenters: first, that we require the impact of transaction costs to be reflected in a fund's expense ratio in the fee table and, second, that we require disclosure of portfolio turnover rates over a period greater than one year. While we believe that both of these suggestions have considerable merit, we have concluded that it is not feasible to implement either at the present time as discussed further below.

Several commenters expressed the view that the Commission should require that transaction costs be reflected in a fund's expense ratio in the fee table and that this disclosure would be more meaningful to investors than the rate of portfolio turnover. The comments on this rulemaking, however, do not provide an adequate basis for prescribing a specific and accurate methodology for reflecting transaction costs in a fund's expense ratio. We do agree with the commenters that portfolio turnover rate is an imperfect measure of portfolio transaction costs. While a higher portfolio turnover rate tends to result in higher transaction costs and a lower portfolio turnover rate tends to result in lower transaction costs, there is not necessarily a direct correlation between portfolio turnover rate and portfolio transaction costs. Nonetheless, in the absence of a basis for prescribing a better measure, we believe that portfolio turnover rate, though imperfect, is an appropriate indicator of transaction costs for purposes of the summary section.

A number of commenters argued that disclosing a portfolio turnover rate over a one-year period would not yield a representative portfolio turnover rate because portfolio turnover rates vary significantly over time depending on a variety of factors, including the need to meet redemption requests, unexpected cash inflows due to sharp swings in markets, or the occurrence of a significant event not likely to repeat in future years, such as a fund merger or a new portfolio manager restructuring the fund's holdings. These commenters suggested that the Commission address this concern by, for example, requiring funds to disclose year-by-year turnover rates for a longer period (*e.g.*, 5-10 years) or an average turnover rate over a longer period of time (*e.g.*, five years). We believe that requiring year-by-year turnover rates for multiple years in the summary section would not further our goal of providing concise, user-friendly disclosure, particularly in light of the fact that there is not necessarily a direct correlation between portfolio turnover and transaction costs. We note that portfolio turnover rates for each of the past five years are already required elsewhere in the prospectus. We do not believe that there is a sufficient basis in the comments to require disclosure of an average turnover rate over a longer period of time (*e.g.*, five years). Doing so would require us to address a number of questions that have not been subject to adequate comment in this rulemaking, including devising a calculation methodology and addressing questions of comparability across funds that have been in existence for different periods of time.

Expense Reimbursement and Fee Waiver Arrangements

Finally, we are adopting, with modifications to address commenters' recommendations, the proposed amendments to the requirement that a fund disclose in its fee table gross operating expenses that do not reflect the effect of expense reimbursement or fee waiver arrangements, which result in reduced expenses being paid by the fund. The adopted amendments will permit a fund to place two additional captions directly below the "Total Annual Fund Operating Expenses" caption in cases where there are expense reimbursement or fee waiver arrangements that will reduce any fund operating expenses for no less than one year from the effective date of the fund's registration statement. We have eliminated the proposed requirement that the reimbursement or waiver arrangement has reduced operating expenses in the past, as suggested by two commenters, because this is irrelevant to the impact that the arrangements will have in the future. The purpose of the permitted line items is to show investors how the arrangements will affect expenses in the future and not how they have affected expenses in the past.

One caption will show the amount of the expense reimbursement or fee waiver, and a second caption will show the fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. Funds that disclose these arrangements will also be required to disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, including the expected termination date, and briefly describe who can terminate the arrangement and under what circumstances. We are adding an express requirement that the expected termination date of the arrangement be disclosed in order to address a commenter's concern that investors should be informed in cases where the commitment on a fee waiver becomes shorter than one year.

In computing the fee table example, a fund will be permitted to reflect any expense reimbursement or fee waiver arrangements that will reduce any operating expenses for no less than one year from the effective date of the fund's registration statement. This adjustment may be reflected only in the periods for which the expense reimbursement or fee waiver arrangement is expected to continue. For example, if such an arrangement were expected to continue for one year, then, in the computation of 10-year expenses in the fee table example, the arrangement could only be reflected in the first of the 10 years.

Commenters made several suggestions with respect to cost disclosure that we have determined not to implement at this time. First, a number of commenters suggested that the fee table in the summary section should simply disclose the total fees and expenses and should omit certain line item breakdowns of expenses that are currently required in the statutory prospectus. Commenters argued that a more abbreviated presentation, such as a fund's total expense ratio, is preferable because they argued that the current breakdown of fees is not crucial information to an investor's investment decision. We believe that this idea deserves further consideration, and we will consider it for possible future rulemaking.

Second, some commenters suggested that we consider alternative terms to describe sales loads or rule 12b-1 fees because the terms are not easily understood by most investors. We have concluded that it is more appropriate to consider these changes in the context of a full reconsideration of sales charges and rule 12b-1 rather than in the current rulemaking.

Finally, some commenters suggested that the fee table require some form of comparison of the fund's fees to a relevant benchmark based on the fees of similar funds. The Commission shares the commenters' view that the ability to compare fees across mutual funds is extremely important to investors. To facilitate this comparison, we have designed the summary section to provide investors with key information in a standardized order. We also note that the Commission's ongoing interactive data initiative is intended to provide investors and other users with the tools necessary to facilitate comparisons of fee information. The Commission recently proposed rules that would, if adopted, require mutual funds to file the information in their fee tables in an interactive data format that would facilitate automated analysis of the information and comparison to other funds. The interactive data format would allow users of fee table information to download cost and performance information directly into spreadsheets and analyze it using commercial off-the-shelf software.

e. Investments, Risks, and Performance

Following the fee table and example, we are requiring, substantially as proposed, that a fund disclose its principal investment strategies and risks. This includes the current bar chart and table illustrating the variability of returns and showing the fund's past performance.

We are modifying the narrative that is required to accompany the bar chart and performance table in one respect to address the views expressed by both focus group investors and commenters. A fund that makes updated performance information available on a Web site or at a toll-free (or collect) telephone number will be required to include a statement explaining this and providing the Web site address and/or telephone number. A number of investors in focus groups expressed the view that the availability of updated performance information, particularly at a Web site, would be helpful. In addition, many industry commenters noted that funds routinely make updated performance information available to investors either by Internet Web site or by telephone and suggested that the summary section direct investors to this information. Particularly in light of our determination not to require quarterly updating of the Summary Prospectus, which is discussed below, we believe that it will be helpful to investors for the summary section to indicate where updated performance information may be found.

We are not modifying the required bar chart and performance table to add additional comparative information as suggested by several commenters. Currently, funds are required to include an appropriate broad-based securities market index in the performance table. We have determined not to require additional comparative performance information at this time because we are concerned that it would tend to undermine our goal of a concise, user-friendly summary of key information by contributing to the length and complexity of the summary section. Further, as with cost information, we believe that it is preferable for investors and other users of the

prospectus to be given the flexibility to make a variety of performance benchmark comparisons. Our ongoing interactive data initiative is intended to provide the tools necessary to facilitate dynamic comparisons of this type, and we note that the information in the bar chart and performance table is covered by our recently proposed rules that would, if adopted, require mutual funds to file information in an interactive data format.

f. Management

We are adopting, as proposed, the requirement that the summary section include the name of each investment adviser and sub-adviser of the fund, followed by the name, title, and length of service of the fund's portfolio managers. A fund will not be required to identify a sub-adviser whose sole responsibility is limited to day-to-day management of cash instruments unless the fund is a money market fund or other fund with a principal investment strategy of regularly holding cash instruments. Also, a fund having three or more sub-advisers, each of which manages a portion of the fund's portfolio, will not be required to identify each sub-adviser, except that the fund will be required to identify any sub-adviser that is (or is reasonably expected to be) responsible for the management of a significant portion of the fund's net assets. For this purpose, a significant portion of a fund's net assets generally will be deemed to be 30% or more of the fund's net assets. The portfolio managers required to be listed will be the same ones with respect to which information is currently required in the prospectus.

Several commenters opposed requiring funds to disclose portfolio managers. Two of these commenters argued that the identity and length of service of portfolio managers do not rise to the level of importance necessary to warrant inclusion in the summary. However, the Commission continues to believe, along with other commenters, that investors in a fund should be provided basic information about the individuals who significantly affect the fund's investment operations.

Some commenters noted that funds are often managed by teams and that disclosing the individuals making up such teams would make the summary section too long and would not add substantive disclosure. We note that, as is currently the case, disclosure will be required only with respect to the members of a management team who are jointly and primarily responsible for the day-to-day management of the fund's portfolio. We agree with other commenters that investors have the same interest in the identity of the individuals who are primarily responsible for management, regardless of whether a fund is managed by an individual portfolio manager or a team.

g. Purchase and Sale of Fund Shares

We are adopting, with modifications to address exchange-traded funds, the proposed requirement that the summary section disclose the fund's minimum initial or subsequent investment requirements and the fact that the fund's shares are redeemable, and identify the procedures for redeeming shares (*e.g.*, on any business day by written request, telephone, or wire transfer). Commenters generally did not express a view with respect to this requirement.

h. Tax Information

We are adopting, as proposed, the requirements for tax information in the summary section. A fund will be required to state, as applicable, that it intends to make distributions that may be taxed as ordinary income or capital gains or that the fund intends to distribute tax-exempt income. A fund that holds itself out as investing in securities generating tax-exempt income will be required to provide, as applicable, a general statement to the effect that a portion of the fund's distributions may be subject to federal income tax. Commenters generally expressed no views on these requirements.

i. Financial Intermediary Compensation

The Commission is adopting the proposed requirement that the summary section of the prospectus conclude with disclosure regarding financial intermediary compensation. Commenters generally supported this requirement, and we are modifying the requirement in two ways to address views expressed during investor focus groups and the concerns of commenters. Specifically, we are requiring the following statement, which could be modified provided that the modified statement contains comparable information:

> *"Payments to Broker-Dealers and Other Financial Intermediaries*
>
> If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."

This disclosure will be new to fund prospectuses and is intended to identify the existence of compensation arrangements with selling broker-dealers or other financial intermediaries, alert investors to the potential conflicts of interest arising from these arrangements, and direct investors to their salesperson or the financial intermediary's Web site for further information. It is intended to address, in part, concerns that mutual fund investors lack adequate information about certain distribution-related costs that create conflicts for broker-dealers and their associated persons.

We have added a provision permitting a fund to omit the financial intermediary disclosure if neither the fund nor any of its related companies pay financial intermediaries for the sale of fund shares or related services. This addresses the concerns of a number of commenters who expressed the view that the Commission should not require the narrative disclosure from funds to which the disclosure does not apply. According to one commenter, such funds include, for example, no-load funds and funds sold directly to investors.

We have also modified the proposed statement to clarify that payments to a broker-dealer or other financial intermediary may create a conflict of interest by influencing the broker-dealer or other intermediary to recommend a fund over another investment. This modification, made in response to investor comments from our focus groups, is intended to increase awareness of potential conflicts of interest. We are, therefore, revising the narrative to expressly notify investors that a conflict of interest may exist with respect to the broker-dealer's recommendation.

We have determined not to add a requirement that the disclosure include standardized language enumerating the types of compensation that may be provided to financial intermediaries, as suggested by one commenter. Rather, we are adopting a statement that will alert investors generally to the payment of compensation and the potential conflicts arising from that payment. An investor could then obtain further detail from his or her salesperson or the intermediary's Web site. As discussed further below, we intend to consider additional steps in the future that would further enhance investors' access to information about broker and intermediary compensation and conflicts of interest.

4. Exchange-Traded Funds

In March of this year, the Commission proposed several amendments to Form N-1A to accommodate the use of the form by ETFs. Most ETFs are organized and registered as open-end funds. Unlike traditional mutual funds, however, they sell and redeem individual shares ("ETF shares") only in large aggregations called "creation units" to certain financial institutions. ETFs register offerings and sales of ETF shares under the Securities Act and list their shares for trading under the Securities Exchange Act of 1934 ("Exchange Act"). As with any listed security, investors trade ETF shares at market prices.

The proposed amendments for ETF prospectuses were designed to meet the needs of investors (including retail investors) who purchase ETF shares in secondary market transactions rather than financial institutions that purchase creation units directly from the ETF. The proposed amendments for ETF prospectuses also addressed the need to modify the summary section of ETF prospectuses to include the amended ETF disclosures. Today, we are adopting the proposed amendments for ETF prospectuses with changes to respond to issues raised by commenters on the summary prospectus proposing release and the ETF proposing release.

a. Purchasing and Redeeming Shares

We are amending Form N-1A to eliminate the requirement that ETF prospectuses disclose information on how to buy and redeem shares directly from the ETF because it is not relevant to investors who are secondary market purchasers of ETF shares. We proposed to require ETF prospectuses to state the number of shares contained in a creation unit (*i.e.*, the aggregate number of shares an ETF will issue or that is necessary to redeem from the ETF), that individual shares can only be bought and sold on the secondary market through a broker-dealer, and that shareholders may pay more than net asset value ("NAV") when they buy ETF shares and receive less than NAV when they sell shares because shares are bought and sold at current market prices. We also

proposed to amend the fee table disclosure in Form N-1A to exclude fees and expenses for purchases or redemptions of creation units and instead to modify the narrative explanation preceding the example in the fee table to state that investors in ETF shares may pay brokerage commissions that are not reflected in the example. Commenters who addressed the proposed amendments generally supported this approach. We are adopting the amendments largely as proposed, with minor changes to conform to the final amendments to the summary section. ETFs still will be required to include disclosure on how creation units are offered to the public in the SAI.

Consistent with our proposal, the alternative disclosures in Items 3 and 6 of Form N-1A will not be available to ETFs with creation units of less than 25,000 shares. Although only certain financial institutions purchase and redeem creation units directly from an ETF, individual or retail investors may be more likely to transact in creation units through one of these financial institutions if the creation unit size is less than 25,000 shares. Because there is greater potential for retail investors to transact (indirectly) in creation units as they decrease in size, we are requiring any ETF that sells and redeems its shares in creation units of 25,000 or less to include in its prospectus information on how to purchase and redeem creation units and the costs associated with those transactions.

b. Total Return

At the suggestion of commenters, we are not adopting our proposal that ETFs include disclosure of market price returns in addition to returns based on NAV. Like any other fund that files Form N-1A, an ETF must disclose returns based on NAV. All commenters who addressed this proposal opposed it. They disagreed that these returns would be more relevant to an investor's experience in the ETF than returns based on NAV because market price (which we proposed to define as closing price) is not tied to an investor's particular purchase price. One commenter suggested that while NAV also does not represent any single investor's experience, it provides a better metric of performance than market price. After consideration of these comments, we agree with these commenters that market price returns would not more closely represent the experience of any particular investor and may confuse investors, particularly when disclosed next to NAV returns. We therefore are not requiring ETFs to disclose market price returns in Form N-1A.

We also are not adopting our proposal that would have required an index-based ETF to compare its performance to its underlying index rather than a benchmark index. Commenters on the ETF proposing release stated that we should not change the disclosure requirement for index-based ETFs without changing the requirement for all index funds. We agree that the proposed change should be considered with respect to all index funds, not just index-based ETFs, and therefore, we are not adopting this amendment but may consider future rulemaking.

c. Premium/Discount Information

We are adopting, as proposed, the amendments to the form to require each ETF to disclose to investors information about the extent and frequency with which market prices of fund shares have tracked the fund's NAV. Each ETF will be required to disclose in its prospectus the number of trading days during the most recently completed calendar year and quarters since that year on which the market price of the ETF shares was greater than the fund's NAV and the number of days it was less than the fund's NAV (premium/discount information). This disclosure is designed to alert investors to the relationship between NAV and the market price of the ETF's shares, and that investors may purchase or sell ETF shares at prices that do not correspond to NAV. In addition, this disclosure will provide historical information regarding the frequency of these deviations.

Commenters on the ETF proposing release were divided as to whether this specific premium/discount information would be useful to investors, although all who commented suggested the information need only be provided on the ETF's Web site. Based on these comments, it appears that specific premium/discount information may not be generally useful to all ETF investors. For that reason, an ETF may omit the disclosure of specific premium/discount information in its prospectus or annual report if the fund provides the information on its Internet Web site and discloses in the prospectus or annual report an Internet address where investors can locate the information. Because ETFs may choose to provide this disclosure on their Web sites instead of in their prospectuses, we have added a requirement that the prospectus disclose that ETF shares may trade at a premium or discount. This approach is designed to require disclosure of the information, but avoid duplicative disclosures that may result in additional regulatory burdens. Commenters who addressed the issue strongly supported permitting ETFs to include historical premium/discount information on their Web sites instead of in their prospectuses and annual reports. Our amendments allow ETFs to choose the most cost-effective method of providing this disclosure to their investors.

For purposes of calculating premium/discount information, we are adopting, with a modification, the proposed definition of "market price. "Commenters objected to our proposed definition of market price as the closing price because of stale pricing concerns. These commenters suggested that ETFs instead be permitted to use the mid-point between the highest bid and the lowest offer at the time the fund's NAV is calculated. To address these concerns, the final amendments define the term "market price" to mean the closing price on the principal market on which ETF shares trade or within the range between the highest offer and the lowest bid if that price more accurately reflects the current market value of the fund's shares at the time the Fund calculates its NAV.

5. Conforming and Technical Amendments to Form N-1A

The foregoing amendments to Form N-1A require adding new items to the form and revising and renumbering certain existing items. We are adopting conforming amendments to

Form N-1A, consistent with these revisions and renumbering, in order to update the table of contents and the various references to Form N-1A items contained within the form. We are also adopting technical amendments to Form N-1A to update the Commission's telephone number and address.

B. New Delivery Option for Mutual Funds

1. Use of Summary Prospectus and Satisfaction of Statutory Prospectus Delivery Requirements

The Commission is adopting, with modifications to address commenters' concerns, the proposal to replace rule 498 with a new rule that permits the obligation under the Securities Act to deliver a statutory prospectus with respect to mutual fund securities to be satisfied by sending or giving a Summary Prospectus and providing the statutory prospectus online. In addition, the new rule will require a fund to send the statutory prospectus in paper or by e-mail upon request. The Summary Prospectus is required to contain the key information that is included in the new summary section of the statutory prospectus in the same order that is required in the statutory prospectus.

The new rule is intended to create a disclosure regime that is tailored to the unique needs of mutual fund investors in a manner that provides ready access to the information that investors need, want, and choose to review in connection with a mutual fund purchase decision. The rule provides for a layered approach to disclosure in which key information is sent or given to the investor and more detailed information is provided online and, upon request, is sent in paper or by e-mail. This is intended to provide investors with better ability to choose the amount and type of information to review, as well as the format in which to review it (online or paper). In addition, the provision of a Summary Prospectus containing key information about the fund, coupled with online provision of more detailed information, should aid investors in comparing funds. In short, we believe that the new rule will result in funds providing investors with more useable information than they receive today in a format that investors are more likely to use and understand. Under the new rule, an investor could choose to receive the statutory prospectus in the same paper format that would be provided under our prior rules.

The new rule provides that any obligation under Section 5(b)(2) of the Securities Act to have a statutory prospectus precede or accompany the carrying or delivery of a mutual fund security in an offering registered on Form N-1A is satisfied if (1) a Summary Prospectus is sent or given no later than the time of the carrying or delivery of the fund security; (2) the Summary Prospectus is not bound together with any materials, except as described below; (3) the Summary Prospectus that is sent or given satisfies the rule's requirements at the time of the carrying or delivery of the fund security; and (4) the conditions set forth in the rule, which require a fund to provide the Summary Prospectus, statutory prospectus, and other information on the Internet in the manner specified in the rule, are satisfied. As discussed in more detail below, we have changed the proposed condition that the Summary Prospectus be given "greater prominence" than accompanying materials into a requirement of the rule, rather than a condition to sat-

isfaction of delivery obligations under Section 5(b)(2) of the Securities Act. We have also clarified that any particular Summary Prospectus is not required to be given "greater prominence" than any other Summary Prospectuses or statutory prospectuses. As adopted, we are also permitting the Summary Prospectuses and statutory prospectuses of multiple underlying funds of a variable insurance contract to be bound with each other and with the statutory prospectus for the contract.

Section 5(b)(2) of the Securities Act makes it unlawful to deliver a security for purposes of sale or for delivery after sale "unless accompanied or preceded" by a statutory prospectus. Under the rule, delivery of the statutory prospectus for purposes of Section 5(b)(2) is accomplished by sending or giving a Summary Prospectus and by providing the statutory prospectus and other required information online. Failure to comply with the rule's requirements for sending or giving a Summary Prospectus and providing the statutory prospectus and other information online would mean that the rule could not be relied on to meet the Section 5(b)(2) prospectus delivery obligation. Absent satisfaction of the Section 5(b)(2) obligation by other available means, a Section 5(b)(2) violation would result. The rule also requires a fund to send the statutory prospectus upon request. This requirement is not a condition to reliance on the rule, and failure to send the requested statutory prospectus will result in a violation of the rule (as opposed to a violation of Section 5(b)(2)).

Section 5(b)(2) does not require delivery of the statutory prospectus prior to delivery of the security or confirmation of the transaction. As a result, mutual fund investors too often receive the statutory prospectus after the purchase transaction when the investment decision is complete. The rules we are adopting will, in practice, require any fund that is relying on the Summary Prospectus to meet its obligations under Section 5(b)(2) to post both its Summary Prospectus and statutory prospectus on the Internet at all times. This will result in significantly enhanced access by investors to information about the fund prior to the time of making an investment decision. Several commenters observed that it would be helpful if investors could review a Summary Prospectus prior to making an investment decision. We intend to consider additional steps in the future that would further enhance investors' access to the Summary Prospectus, other information about the fund, and enhanced information about broker and intermediary compensation and conflicts of interest before the investment decision. For example, we continue to consider appropriate disclosures at the point of sale by financial intermediaries, including whether there should be an obligation to direct investors to the online availability of the Summary Prospectus and offer investors a copy of the Summary Prospectus.

The rule we are adopting also provides that a communication relating to an offering registered on Form N-1A that is sent or given after the effective date of a mutual fund's registration statement (other than a prospectus permitted or required under Section 10 of the Securities Act) shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act if (1) it is proved that prior to or at the same time with the communication a Summary Prospectus was sent or given to the person to whom the communication was made; (2) the Summary Prospectus is not bound together with any materials, except as described below; (3) the Summary Prospectus that was sent or given satisfies the rule's requirements at the time of the communication; and (4) the

conditions set forth in the rule, which require a fund to provide the Summary Prospectus, statutory prospectus, and other information on the Internet in the manner specified in the rule, are satisfied. This provision is similar to Section 2(a)(10)(a) of the Securities Act, which provides that a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of Section 10) shall not be deemed a prospectus if it is proved that prior to or at the same time with the communication a written prospectus meeting the requirements for a statutory prospectus at the time of the communication was sent or given to the person to whom the communication was made. Pursuant to this provision, communications that would otherwise be considered "prospectuses" subject to the liability provisions of Section 12(a)(2) of the Securities Act are not deemed prospectuses and are not subject to Section 12(a)(2) if they are preceded or accompanied by the statutory prospectus. Similarly, under the new rule, communications that are preceded or accompanied by a Summary Prospectus are not deemed to be prospectuses and are not subject to Section 12(a)(2) if all the conditions of the rule are met. These communications remain subject to the general antifraud provisions of the federal securities laws.

Commenters generally supported the proposal, noting that investors will be more likely to read and understand the Summary Prospectus than the statutory prospectus and that use of the Summary Prospectus will help investors to focus on what is most important in making investment decisions with respect to a particular fund. One commenter noted that its own research has shown that most investors do not find the statutory prospectus to be a particularly useful document and do not rely heavily on it in making a fund selection. The commenter agreed that it makes little sense to continue to require delivery of a document to all investors that most say they do not value. A second commenter noted that the proposal "reflects the strikingly broad consensus that investors would be best served by simplified, streamlined disclosure of essential fund information" and is supported by research conducted by the Commission and others. Similarly, investors in our focus groups generally expressed favorable views of the Summary Prospectus, noting its usefulness as a screening tool to identify funds that they might wish to research further. Commenters also approved of the proposal's use of the power of the Internet and advances in technology to deliver information to investors.

Two commenters argued that use of the Summary Prospectus should be mandatory, including one who noted that inconsistent use of the Summary Prospectus could create confusion and would make comparison of funds more difficult for investors. We have determined not to mandate use of the Summary Prospectus at this time. We believe that further public comment on this important step is necessary, and we intend to review the use of the Summary Prospectus by investors in funds that voluntarily adopt the Summary Prospectus and reconsider whether the Summary Prospectus should be mandated in the future.

As noted above, we are modifying the rule's conditions in three respects to address the concerns of commenters. First, we have eliminated the condition that the Summary Prospectus be given greater prominence than any accompanying materials and instead made it a rule requirement. Second, we have modified this requirement to clarify that a Summary Prospectus need not be given "greater prominence" than other Summary Prospectuses or statutory prospectuses that

accompany the Summary Prospectus. Third, we have revised the condition that would have prohibited the Summary Prospectus from being bound together with any other materials to permit a Summary Prospectus for a fund that is available as an investment option in a variable annuity or variable life insurance contract to be bound together with the statutory prospectus for the contract and Summary Prospectuses and statutory prospectuses for other investment options available under the contract.

We have made the "greater prominence" standard a rule requirement instead of a condition to satisfaction of Section 5(b)(2) obligations. While we continue to believe that the "greater prominence" requirement is important to prevent the Summary Prospectus from being obscured by accompanying sales and other materials and to highlight for investors the concise, balanced presentation of the Summary Prospectus, we are persuaded by commenters that the consequences of failure to meet the condition—a Section 5 violation—is not needed to achieve our goal. Therefore, we are adopting commenters' suggestion that satisfaction of the "greater prominence" standard be a rule requirement. As adopted, the "greater prominence" requirement is not a condition to reliance on the rule to satisfy a fund's or intermediary's delivery obligations under Section 5(b)(2) of the Securities Act or the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act. A person that complies with the conditions to the rule will not violate Section 5(b)(2) if the "greater prominence" standard is not satisfied. This failure will, however, constitute a violation of the Commission's rules. Generally, we believe that the "greater prominence" requirement would be satisfied if the placement of the Summary Prospectus is more prominent than accompanying materials, *e.g.*, the Summary Prospectus is on top of a group of paper documents that are provided together.

We are adopting the condition that prohibits a Summary Prospectus from being bound together with any other materials. Although commenters were split on the proposed binding prohibition, with some supporting the requirement and others opposed or seeking modifications, we continue to believe that it is important to prevent the Summary Prospectus from being obscured by accompanying sales and other materials and to highlight for investors the concise, balanced presentation of the Summary Prospectus. We are, however, persuaded that it is appropriate to permit binding the statutory prospectus of a variable insurance contract with the Summary Prospectuses and statutory prospectuses of its underlying funds. This will permit satisfaction of prospectus delivery requirements for both a variable insurance contract and its underlying funds in one consolidated package and does not involve any risk of the prospectuses being obscured by sales or other materials. Specifically, under rule 498, a Summary Prospectus for a fund that is available as an investment option in a variable annuity or variable life insurance contract may be bound together with the statutory prospectus for the contract and Summary Prospectuses and statutory prospectuses for other investment options available in the contract, provided that: (i) all of the funds to which the Summary Prospectuses and statutory prospectuses that are bound together relate are available to the person to whom such documents are sent or given; and (ii) a table of contents identifying each Summary Prospectus and statutory prospectus that is bound together, and the page number on which it is found, is included at the beginning or immediately following a cover page of the bound materials. These conditions are intended to ensure that investors are not inundated with prospectuses that are not relevant to the contract

they are considering and to ensure that investors can readily locate the particular prospectuses in which they are interested.

2. Content of Summary Prospectus

Rule 498 sets forth the content requirements that a Summary Prospectus must satisfy. A Summary Prospectus meeting the requirements of the rule will be deemed to be a prospectus that is authorized under Section 10(b) of the Securities Act and Section 24(g) of the Investment Company Act for the purposes of Section 5(b)(1) of the Securities Act. A Summary Prospectus meeting these content requirements could be used to offer securities of the fund pursuant to Section 5(b)(1) even if the other conditions of the rule were not satisfied. The failure to satisfy these other conditions will, however, preclude the use of the Summary Prospectus for the other purposes described in rule 498, including for purposes of satisfying, in part, a fund's obligation under Section 5(b)(2) to deliver a statutory prospectus. In these circumstances, the Section 5(b)(2) obligation to deliver a fund's statutory prospectus will have to be met by means other than the new rule or a Section 5(b)(2) violation will result.

a. General

We are adopting, with one clarification, the requirement that the Summary Prospectus include the same information as required in the summary section of the statutory prospectus in the same order required in the statutory prospectus. This key information about investment objectives, costs, and risks forms the body of the Summary Prospectus.

We are adopting a new requirement to clarify that if a fund relies on rule 498 to meet its statutory prospectus delivery obligations, the information contained in the Summary Prospectus must be the same as the information contained in the summary section of the fund's statutory prospectus, except as expressly permitted by rule 498. That is, a fund may not provide different, such as more or less expansive, information in its Summary Prospectus than it provides in its statutory prospectus. If, pursuant to rule 497, a mutual fund files a "sticker" to its statutory prospectus that changes any information in the summary section, the Summary Prospectus should either be "stickered" or amended to reflect the information in the statutory prospectus "sticker." This new requirement is intended to clarify our intent in adopting the same content requirements for the Summary Prospectus and the summary section of the statutory prospectus.

The Summary Prospectus will not be permitted to omit any of the required information or to include additional information except as described below. A document that omits information required in a Summary Prospectus or includes additional information not permitted by the rule will not be a Summary Prospectus under the rule and may not be used under the rule for any purpose, including meeting the obligation to deliver a fund's statutory prospectus. We are adopting these requirements, as proposed, because we believe that uniformity of content in Summary Prospectuses will provide better comparability, which will help investors to make a more informed investment decision, a conclusion which was supported by a number of commenters.

While some commenters argued that the rule should provide funds with flexibility to customize the content of the Summary Prospectus, we are not persuaded because customization would significantly impair investors' ability to compare information across funds. We note that, provided the content and order requirements of the rule are met, funds have almost complete flexibility with respect to design issues, including layout, graphics, and color.

We are adopting, as proposed, the requirement that a Summary Prospectus describe only one fund, but may describe multiple classes of a single fund. This requirement is similar to the requirements for the summary section of the statutory prospectus. Like those requirements, it is intended to result in a presentation of key fund information that is concise and easy to read.

One commenter suggested that the Commission permit funds to satisfy their obligation to deliver a statutory prospectus to their existing shareholders by delivering a document directing shareholders' attention to material changes that have occurred during the covered period. The commenter argued that such an approach would focus shareholders' attention on the factors that are most likely to affect their continuing evaluation of the fund and impose lower costs than delivery of the Summary Prospectus. We are not adopting this suggestion at this time. We are concerned that creation of an additional document to be used only for existing shareholders could impose significant costs on funds and their shareholders. Moreover, as noted earlier, we recently proposed to require mutual funds to submit in interactive data format information contained in the risk/return summary section of their statutory prospectuses. We are continuing to consider that proposal and believe that, if adopted, this requirement would help investors, intermediaries, and others to readily identify any changes in this information.

b. Cover Page or Beginning of Summary Prospectus

We are adopting, as proposed, the requirements for the cover page or beginning of the Summary Prospectus, with the addition of a requirement to include the exchange ticker symbols of the fund's securities. The Summary Prospectus will be required to include the following information on the cover page or at the beginning of the Summary Prospectus:

- the fund's name and the share classes to which the Summary Prospectus relates;
- the exchange ticker symbol of the fund's securities or, if the Summary Prospectus relates to one or more classes of the fund's securities, adjacent to each such class, the exchange ticker symbol of such class of the fund's securities;
- a statement identifying the document as a "Summary Prospectus"; and
- the approximate date of the Summary Prospectus's first use.

In addition, the cover page or beginning of the Summary Prospectus is required to include the following legend:

> "Before you invest, you may want to review the Fund's prospectus, which contains more information about the Fund and its risks. You can find the Fund's prospectus and other information about the Fund online at [ ]. You can also get this information at no cost by calling [ ] or by sending an e-mail request to [ ]."

In addition, the legend may include a statement to the effect that the Summary Prospectus is intended for use in connection with a defined contribution plan that meets the requirements for qualification under Section 401(k) of the Internal Revenue Code, a tax-deferred arrangement under Section 403(b) or 457 of the Internal Revenue Code, or a variable contract as defined in Section 817(d) of the Internal Revenue Code and is not intended for use by other investors.

The legend is required to provide an Internet address, toll free (or collect) telephone number, and e-mail address that investors can use to obtain the statutory prospectus and other information. The legend is also permitted to indicate that the statutory prospectus and other information are available from a financial intermediary (such as a broker-dealer or bank) through which shares of the fund may be purchased or sold. The Internet address at which the statutory prospectus and other information are available is not permitted to be the address of the Commission's Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR"). The address is required to be specific enough to lead investors directly to the statutory prospectus and other required information, rather than to the home page or other section of the Web site on which the materials are posted. The Web site could be a central site with prominent links to each required document.

We are not modifying the proposal in response to commenters who suggested that the legend provide more guidance regarding the types of information available, because we believe that investors will be less likely to read a longer legend describing multiple documents and that the legend, as adopted, is sufficient to alert investors to the existence and location of additional information about the fund. Moreover, as discussed below in Part III.B.4.a., a Summary Prospectus that incorporates information by reference is required to include more specific disclosure identifying the documents from which the information is incorporated. We also are not modifying the proposal in response to a commenter who suggested that the legend make clearer that the Summary Prospectus is only a part of the full statutory prospectus. We believe that the combination of the legend and the requirement to identify the Summary Prospectus as a "Summary Prospectus" will provide clear notice to investors that more information is contained in the statutory prospectus.

c. Updating Requirements

We are not adopting the proposed requirement that performance information in the Summary Prospectus be updated quarterly and related provisions of the proposed rule. We are persuaded by commenters who expressed concerns about potential investor confusion, focus on short-term performance, and the costs and operational difficulties associated with implementing quarterly updating. As adopted, the rule will require a fund that makes updated performance information available on a Web site or at a toll-free (or collect) telephone number to include a statement explaining this and providing the Web site address and/or telephone number.

Some commenters noted that investors may be confused if different information is contained in the summary section of the statutory prospectus (which the proposal did not require to be

updated on a quarterly basis) and the Summary Prospectus. A number of commenters also expressed concern that the proposed quarterly updating requirement signals a troubling shift toward focusing on short-term performance information, rather than encouraging investors to consider long-term performance. Commenters also noted that updated performance information is already widely available on the Internet and from other sources. Many commenters suggested as an alternative that the Commission require annual updating of the Summary Prospectus, with prominent disclosure in the document describing how investors can access updated performance information (i.e., through a Web site address or toll-free telephone number). Investors participating in our focus groups also indicated that they would be willing to obtain updated fund information online.

In addition, many commenters from the fund industry also stated that the costs and operational difficulties associated with implementing the quarterly updating requirement would discourage funds from using the Summary Prospectus. The commenters noted that updating of Summary Prospectuses would likely require an entirely new process that would be more complex than the one used for existing quarterly fund fact sheets. Moreover, these commenters noted that a quarterly updating requirement would essentially require them to move to an "on demand" printing model for distribution of Summary Prospectuses, which would entail changes in business practices, new or amended vendor contracts, and, for a few fund families, significant initial outlays that could substantially delay implementation of the Summary Prospectus. Financial intermediaries similarly expressed concern about "the ability of even large intermediaries to maintain and track a hard copy inventory of prospectuses which change multiple times per year." Some commenters also noted that updated performance information is already widely available from other sources.

On the other hand, a small number of commenters supported the proposed quarterly updating requirement. One such commenter argued that quarterly updating would enhance the public's perception of the Summary Prospectus and the information provided. The commenter noted that funds presently provide such updated information in their sales materials; that displaying annually updated performance information in the statutory prospectus and quarterly updated information in the Summary Prospectus would not necessarily confuse investors; and that although funds post updated information online throughout the year, investors without access to the Internet would be greatly disadvantaged if the Commission did not require quarterly updating of the paper Summary Prospectus.

We have determined not to require quarterly updating of performance information in the Summary Prospectus because we are persuaded that this requirement could confuse investors and would discourage funds from using the Summary Prospectus and thereby undermine our goal of encouraging concise, user-friendly disclosure to investors. We have concluded that the benefits to be derived from quarterly updating do not outweigh this significant disincentive to use of the Summary Prospectus because updated performance information is widely available in fund sales materials, on fund Web sites, and from third-party sources. As noted above, investors in our focus groups indicated that they would be willing to obtain updated information online. As a result, we are requiring a fund that makes updated performance information available on a Web

site or at a toll-free (or collect) telephone number to include a statement explaining this and providing the Web site address and/or telephone number. This approach will eliminate any potential investor confusion that could arise as a result of a fund's Summary Prospectus containing more updated information than the fund's statutory prospectus.

3. Provision of Statutory Prospectus, SAI, and Shareholder Reports

We are adopting, with certain modifications to address the concerns of commenters, the requirement that, in addition to sending or giving a Summary Prospectus, a person relying on rule 498 to meet its statutory prospectus delivery obligations must provide the statutory prospectus on the Internet, together with other information, in the manner specified by the rule. We are also adopting, as proposed, the requirement to send the statutory prospectus to any investor requesting a copy. We believe that requiring the statutory prospectus to be provided in two ways, by posting on an Internet Web site and by sending the information directly to any investor requesting a copy, maximizes both the accessibility and usability of the information, as indicated by the preference of commenters and investors participating in our focus groups for access to both online and paper resources. Sending the information directly to an investor is not, however, a condition of reliance on the rule.

a. Documents Required to be Provided on the Internet

Under the rule, the statutory prospectus and other information are required to be provided through the Internet as follows. The fund's current Summary Prospectus, statutory prospectus, SAI, and most recent annual and semi-annual reports to shareholders are required to be accessible, free of charge, at the Web site address specified on the cover page or at the beginning of the Summary Prospectus. These documents are required to be accessible on or before the time that the Summary Prospectus is sent or given and current versions of the documents are required to remain on the Web site through the date that is at least 90 days after (i) in the case of reliance on the rule to satisfy the obligation to have a statutory prospectus precede or accompany the carrying or delivery of a mutual fund security, the date that the mutual fund security is carried or delivered, or (ii) in the case of reliance on the rule to deem a communication with respect to a mutual fund security not to be a prospectus under Section 2(a)(10) of the Securities Act, the date that the communication is sent or given. This requirement is designed to ensure continuous access to the information from the time the Summary Prospectus is sent or given until at least 90 days after the date of delivery of a security or communication in reliance on rule 498.

A number of commenters expressed concern regarding the meaning of the term "current" and asked whether funds would be required to maintain stale information online. In response to these commenters' concerns, we note that the "current" standard does not require a fund to maintain online an outdated version of a document that was current at the time the Summary Prospectus was sent or given, but that has subsequently been updated. Rather, the "current" standard requires a fund to maintain updated versions of the required documents online.

Several commenters argued that a person relying on the rule should not be required to provide the fund's SAI on the Web site. We have not adopted this suggestion. As discussed above, the rule provides for a layered approach to disclosure in which key information is sent or given to the investor and more detailed information is provided online and, upon request, is sent in paper or by e-mail. The approach of rule 498 is two-fold, both to encourage funds to provide a concise, user-friendly Summary Prospectus to investors and to enhance investor access to more detailed information. Requiring the SAI to be provided online furthers the latter goal.

b. Formatting Requirements for Information Provided on the Internet

We are adopting, with modifications to reflect commenters' concerns, the proposed formatting requirements for the information that is required to be provided online. The proposed rule would have required, as a condition to reliance on the rule to satisfy a person's delivery obligations under Section 5(b)(2) of the Securities Act and the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act, that the information on the Internet be presented in a format that is convenient for both reading online and printing on paper. In lieu of this condition, we are adopting a condition requiring that the information on the Internet be presented in a format that is human-readable and capable of being printed on paper in human-readable format. We are also adopting a requirement that the information be in a format that is convenient for both reading online and printing on paper, but this requirement is not a condition to reliance on the rule to satisfy a person's delivery obligations under Section 5(b)(2) of the Securities Act or the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act. A person that complies with the conditions to the rule will not violate Section 5(b)(2) if the "convenient for both reading online and printing on paper" standard is not satisfied, but this failure will constitute a violation of the Commission's rules.

The condition that we are adopting, that information on the Internet be presented in a format that is human-readable and capable of being printed on paper in human-readable format, is a more objective standard than the proposed "convenient" condition. Commenters expressed concern about applying the proposed standard as a condition to satisfying Section 5 obligations. The adopted condition simply makes clear that posted information must be presented in human-readable text, rather than machine-readable software code, when accessed through an Internet browser and that it must be printable in human-readable text. This condition does not impose any further requirements relating to user-friendliness of the presentation.

We are, however, retaining the standard that posted information be "convenient for both reading online and printing on paper" as a rule requirement. This implements the suggestion of commenters who criticized the "convenient" standard as a condition and suggested that it could, instead, be made a rule requirement. This standard was designed to ensure that the information provided over the Internet is user-friendly, both online and when printed. It imposes on the online information a standard of usability that is comparable to the readability of a paper document. While we continue to believe that this standard is important to the enhanced disclosure framework we are adopting, we are persuaded by commenters that the consequence of failure to meet a condition—a Section 5 violation—is not needed to achieve our goal.

We are not, at this time, specifying that any particular format, such as HTML or PDF, would constitute a convenient format for both reading online and printing on paper. We are concerned that the Commission's endorsement of any particular format could result in the use of that format to the exclusion of other formats that are in existence today or that may be developed in the future and that are more user-friendly. Moreover, whether a particular format is convenient for reading online and printing depends on a number of factors and must be decided on a case-by-case basis. These factors include the manner in which the online version renders charts, tables, and other graphics; the extent to which the fund utilizes search and other capabilities of the Internet to enhance investors' access to information and provides access to any software necessary to view the online version; and the time required to download the online materials.

c. Technological Requirements for Online Information

We are adopting the proposed requirements for linking within the statutory prospectus and SAI and for linking between the Summary Prospectus, on the one hand, and the statutory prospectus and SAI, on the other. These requirements are intended to result in online information that is in a better and more useable format than the same information when provided in paper. The requirements were generally supported by commenters in concept, although, as discussed below, many expressed concern regarding specific requirements under the proposal. We are making several modifications to the requirements to address technical considerations raised by commenters.

Linking within the Statutory Prospectus and SAI

We are adopting a requirement that persons accessing the statutory prospectus or SAI online be able to move directly back and forth between each section heading in a table of contents of the document and the section of the document referenced in that section heading. In the case of the statutory prospectus, the linked table of contents must be either the table of contents required by rule 481(c) or a table of contents that contains the same section headings as the required table of contents. This requirement allows an investor or other user to move directly between a table of contents of the prospectus or SAI and the related sections of that document, by a single mouse click and without the need to flip through multiple pages of a paper document.

This requirement includes two modifications from the proposed requirement. First, we are clarifying that the linked table of contents may be outside the document, *e.g.*, in a separate frame or panel of the computer screen and need not be the table of contents that is contained within the document itself, as long as the linked table of contents for the statutory prospectus conforms to the table of contents that is required by our rules to be contained within the document itself. This modification is intended to provide flexibility to use linking technologies other than hyperlinking within the document itself. Permitted technologies would include, for example, the use of "bookmarks" that replicate the document's table of contents, but are displayed in a separate

panel from the document itself. We have accomplished this clarification by modifying the language of the proposed requirement to refer to "***a*** table of" contents ***of***" the relevant document rather than "***the*** table of contents ***in***" the relevant document and by requiring that, in the case of the statutory prospectus, the linked table of contents either be the table of contents required by rule 481(c) or contain the same section headings as the table of contents required by that rule. Second, we are revising the rule language to clarify that the links must permit movement directly back and forth between each section heading in a table of contents and the particular section of the document referenced in that section heading.

Linking Between Documents

We are also adopting a requirement for funds to comply with one of two options: that persons accessing the Summary Prospectus be able to move directly back and forth between either (i) each section of the Summary Prospectus and any section of the statutory prospectus and SAI that provides additional detail concerning that section of the Summary Prospectus; or (ii) links located at both the beginning and end of the Summary Prospectus, or that remain continuously visible to persons accessing the Summary Prospectus, and tables of contents of both the statutory prospectus and the SAI that meet the linking requirements described in the preceding section. This requirement allows an investor to move back and forth between related sections of the Summary Prospectus, on the one hand, and the statutory prospectus and SAI, on the other, either directly through a single mouse click or indirectly by means of a table of contents of the prospectus or SAI, in which case two mouse clicks would be required.

We are adopting, as proposed, the first option, which permits movement between related sections of the Summary Prospectus, on the one hand, and the statutory prospectus and SAI, on the other, directly through a single mouse click. Although a number of commenters suggested that this option is unlikely to be used as a result of the number of links that would be required to be maintained, we believe that the option should remain available because the ability to single-click between related sections has the potential to result in an extremely user-friendly presentation.

We are, however, modifying the second proposed option, which involves linking between the Summary Prospectus and tables of contents of the statutory prospectus and SAI, in order to reduce the number of links that would be required. As proposed, this option would have required links between each section of the Summary Prospectus and tables of contents in the statutory prospectus and SAI. This would potentially have required two links in each section of the Summary Prospectus (one for the statutory prospectus and one for the SAI). As adopted, this option will require either links located at both the beginning and end of the Summary Prospectus, or links that remain continuously visible to persons accessing the Summary Prospectus, perhaps in a separate panel or frame. The number of links will be reduced, but their placement, either at the beginning and end of the Summary Prospectus or continuously visible, will ensure that they are prominent and readily accessible to investors. This modification responds to commenters' concerns that multiple links within the Summary Prospectus could result in a cluttered presentation, create mistaken expectations that the Summary Prospectus links would lead directly to related information rather than to tables of contents of the statutory prospectus and SAI, and would be expensive to maintain.

Interactive Data

Some commenters urged the Commission to make greater use of technology to permit investors to access the specific information they need and to facilitate automated comparisons of data across multiple funds. The Commission agrees with these commenters that technology holds great promise for enabling mutual fund investors to make better use of existing information to understand and compare funds. To that end, we note that the Commission has already proposed to require a significant portion of the information that is contained in the summary section of the statutory prospectus and the Summary Prospectus to be filed in interactive data format, which is intended to facilitate automated analysis and comparison of this information. Accordingly, while we are taking a number of steps in the current rulemaking to make greater use of technology, we are considering additional steps, along the lines suggested by the commenters, in the context of the pending interactive data rulemaking. In addition, we recently undertook an initiative to fundamentally reexamine how we can make greater use of technology to deliver information to investors more effectively.

d. Ability to Retain Documents

We are adopting the proposed requirement that persons accessing the Web site must be able to permanently retain, through downloading or otherwise, free of charge, an electronic version of the Summary Prospectus, statutory prospectus, SAI, and shareholder reports in a format that, like the online version, (i) is human-readable and capable of being printed on paper in human-readable format; and (ii) permits persons accessing the downloaded statutory prospectus or SAI to move directly back and forth between each section heading in a table of contents of that document and the section of the document referenced in that section heading. The permanently retained document is not required to be in a format that allows an investor to move back and forth between the Summary Prospectus and the statutory prospectus and SAI because of technical difficulties associated with maintaining links between multiple downloaded documents.

Commenters generally expressed support for this proposal. Two commenters suggested that rule 498 expressly provide that once a user saves a document, a fund is not responsible for maintaining the links that it contains to other documents and that failure to maintain a link will not provide a basis for liability. We have determined that such a provision is unnecessary because we are not requiring downloaded documents to retain any links to other documents. In addition, as described above in Part III.B.3.c., we have revised the requirements for online linking between documents to permit the links to be external to the documents, in which case they would not even appear in the online versions of the documents.

e. Safe Harbor for Temporary Noncompliance

As discussed above, compliance with all of the conditions in rule 498 regarding Internet posting (other than the convenient for reading and printing standard) is required in order to meet prospectus delivery obligations under Section 5(b)(2) of the Securities Act. Failure to comply with any of these conditions will be a violation of Section 5(b)(2) unless the fund's statutory

prospectus is delivered by means other than reliance on the rule. The Commission recognizes, however, that there may be times when, due to events beyond a fund's control, such as system outages or other technological issues, natural disasters, acts of terrorism, or pandemic illnesses, a fund is temporarily not in compliance with the Internet posting requirements of the rule. For that reason, we are adopting the proposed safe harbor provision stating that the conditions regarding Internet availability of a fund's Summary Prospectus, statutory prospectus, SAI, and shareholder reports will be deemed to be met, notwithstanding the fact that those materials are not available for a time in the manner required, provided that the fund has reasonable procedures in place to ensure that those materials are available in the required manner. In addition, a fund is required to take prompt action to ensure that those materials become available in the manner required, as soon as practicable following the earlier of the time at which the fund knows or reasonably should have known that the documents are not available in the manner required. The safe harbor, by its terms, is expressly applicable to the format, linking, and permanent retention conditions of the rule, in addition to the conditions requiring that the documents be available online.

f. Requirement to Send Documents

We are adopting the proposed requirement that a fund (or financial intermediary through which shares of the fund may be purchased or sold) send, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means, a paper copy of the fund's statutory prospectus, SAI, and most recent annual and semi-annual shareholder report to any person requesting such a copy within three business days after receiving a request for a paper copy. We are also adopting, with one modification, the proposed requirement that a fund (or financial intermediary through which shares of the fund may be purchased or sold) send, at no cost to the requestor and by e-mail, an electronic copy of the fund's statutory prospectus, SAI, and most recent annual and semi-annual shareholder report to any person requesting such a copy within three business days after receiving a request for an electronic copy. These requirements are intended to ensure that every investor in a fund taking advantage of the new prospectus delivery framework is permitted to choose whether to review a fund's information on the Internet or whether to receive that information directly, either in paper or through an e-mail. As a result of these requirements, each investor will have prompt access to the required information in the form that he or she prefers.

We are modifying the proposal, as suggested by one commenter, to clarify that the requirement to send an electronic copy of a document by e-mail may be satisfied by sending a direct link to the document on the Internet, provided that a current version of the document is directly accessible through the link from the time that the e-mail is sent through the date that is six months after the date that the e-mail is sent and the e-mail explains both how long the link will remain useable and that, if the recipient desires to retain a copy of the document, he or she should access and save the document. We believe that six months is a reasonable period of time to require the documents to be available and will provide sufficient time for an investor who has requested a copy to access and, if desired, download the information. We also note that an investor may at any time request to receive a paper copy of the documents.

As in the proposal, the requirement that a fund send a paper or electronic copy of the statutory prospectus, SAI, and most recent annual and semi-annual shareholder reports to a person requesting such a copy is not a condition to reliance on the rule to satisfy a fund's delivery obligations under Section 5(b)(2) of the Securities Act or the provision that a communication shall not be deemed a prospectus under Section 2(a)(10) of the Securities Act. A person that complies with all other aspects of rule 498 will not violate Section 5(b)(2) of the Securities Act if the fund (or financial intermediary) fails to send the required paper or electronic copy of the statutory prospectus, SAI, and most recent shareholder reports. This failure will, however, constitute a violation of the Commission's rules.

4. Incorporation by Reference

a. Permissible Incorporation by Reference

We are adopting, with modifications, the proposal to permit a fund to incorporate by reference into the Summary Prospectus information contained in its statutory prospectus, SAI, and shareholder reports. The proposal would have permitted a fund to incorporate by reference information from the fund's most recent report to shareholders. As adopted, rule 498 permits a fund to incorporate by reference any information from the fund's reports to shareholders that the fund has incorporated by reference into its statutory prospectus. This modification addresses commenters' concerns that the proposal was overbroad by limiting incorporation from shareholder reports to information that has been incorporated into the fund's statutory prospectus and, as a result, is subject to liability under Section 11 of the Securities Act. The modification also addresses other commenters' concerns that funds be permitted to incorporate by reference information from both the most recent annual shareholder report and most recent semi-annual shareholder report and will permit the Summary Prospectus to incorporate from shareholder reports precisely the same information that the statutory prospectus may incorporate today. Incorporation by reference is subject to the conditions described below.

A fund may not incorporate by reference into a Summary Prospectus information from any source other than those described above. In addition, a fund may not incorporate by reference into the Summary Prospectus any of the information described above that is required to be included in the Summary Prospectus. Information may be incorporated by reference into the Summary Prospectus only by reference to the specific document that contains the information, and not by reference to another document that incorporates the information by reference. Thus, if a fund's statutory prospectus incorporates the fund's SAI by reference, the fund's Summary Prospectus could not incorporate information in the SAI simply by referencing the statutory prospectus but would be required to reference the SAI directly.

Incorporation by reference of information from a fund's statutory prospectus, SAI, and shareholder reports is permitted only if the fund satisfies the conditions described above in Part III.B.3., which prescribe the means by which the incorporated information is provided to investors. In addition, if a fund incorporates information by reference, the Summary Prospectus legend must specify the type of document (*e.g.*, statutory prospectus) from which the information is

incorporated and the date of the document. If a fund incorporates by reference a part of a document, the Summary Prospectus legend must clearly identify the part by page, paragraph, caption, or otherwise. These document identification requirements have been modified from the proposal, which would have required that the legend clearly identify documents that are incorporated by reference, including the date of the documents, in order to make the requirements more precise. The legend is also required to explain that any information that is incorporated from the SAI or shareholder reports may be obtained, free of charge, in the same manner as the statutory prospectus.

A fund that fails to comply with any of the above conditions may not incorporate information by reference into its Summary Prospectus. A fund that provides the incorporated information to investors by complying with all of the conditions, including the conditions for providing the incorporated information through the Internet, is not also required to send or give the incorporated information together with the Summary Prospectus.

A significant number of commenters expressed support for the Commission's proposal to permit incorporation by reference of information from other fund documents into the Summary Prospectus. Commenters stated that, by permitting incorporation by reference, the proposal significantly addresses liability issues that resulted in funds' unwillingness to use the fund profile and will encourage wider use of the Summary Prospectus.

A joint comment letter from three consumer and investor groups, however, stated that the Commission did not adequately address serious questions accompanying incorporation by reference in the proposing release. These commenters argued, first, that the Commission did not adequately explain any purpose for permitting incorporation by reference other than the limitation of funds' liability. Second, the commenters argued that the Commission's proposal would relieve issuers of legal responsibility for misleading disclosure under Sections 12(a)(2) and 17(a)(2) of the Securities Act and that the proposing release had not discussed whether the benefits of having a Summary Prospectus that satisfies prospectus delivery obligations is worth the cost of relieving funds of this legal responsibility or whether such a tradeoff is appropriate.

With respect to the commenters' first concern, our purpose in permitting incorporation by reference into the Summary Prospectus is to further our goal of creating an improved mutual fund disclosure framework for the benefit of investors. We have concluded, and the comments and recent investor research support our conclusion, that investors will benefit greatly from receiving a shorter document, such as the Summary Prospectus. We have also concluded, based on both the comments and our experience with the fund profile that, to a significant extent, investors will not realize these benefits unless we permit incorporation by reference because many funds are unlikely to use the Summary Prospectus if incorporation by reference is prohibited. With respect to the commenters' second concern, we do not agree that permitting incorporation by reference will relieve funds of legal responsibility for misleading disclosure. Therefore, we believe that it is appropriate to permit incorporation by reference in order to realize for investors the considerable benefits that the Summary Prospectus will afford. We discuss our analysis more fully below.

Incorporation by Reference is Necessary to Improve Disclosure Framework

We have concluded that investors will benefit greatly from receiving the Summary Prospectus containing key information that they will be more likely to read and understand than the statutory prospectus, with the ability to access more detailed information either immediately in a user-friendly format online or, within a matter of days, in paper. Nearly all of the commenters, including those who opposed incorporation by reference, agreed with this conclusion. This conclusion is also supported by our recent telephone survey of investors, which found that many mutual fund investors do not read statutory prospectuses because they are long, complicated, and hard to understand. The views expressed by investors in our focus groups also support our conclusion that investors will derive significant benefits from the Summary Prospectus, coupled with ready access to more detailed information in whatever format they choose, paper or electronic. By using multiple means to provide information and by using technology to provide information in a layered format that permits users to move from key information to more detailed information, the new rule is intended to facilitate each investor's ability to effectively choose to review the particular information in which he or she is interested. Each investor in a fund taking advantage of the new prospectus delivery regime can choose the particular means of receiving information that he or she prefers because all of the information is required to be sent promptly to any requesting investor in paper or electronically. Thus, the Summary Prospectus disclosure framework will permit each and every investor to choose both the information he or she wants to review and the format in which he or she wants to review it.

We also believe that significantly more funds and intermediaries will utilize the Summary Prospectus if we permit funds to incorporate by reference information from the funds' statutory prospectus, SAI, and shareholder reports. Numerous commenters stated that, by permitting incorporation by reference, the proposal significantly addresses liability issues that resulted in funds' unwillingness to use the fund profile and will encourage wider use of the Summary Prospectus. Our own experience with the fund profile over the past 10 years confirms that very few funds have adopted it. We believe that one of the principal reasons for the profile's low adoption rate is concern about potential liability for omitting facts from the profile that are contained in the statutory prospectus or SAI. While we acknowledge that an additional contributing factor was the requirement that funds using the profile also provide a statutory prospectus with the confirmation, we do not believe that elimination of this requirement alone, without permitting incorporation by reference, would result in widespread use of the Summary Prospectus by funds.

Thus, permitting incorporation by reference into the Summary Prospectus is essential to accomplishing the Commission's important goal of encouraging use of a disclosure document that provides key information that investors are more likely to read and understand than the statutory prospectus. Commenters and investor testing consistently affirm the importance of the goal and of the Summary Prospectus in achieving the goal. Commenters on the current proposal, and our experience with the profile, confirm that we cannot accomplish the goal without permitting incorporation by reference. Investor Protection

We have also concluded that permitting incorporation by reference will not relieve funds of any legal responsibility for misleading disclosure under Sections 12(a)(2) and 17(a)(2) of the Securities Act. As a result, we have concluded that it is appropriate to permit incorporation by reference in order to realize for investors the considerable benefits that the Summary Prospectus will afford.

The Summary Prospectus, together with information incorporated therein by reference, is subject to liability under Sections 12(a)(2) and 17(a)(2) of the Securities Act, and nothing in rule 498 removes, or diminishes, that liability. Under Section 12(a)(2) of the Securities Act, sellers have liability to purchasers for offers or sales by means of a prospectus or oral communication that includes an untrue statement of material fact or omits to state a material fact that makes the statements made, based on the circumstances under which they were made, not misleading. Section 17(a)(2) of the Securities Act is a general antifraud provision which makes it unlawful for any person in the offer and sale of a security to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

We are permitting incorporation by reference of the statutory prospectus, SAI, and information from the shareholder reports that is incorporated into the statutory prospectus in order to reflect, as a legal matter, the practical reality that, under the conditions of rule 498, the information incorporated into the Summary Prospectus will be provided at the same time as the Summary Prospectus though by different means. Funds and other sellers will be liable under Sections 12(a)(2) and 17(a)(2) for information incorporated by reference into the statutory prospectus. Investors who choose to review the statutory prospectus, SAI, and shareholder reports in paper will have the same ability to do so that they do today. In addition, rule 498 requires that all information contained in the Summary Prospectus, statutory prospectus, SAI, and shareholder reports be immediately available to investors online in a user-friendly format. By using multiple means to provide this information and using technology to provide information in a layered format, the new rule is intended to facilitate investors' ability to easily access and review the particular information in which they are interested. Indeed, each investor in a fund taking advantage of the new prospectus delivery regime can choose the particular means of receiving information because all of the information is required to be promptly sent to any requesting investor in paper or electronically. The Summary Prospectus disclosure regime enhances the accessibility of the information that is available to investors and increases their options for how to receive the information; it does not take away any information or any option for the method by which information is received.

Our determination to permit incorporation by reference of information into the Summary Prospectus is different from the determination we made with respect to the profile and is made in light of technological advances that have occurred during the intervening years. When the Commission adopted the profile more than 10 years ago, it did not permit incorporation by reference of the statutory prospectus into the profile and stated its belief that allowing this incorporation would be inconsistent with the purpose of the profile and not in the public interest. The Commission noted that the profile was designed to provide summary information about a fund

in a self-contained format and that permitting incorporation by reference of the statutory prospectus would be inconsistent with the profile being a self-contained document.

By contrast, the Summary Prospectus is not a self-contained document, but rather one element in a layered disclosure regime that is intended to provide investors with better, more useable access to the information in the statutory prospectus, SAI, and shareholder reports than they have today. The expansion in Internet access and the strides in the speed and quality of Internet connections since the profile rule was adopted in 1998 have made this possible. As a result of these considerations and for the other reasons discussed above, we believe that it is consistent with the purpose of the Summary Prospectus and in the public interest to permit incorporation by reference of information from the statutory prospectus, SAI, and shareholder reports into the Summary Prospectus, subject to the conditions to incorporation by reference contained in rule 498.

b. Effect of Incorporation by Reference

We are adopting, as proposed, the provision of rule 498 stating that, for purposes of rule 159 under the Securities Act, information is conveyed to a person not later than the time that a Summary Prospectus is received by the person if the information is incorporated by reference into the Summary Prospectus in accordance with rule 498. This provision addresses the question of when information that is incorporated into the Summary Prospectus under rule 498 is conveyed for purposes of Sections 12(a)(2) and 17(a)(2) of the Securities Act. Commenters who addressed this provision generally supported the position that all information that is properly incorporated by reference into the Summary Prospectus is conveyed to an investor for purposes of these sections. As we have previously stated, we interpret Section 12(a)(2) and Section 17(a)(2) to mean that, for purposes of assessing whether at the time of sale (including a contract of sale) a prospectus or oral communication or statement includes or represents a material misstatement or omits to state a material fact necessary in order to make the prospectus, oral communication, or statement, in light of the circumstances under which it was made, not misleading, information conveyed to the investor only after the time of sale (including a contract of sale) should not be taken into account. In furtherance of this interpretation, we adopted rule 159 under Sections 12(a)(2) and 17(a)(2). Consistent with our interpretation, rule 159 provides that, for purposes of Sections 12(a)(2) and 17(a)(2) only, and without affecting any other rights under those sections, for purposes of determining at the time of sale (including the time of the contract of sale) whether a prospectus, oral statement, or a statement includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading, any information conveyed to the purchaser only after the time of sale will not be taken into account.

Rule 498 provides that, for purposes of rule 159 (and therefore for purposes of Sections 12(a)(2) and 17(a)(2)), information is conveyed to a person not later than the time that a Summary Prospectus is received by the person if the information is incorporated by reference into the Summary Prospectus in accordance with the rule. For purposes of Sections 12(a)(2) and 17(a)(2), whether or not information has been conveyed to an investor at or prior to the time of the contract of sale is a facts and circumstances determination. We have designed the requirements of

rule 498 specifically so that the facts and circumstances surrounding receipt by a person of the Summary Prospectus will, in fact, result in the effective conveyance to that person of any information that is incorporated by reference into the Summary Prospectus in compliance with the conditions of the rule. For that reason, rule 498 expressly states that, for purposes of rule 159, information incorporated into a Summary Prospectus is conveyed not later than the time that the Summary Prospectus is received. The relevant facts and circumstances required by rule 498 include actual receipt of the Summary Prospectus; incorporation by reference of the information into the Summary Prospectus and clear disclosure of how the incorporated information may be obtained free of charge; and continuous Internet availability of the incorporated information in formats that permit permanent retention, are human-readable and capable of being printed on paper in human-readable format, and meet the document linking requirements of the rule. We are not adopting the suggestion of two commenters that rule 498 state that information is conveyed to a person not later than the time that the Summary Prospectus is conveyed to the person, rather than received by the person. We are unable to conclude that, in all circumstances, information incorporated into a Summary Prospectus has been conveyed to an investor before the investor has received the Summary Prospectus.

Rule 498 addresses one particular set of facts and circumstances under rule 159 and does not address any other situations. For purposes of Sections 12(a)(2) and 17(a)(2), whether or not information has been conveyed to an investor at or prior to the time of the contract of sale remains a facts and circumstances determination. Rule 498 does not address any facts and circumstances relating to operating companies or any other issuers that are not mutual funds, nor does it address any information other than information incorporated by reference into a mutual fund Summary Prospectus in accordance with the new rule.

The Commission believes that a person that provides investors with a mutual fund Summary Prospectus in good faith compliance with rule 498 will be able to rely on Section 19(a) of the Securities Act against a claim that the Summary Prospectus did not include information that is disclosed in the fund's statutory prospectus, whether or not the fund incorporates the statutory prospectus by reference into the Summary Prospectus. Section 19(a) protects a defendant from liability for actions taken in good faith in conformity with any rule of the Commission.

5. Filing Requirements for the Summary Prospectus

We are requiring each Summary Prospectus to be filed with the Commission on EDGAR no later than the date that it is first used, rather than, as proposed, the fifth business day after the date that it is first used. We agree with commenters who suggested that the Summary Prospectus should be filed with the Commission and be available on the Commission's Web site earlier than the fifth business day after it is first used. In addition, we do not believe that the proposed five-day lag between first use of a Summary Prospectus and filing is necessary, given that we are requiring that the Summary Prospectus be updated only once a year, at the same time that a fund files its updated statutory prospectus. A Summary Prospectus that is filed on EDGAR will be publicly available; however, a fund may not rely on this availability to satisfy the requirements to post the document online discussed in Part III.B.3. above.

Section 10(b) of the Securities Act provides that a prospectus permitted under that section shall, unless provided otherwise by Commission rule, be filed as part of the registration statement but shall not be deemed part of the registration statement for the purposes of Section 11 of the Securities Act. In accordance with Section 10(b), a Summary Prospectus will be filed as part of the registration statement, but will not be deemed a part of the registration statement for purposes of Section 11 of the Securities Act.

A joint comment letter from three consumer and investor groups expressed concerns that the Summary Prospectus would not be subject to Section 11 liability, suggesting that this would result in a diminution of funds' liability under that section. We emphasize that the registration statement of a fund that uses the Summary Prospectus will remain subject to liability under Section 11, as is the case today. All of the information that may be included in, or incorporated by reference into, a fund's Summary Prospectus is also required to be included in the fund's registration statement. Thus, as described more fully in the following paragraph, all information included in, or incorporated by reference into, the Summary Prospectus will be subject to liability under Section 11 of the Securities Act.

As described in Part III.B.2.a., we are adopting a new requirement to clarify that the information contained in a Summary Prospectus that is used to satisfy prospectus delivery obligations must be the same as the information contained in the summary section of the fund's statutory prospectus. This information is, and will remain, subject to Section 11 liability because the fund's prospectus, in its entirety, is subject to Section 11 liability. In addition, information may be incorporated by reference into a Summary Prospectus only if it is contained in the fund's statutory prospectus, SAI, or has been incorporated into the statutory prospectus from the shareholder reports. That is, information that may be incorporated by reference into the Summary Prospectus is already a part of the fund's registration statement and, as a result, is subject in its entirety to liability under Section 11. Thus, while Section 10(b) of the Securities Act prescribes that the Summary Prospectus will not itself be deemed a part of the registration statement for purposes of Section 11, all of the information in the Summary Prospectus will be subject to liability under Section 11, either because the information is the same as information contained in the statutory prospectus or because the information is incorporated by reference from the registration statement.

We also note that a Summary Prospectus is subject to the stop order and other administrative provisions of Section 8 of the Securities Act. This is in addition to the Commission's power under Section 10(b) of the Securities Act to prevent or suspend the use of the Summary Prospectus, regardless of whether or not it has been filed.

C. Technical and Conforming Amendments

We are adopting the following conforming amendments to rule 482 under the Securities Act, the investment company advertising rule, to reflect the Summary Prospectus and the elimination of the voluntary profile.

The scope section of rule 482 is revised to clarify that the rule does not apply to a Summary Prospectus or to a communication that, pursuant to rule 498, is not deemed a "prospectus" under section 2(a)(10) of the Securities Act.

For funds using the Summary Prospectus, the legend required in a rule 482 advertisement regarding the availability of the statutory prospectus will be required to include references to the Summary Prospectus.

The provision addressing the use of rule 482 advertisements together with a profile that includes an application to purchase shares is deleted as unnecessary.

We are also adopting amendments to various cross-references to Form N-1A in our rules and forms to reflect changes that we are adopting to Form N-1A. These include cross-references in rule 485 under the Securities Act, rules 304 and 401 of Regulation S-T, Form N-4 under the Securities Act and the Investment Company Act, and Form N-14 under the Securities Act. We are also revising rule 159A under the Securities Act to refer to a Summary Prospectus rather than a profile.

D. Compliance Date

As discussed in the proposing release, the Commission is providing for a transition period after the effective date of the amendments to Form N-1A that gives funds sufficient time to update their prospectuses or to prepare new registration statements under the revised Form N-1A requirements. The effective date of the amendments is March 31, 2009.

All initial registration statements on Form N-1A, and all post-effective amendments that are annual updates to effective registration statements on this form, filed on or after January 1, 2010, must comply with the amendments to Form N-1A. All post-effective amendments that add a new series, filed on or after January 1, 2010, must comply with the amendments with respect to the new series. The final compliance date for filing amendments to effective registration statements to comply with the new Form N-1A requirements is January 1, 2011. Based on the comments, we believe that this will provide adequate time for funds to compile and review the information that must be disclosed. A fund may, at its option, prepare documents in accordance with the requirements of Form N-1A, as amended, at any time after the effective date of the amendments. A person may not rely on rule 498 to satisfy its obligations to deliver a mutual fund's statutory prospectus unless the fund is also in compliance with the amendments to Form N-1A

Post-effective amendments to existing registration statements filed to comply with the amendments to Form N-1A should be filed under Securities Act rule 485(a). However, in appropriate circumstances, we will consider requests by existing funds to file these post-effective amendments pursuant to Securities Act rule 485(b)(1)(vii). Appropriate circumstances may include, for example, situations where a fund complex has previously filed under rule 485(a) post-effective amendments for a number of funds that implement the new requirements, and the staff determines not to review additional such filings by the fund complex in light of the staff's experience with the previously filed amendments.

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By the Commission. January 13, 2009

Registration Form Used by Open-End Management Investment Companies
Securities and Exchange Commission
[Release Nos. 33-7512; 34-39748; IC-23064; S7-10-97]
February 10, 1998

AGENCY: Securities and Exchange Commission

ACTION: Final rules.

SUMMARY: The Securities and Exchange Commission is adopting amendments to Form N-1A, the form used by mutual funds to register under the Investment Company Act of 1940 and to offer their shares under the Securities Act of 1933. The amendments are intended to improve fund prospectus disclosure and to promote more effective communication of information about funds to investors. The amendments focus the disclosure in a fund's prospectus on essential information about the fund that will assist investors in deciding whether to invest in the fund. The amendments also minimize prospectus disclosure about technical, legal, and operational matters that generally are common to all funds.

DATES:

Effective Date: June 1, 1998.

Compliance Dates:

1. Initial Compliance Date: All new registration statements filed on or after December 1, 1998 must comply with the amendments to Form N-1A.

2. Final Compliance Date: All funds with effective registration statements must comply with the amendments to Form N-1A for post-effective amendments filed to update their registration statements on or after December 1, 1998, and no later than December 1, 1999.

FOR FURTHER INFORMATION CONTACT: Kathleen K. Clarke, Assistant Director, Markian M.W. Melnyk, Deputy Chief, George J. Zornada, Team Leader, Jonathan F. Cayne, Senior Counsel, John M. Ganley, Senior Counsel, Doretha M. VanSlyke, Attorney, (202) 942-0721, Office of Disclosure Regulation, or Anthony A. Vertuno, Senior Special Counsel, (202) 942-0591, Office of the Associate Director (Legal and Disclosure), Division of Investment Management, Securities and Exchange Commission, 450 5th Street, N.W., Mail Stop 5-6, Washington, D.C. 20549-6009. Contact the Office of Chief Counsel, Division of Investment Management, Securities and Exchange Commission, at (202) 942-0659, 450 5th Street, N.W., Mail Stop 5-6, Washington, D.C. 20549-6009 for additional information, including interpretive guidance, about this release or Form N-1A, as amended, and related rules.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting amendments to Form N-1A [17 CFR 274.11A], the registration form used by open-end management investment companies ("funds") to register under the

Investment Company Act of 1940 [15 U.S.C. 80a-1, et seq.]("Investment Company Act") and to offer their shares under the Securities Act of 1933 [15 U.S.C. 77a, et seq.] ("Securities Act"). The Commission also is adopting technical amendments to rules 483, 485, 495, and 497 under the Securities Act [17 CFR 230.483, 230.485, 230.495, and 230.497]. In a companion release, the Commission is adopting new rule 498 [17 CFR 230.498] under the Securities Act and the Investment Company Act that permits a fund to provide investors with a new short-form document, called a "profile," which summarizes key information about the fund. If a fund makes a profile available, an investor would have the option of purchasing the fund's shares after reviewing the information in the profile or after requesting and reviewing the fund's prospectus (and other information about the fund) before making a decision about investing in the fund. An investor deciding to purchase a fund's shares based on a profile will receive a copy of the fund's prospectus with the purchase confirmation.[1]

I. INTRODUCTION AND BACKGROUND

Over the last decade, the mutual fund industry has grown enormously both in total assets and in the number of funds.[2] Today, fund assets exceed the deposits of commercial banks.[3] Coincident with the explosive growth of fund investments, the business operations of many funds have become increasingly complex as funds offer new investment options and a wider variety of shareholder services. These factors, combined with new and more sophisticated fund investments, have resulted in fund prospectuses that often include long and complicated disclosure, as funds explain their operations, investments, and services to investors.

Many have criticized fund prospectuses, finding them unintelligible, tedious, and legalistic.[4] Although the prospectus remains the most complete source of information about a fund, technical and unnecessarily long prospectus disclosure often obscures important information about a

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[1]*Investment Company Act Release No. 23065 (Mar. 13, 1998) ("Profile Adopting Release").*

[2]See *INVESTMENT COMPANY INSTITUTE ("ICI"), MUTUAL FUND FACT BOOK 16-23 (37th ed. 1997) ("ICI FACT BOOK") and ICI,* Trends in Mutual Fund Investing: September 1997, *at 3 (Oct. 30, 1997) (ICI News No. 97-93) ("ICI Trends") (between 1990 and 1997, fund assets increased from $1.1 trillion to $4.4 trillion and the number of funds increased from 3,105 to 6,666).*

[3]Compare *ICI Trends at 1 (fund net assets exceeded $4.4 trillion as of Sept. 1997) with Federal Reserve Bank Statistical Release H.8: Assets and Liabilities of Commercial Banks in the United States (Nov. 7, 1997) (commercial bank deposits were approximately $3.0 trillion as of Oct. 1997).*

[4]See, e.g., The Investment Company Amendments of 1995: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Commerce, *104th Cong., 1st Sess. 56, 58 (1995) (statement of Don Powell, President and CEO of Van Kampen American Capital, Inc.) (noting the frequent complaint that prospectuses are too long, cumbersome, and legalistic); J. BOGLE, ON MUTUAL FUNDS 147 (1994); Rothchild,* The War on Gobbledygook, *TIME, Oct. 31, 1994, at 51; Savage,* SEC Doesn't Want 1987's Painful Lessons Forgotten, *CHICAGO SUN-TIME, Oct. 26, 1997, at 53; Sloan, Selling Attitude, NEWSWEEK, June 17, 1996, at 52; Skrzycki, Prospectuses to be in English, Donkeys to Fly Tomorrow, WASH. POST, Oct. 21, 1994, at B1; "Taking the Mystery Out of Mutual Funds," Remarks by Arthur Levitt, Chairman, SEC, before the Boston Citizens "Fulfilling the Promise of Disclosure," Remarks by Arthur Levitt, Chairman, SEC, before the American Savings Education Council, New York, NY (July 23, 1997) Seminar, Boston, MA (Feb. 25, 1997).*

fund investment and does not serve the informational needs of the majority of fund investors.[5] The millions of investors who turn to funds as their investment vehicle of choice[6] need clear and comprehensible information to help them evaluate and compare fund investments.

New Disclosure Initiatives

In seeking to improve the quality and usefulness of fund disclosure, the Commission proposed two major disclosure initiatives on February 27, 1997.[7] First, the Commission issued for public comment a release (the "Form N-1A Proposing Release") that proposed significant amendments to the prospectus disclosure requirements for funds (the "Proposed Amendments").[8] Second, the Commission proposed, in a companion release, new rule 498 under the Securities Act and the Investment Company Act that would allow a fund to offer investors the option to purchase its shares after reviewing the information in the fund's profile or after requesting and reviewing the fund's prospectus (and other information about the fund) before making a decision about investing in the fund.[9] As proposed, the profile (the "Proposed Profile") would summarize key information about a fund, including the fund's investment objectives, strategies, risks, performance, and fees. Under proposed rule 498, a fund would be required to send investors the fund's prospectus and certain other information within 3 business days of a request, and any investor purchasing the fund's shares on the basis of a profile would receive the prospectus with the purchase confirmation.

The Commission's disclosure initiatives were intended to: improve fund disclosure by requiring prospectuses to focus on information central to investment decisions; provide new disclosure options for investors; and enhance the comparability of information about funds. Taken together, these initiatives are designed to promote more effective communication of information

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[5]*Levitt,* Plain English in Prospectuses, *N.Y. ST. B. J., Nov. 1997, at 37 ("Levitt Article") ("[D]isclosure is not disclosure if it doesn't communicate.").* See also *REPORT ON THE OCC/SEC SURVEY OF MUTUAL FUND INVESTORS 12-13 (June 26, 1996) (although fund investors surveyed consulted the prospectus more than any other source of information about the fund they bought, they considered the prospectus only the fifth-best source of information, behind employer-provided written materials, financial publications, family or friends, and brokers); ICI, THE PROFILE PROSPECTUS: AN ASSESSMENT BY MUTUAL FUND SHAREHOLDERS 4 (1996) ("ICI PROFILE SURVEY") (about half of fund shareholders surveyed had not consulted a prospectus before making a fund investment).*

[6]*U. S. households own 74.2% of the mutual fund industry's assets. ICI FACT BOOK, supra note 2, at 35.*

[7]*As part of these disclosure initiatives, the Securities and Exchange Commission (the "Commission") also proposed a new rule that would address investment company names that are likely to mislead investors about the investments and risks of an investment company. Investment Company Act Release No. 22530 (Feb. 27, 1997) [62 FR 10955], correction [62 FR 24161]. This proposed rule would require, among other things, funds and other registered investment companies with names suggesting a specific investment emphasis to invest at least 80% of their assets in the type of investment suggested by their name. The Commission received a number of substantive comments on the proposed rule, many of which asserted that the proposal had flaws that the Commission should address. The Commission's Division of Investment Management (the "Division") is analyzing the comments and expects to recommend a final rule for Commission consideration in the near future.*

[8]*Investment Company Act Release No. 22528 (Feb. 27, 1997) [62 FR 10898], correction [62 FR 24160] ("Form N-1A Proposing Release").*

[9]See *Investment Company Act Release No. 22529 (Feb. 27, 1997) [62 FR 10943], correction [62 FR 24160] ("Profile Proposing Release").*

about funds to investors without reducing the amount of information provided to investors. The Proposed Amendments reflected the Commission's strong belief that the primary purpose of the disclosure in a fund's prospectus is to help an investor make a decision about investing in the fund.[10] Consistent with this belief, the objective of the Proposed Amendments was to provide investors with prospectus disclosure that presents clear, concise, and understandable information about an investment in a fund. Commenters expressed overwhelming support for the Commission's disclosure initiatives.[11] Commenters believed that the Commission's disclosure initiatives would enhance the quality of disclosure that funds provide to investors. Some commenters emphasized that improved disclosure about funds was long overdue and would substantially benefit investors. In particular, commenters strongly supported the Proposed Amendments as effective steps toward improving fund prospectuses. Commenters also provided numerous additional suggestions to improve prospectus disclosure. The Commission is adopting the initiatives substantially as proposed.

Prior Commission Disclosure Initiatives

The amendments to the prospectus disclosure requirements adopted today are another important step in the Commission's ongoing efforts to improve disclosure about funds. In 1983, the Commission introduced an innovative approach to prospectus disclosure by adopting a two-part disclosure format that permitted a fund to provide investors with a simplified prospectus containing essential information about the fund and to place more detailed information in a companion document called the "Statement of Additional Information" ("SAI"), which investors could obtain upon request.[12] The Commission intended that, under this format, a fund's prospectus would include essential information about the fund that would be most useful to typical or average investors in making an investment decision about the fund. The Commission contemplated that more detailed discussions of matters geared to the needs of more sophisticated investors would be available in the SAI, which all fund investors could obtain upon request. In adopting this new format, the Commission's goal was to provide investors with more useful information in "a prospectus that is substantially shorter and simpler, so that the prospectus clearly discloses the fundamental characteristics of the particular investment company . . . ."[13]

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[10]*The Commission is adopting the amendments to Form N-1A under its authority in section 10(a) of the Securities Act [15 U.S.C. 77j(a)] based on its determination that certain disclosure requirements result in information that, while useful to some investors, is not necessary in the public interest or for the protection of investors to be included in the prospectus.*

[11]*Eighty-seven percent of the commenters supported the Proposed Amendments. The Commission received 78 comment letters on the Proposed Amendments, over half of which were from individual investors (44 letters or 57%). The Commission also received comment letters from 8 professional and trade associations, 13 fund groups, 4 law firms, 2 broker-dealers/investment advisers, and 7 other interested organizations. The comment letters, as well as a comment summary prepared by the Commission's staff, are available for public inspection and copying at the Commission's Public Reference Room in File No. S7-10-97. The Commission received 256 comment letters on the fund profile, a large number of which were from individual investors (226 letters or 88%). See Profile Adopting Release, supra note 1.*

[12]*Investment Company Act Release No. 13436 (Aug. 12, 1983) [48 FR 37928] ("1983 Form N-1A Adopting Release").*

[13]*Investment Company Act Release No. 12927 (Dec. 27, 1982) [48 FR 813, 814] ("1982 Form N-1A Proposing Release").*

Since 1983, the Commission has implemented a number of other initiatives to improve fund prospectus disclosure, including a uniform fee table[14] and a requirement that a fund's management discuss the fund's performance over the past year in its prospectus or annual report to shareholders (the management's discussion of fund performance ("MDFP")).[15] While these changes have provided investors with clear and helpful information about fund expenses and performance, they were not intended to address the overall effectiveness of Form N-1A's prospectus disclosure requirements. The Proposed Amendments and Form N-1A, as amended, reflect the Commission's view that current prospectus disclosure must be considered on a comprehensive basis to ensure that the prospectus, as a whole, meets the information needs of investors.

Reassessment of Fund Disclosure

The Commission's recent efforts to improve disclosure began with an evaluation of the use of a standardized, summary disclosure document that highlights key information about a fund. The Commission, with the cooperation of the Investment Company Institute ("ICI") and several large fund groups, conducted a pilot program permitting funds to use profile-like summaries ("Pilot Profiles") together with their prospectuses.[16] The program's purpose was to determine whether investors found the Pilot Profiles, which summarize important information about a fund, helpful in making investment decisions. Focus groups conducted on the Commission's behalf, and fund investors participating in a survey sponsored by the ICI, responded very positively to the profile concept.[17]

In considering fund disclosure issues, the Commission also has evaluated over 3,700 letters submitted in response to a release requesting comment on ways to improve risk disclosure in fund prospectuses, as well as the comparability of fund risk levels ("Risk Concept Release").[18] The commenters, mostly individual investors, confirmed the importance of risk disclosure in evaluating and comparing funds and emphasized the need to improve prospectus disclosure of fund risks. In particular, commenters indicated that current risk disclosure is difficult to understand and does not fully convey to investors the risks associated with an investment in a fund.

Plain English Initiatives

The fund disclosure initiatives being adopted today are part of the Commission's broad undertaking to bring sweeping revisions to prospectus disclosure for all public companies.[19] As

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[14] *See Item 3 of current Form N-1A; Investment Company Act Release No. 16244 (Feb. 1, 1988) [53 FR 3192] ("Fee Table Adopting Release").*

[15] *Item 5A of current Form N-1A; Investment Company Act Release No. 19382 (Apr. 6, 1993) [58 FR 19050] ("MDFP Adopting Release").*

[16] See *Investment Company Institute (pub. avail. July 31, 1995) ("1995 Profile Letter"); Investment Company Institute (pub. avail. July 29, 1996) ("1996 Profile Letter"). The Division permitted the pilot program to continue pending the adoption of proposed rule 498. Investment Company Institute (pub. avail. July 16, 1997) ("1997 Profile Letter"). After the effective date of new rule 498, a fund could continue to use a Pilot Profile as supplemental sales literature.* See *Profile Adopting Release,* supra *note 1.*

[17] See *ICI PROFE SURVEY,* supra *note 5, at 31-32.*

[18] See *Investment Company Act Release No. 20974 (Mar. 29, 1995) [60 FR 17172] ("Risk Concept Release").*

[19] See *Levitt Article,* supra *note 5, at 36.*

part of its commitment to make all prospectuses simpler, clearer, and more useful, and to eliminate jargon and boilerplate, the Commission recently adopted rule amendments to require the use of plain English principles in drafting prospectuses and to provide other guidance on improving the readability of prospectuses.[20] The Commission's plain English principles reflect fundamentals of clear communication and contemplate disclosure documents that:

- Present information in an easily readable format;
- Use everyday language that investors can easily understand; and
- Eliminate repetition of disclosure that lengthens a document and overwhelms the investor.

Improved Fund Disclosure

As one commenter on the disclosure initiatives pointed out, the Commission's proposals reflect an unprecedented number and variety of public comments and expert views, the results of Commission and other research, and broad investor input. The Commission agrees with the commenter's further observation that the Commission has never had a more detailed, comprehensive, and compelling basis for a rulemaking than that developed for the fund disclosure initiatives. Through focus groups and written comments on the initiatives, investors have confirmed that they concur strongly with the Commission's view that fund disclosure documents will be useful only if they communicate information effectively. The Commission has designed both the fund prospectus and profile initiatives to meet this goal. The amendments to Form N-1A seek to make the prospectus, which will remain a fund's primary disclosure document, a more effective tool by focusing its contents on information that is essential to an investment in the fund. The profile responds to investors' strongly expressed desire for a new, concise disclosure document that summarizes key fund information and helps investors evaluate and compare funds more easily.

To encourage the use of disclosure that communicates effectively, the Commission's fund disclosure initiatives include a number of important innovations:

- The initiatives provide for a standardized risk/return summary at the beginning of every fund prospectus and in the profile that:[21]
  - ♦ Concisely summarizes information in a specific sequence about a fund's investment objectives, strategies, risks and performance, and fees;
  - ♦ Discusses the risks of a fund's portfolio taken as a whole and minimizes detailed and technical descriptions of the risks associated with specific portfolio securities potentially held by the fund; and

[20]*Rule 421 under the Securities Act [17 CFR 230.421].* See *Securities Act Release No. 7497 (Jan. 28, 1998) [63 FR 6370] ("Plain English Release") and discussion* infra *Section II.D.2. As part of the plain English initiatives, the Commission plans to issue* A Handbook on Plain English: How to Create Clear SEC Disclosure Documents, *prepared by the Commission's Office of Investor Education and Assistance.*

[21]*These improvements are based in large part on comments received in response to the Risk Concept Release.* See *Risk Concept Release*, supra *note 18. The Commission also considered other information about fund risk disclosure, including the results of an investor survey sponsored by the ICI.* See *ICI, SHAREHOLDER ASSESSMENT OF RISK DISCLOSURE METHODS (1996) ("ICI RISK SURVEY").*

- Provides a graphic presentation of a fund's annual returns over a 10-year period in a bar chart that illustrates the variability of the fund's returns and gives investors some idea of the risks of an investment in the fund. To help investors evaluate a fund's risks and returns relative to "the market," a table accompanying the bar chart compares the fund's average annual returns for 1, 5, and 10 years with that of a broad-based securities market index.

- The initiatives require a fund to prepare disclosure documents using plain English disclosure, which is designed to give investors understandable disclosure documents.

- The initiatives eliminate prospectus clutter that obscures other information helpful to investors when making a decision about an investment in a fund. Specifically, the amendments to prospectus disclosure requirements:

  - Move certain disclosure about fund organization and legal requirements from the prospectus to the SAI;

  - Permit a fund that is offered as an investment alternative in a participant-directed defined contribution plan (or certain other tax-advantaged arrangements) to tailor its prospectus for the plan (or other arrangement);

  - Update and incorporate certain staff interpretive positions into Form N-1A;[22] and

  - Simplify current disclosure instructions to provide clearer guidance for preparing and filing fund registration statements.

Disclosure Principles

The Commission believes that, in revising Form N-1A and in providing for the use of profiles, it has laid the foundation for the development of fund disclosure documents of a significantly higher quality than those often used today, which have drawn the consistent criticism of fund investors and others. If the initiatives are to have their intended effect, however, all those who participate in the preparation and review of those documents funds, their legal counsels and other advisors, the Commission and its staff, and other regulators and their staffs—should act consistently with the basic disclosure principles that serve as the cornerstones of the initiatives. These principles, which are referred to throughout this release, include the following:

- Funds should design disclosure documents, particularly their prospectuses, first and foremost, to communicate information to investors effectively. Funds should present information in prospectuses following the principles of plain English, using language that is concise, straightforward, and easy to understand.

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[22]*The amendments contemplate further that the Division will consolidate its interpretive positions under the Investment Company Act relating to, among other things, fund operations in a new "Investment Company Registration Guide" ("Registration Guide"). The Registration Guide is discussed infra Section II.D.6. Form N-1A, as amended, incorporates certain staff disclosure requirements to identify those requirements that would apply to all funds regardless of their particular circumstances. Among other things, this approach addresses disclosure requirements that have been developed in connection with an issue presented by a specific fund, but applied to all funds regardless of their particular circumstances.*

- A fund's prospectus principally should include essential information about the fundamental characteristics of, and risks of investing in, the fund. Whenever possible, a fund should present this information in a manner that:
  - ♦ assists investors in comparing and contrasting the fund with other funds;
  - ♦ avoids simply restating legal or regulatory requirements to which funds generally are subject; and
  - ♦ avoids a disproportionate emphasis on possible investments or activities of the fund that are not a significant part of the fund's investment operations.
- Funds should limit disclosure in prospectuses generally to information that is necessary for an average or typical investor to make an investment decision. Detailed or highly technical discussions, as well as information that may be helpful to more sophisticated investors, dilute the effect of necessary prospectus disclosure and should be placed in the SAI.
- Prospectus disclosure requirements should not lead to lengthy disclosure that discourages investors from reading the prospectus or obscures essential information about an investment in a fund.

The Commission has instructed its staff to use these principles consistently in administering the requirements of both amended Form N-1A and new rule 498 and strongly encourages all other participants in the development of fund disclosure documents to apply these principles in preparing their prospectuses and profiles.[23]

II. DISCUSSION

Part A—Information in the Prospectus

Form N-1A, as amended, retains the overall structure of current Form N-1A. The most significant changes to Form N-1A adopted today are the new risk/return summary at the beginning of the prospectus and improved disclosure about the risks of investing in a fund. This release first addresses these changes and then discusses other changes to substantive prospectus disclosure requirements in Part A of Form N-1A.[24] Following this discussion, the release describes revisions to requirements for information on the front and back cover pages of the prospectus, the General Instructions to Form N-1A, which have been updated and revised to make them easier to use, and other technical revisions to Form N-1A's requirements.[25]

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[23] *A chart in Appendix A to this release compares the revised Items in Form N-IA, as amended, to the current Items in Form N-IA.*

[24] *The Commission expects that these disclosure principles also will provide useful guidance in resolving disclosure issues relating to funds under the federal securities laws as these issues arise from time to time. See discussion of administration of Form N-1A, infra Section II.F.*

[25] *Form N-1A, as amended, incorporates certain disclosure requirements from the Guidelines to current Form N-1A (the "Guides") and the Generic Comment Letters ("GCLs") that have been issued over time by the Division.* See *Letters to Registrants (Jan. 11, 1990) ("1990 GCL"); (Jan 3, 1991) ("1991 GCL"); (Jan. 17, 1992) ("1992 GCL"); (Feb. 22, 1993) ("1993 GCL"); (Feb. 25, 1994) ("1994 GCL"); (Feb. 3, 1995) ("1995 GCL"); (Feb. 16, 1996) ("1996 GCL"). For a discussion of the Guides and the GCLs,* see infra *notes 209-215 and accompanying text.*

1. Risk/Return Summary: Investments, Risks, and Performance (Item 2).

The Commission proposed to require a risk/return summary at the beginning of every prospectus that would provide key information about a fund's investment objectives, principal strategies, risks, performance, and fees. The risk/return summary, also included in the Proposed Profile, was intended to respond to investors' strong preference for summary information about the fund in a standardized format.[26] The proposed risk/return summary in a fund's prospectus would provide investors with a type of "executive summary" of key information about the fund in a standardized, easily accessible place that investors could use to evaluate and compare the fund to others, regardless of whether the fund uses a profile.

While most commenters supported the proposed risk/return summary, several questioned whether it was necessary in a prospectus. These commenters argued that the summary could repeat other information in the prospectus and that it would undermine the Commission's goal of making prospectus disclosure clear and concise.

The Commission is of the view that the prospectus risk/return summary will not undermine, but further, the goal of making prospectuses more useful for investors. The Commission believes that the disclosure in the risk/return summary need not generally repeat other information in the prospectus; much of the summary consists of information that Form N-1A would not require to be disclosed elsewhere in the prospectus, such as the bar chart, performance table, and fee table. The Commission has concluded that the possibility that the risk/return summary could repeat some information appearing elsewhere in the prospectus is outweighed by the benefits of providing investors with standardized and comparable fund information at the beginning of every prospectus and in the profile. Thus, the Commission is adopting the requirement that every prospectus and profile contain a risk/return summary.[27]

The Commission proposed to require that the risk/return information in the prospectus, like that in the Proposed Profile, appear in a specific sequence and in a question-and-answer format. Many commenters objected to the question-and-answer format, stating, among other things, that rigid adherence to the format would not necessarily result in effective communication of information to investors.[28] To allow funds to design effective disclosure documents, the Commission has determined not to require this format in the prospectus or the profile. Any fund that chose to do so could use a question-and-answer format in its prospectus, profile, or in both documents.

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[26]*Participants in focus groups conducted on the Commission's behalf ("Focus Groups"), for example, expressed strong support for summary information in a standardized format. Many individuals in commenting on the profile initiative have confirmed the need for concise, summary information relating to a fund.* See also *Joe Six-Pack: Public Favors Profile Plan, FUND ACTION, Oct. 1997, at 9; Profile Prospectuses: An Idea Whose Time Has Come, MUTUAL FUNDS MAGAZINE, Aug. 1996, at 11.*

[27]*Items 2 and 3. Consistent with the goal of providing key information in a standardized summary, General Instruction C.3(b) to Form N-1A, as amended, precludes a fund from including information in the prospectus risk/return summary that is not required or otherwise permitted by Items 2 and 3. Form N-1A, as amended, does not require a fund to include any risk disclosure elsewhere in the prospectus if the requirements of Item 4 of Form N-1A are met by the disclosure in the fund's risk/return summary (i.e., if a fund is able to describe its risks, as required by Item 4, in its risk/return summary, the fund would not need to describe those risks elsewhere in its prospectus).*

[28]See *Profile Adopting Release,* supra *note 1 (discussing commenters' critiques of the question-and-answer format).*

a. Investment Objectives and Principal Strategies

The Proposed Amendments would require a fund to disclose its investment objectives in the risk/return summary and to summarize, based on the information provided in its prospectus, how the fund intends to achieve those objectives. The purpose of the proposed disclosure was to provide a summary of the fund's principal investment strategies, including the specific types of securities in which the fund principally invests or will invest, and any policy of the fund to concentrate its investments in an industry or group of industries.[29] The Commission is adopting this requirement as proposed.[30]

The information contained in the risk/return summary about a fund's investment objectives and principal strategies is intended to meet the needs of an average or typical fund investor. Recognizing that disclosure about a fund's specific portfolio holdings may be important to some investors, the Proposed Amendments would require a fund to inform investors in its prospectus risk/return summary that additional information about the fund's investments is available in the fund's shareholder reports.[31] While supporting the proposed disclosure, most commenters suggested placing statements about how investors can obtain a fund's SAI, shareholder reports, and other information about the fund on the back cover page of the prospectus. According to these commenters, this disclosure would be easier for investors to find if it were located in one place rather than in different places in the prospectus. The Commission agrees with the commenters that typical fund investors may find a single reference to the availability of additional information helpful. Therefore, Form N-1A, as amended, requires all disclosure about the availability of additional information to appear on the back cover page of the prospectus.[32]

The Commission is adopting the disclosure as proposed, with minor adjustments to the language to ensure that the disclosure clearly explains the availability of additional information about a fund to a typical investor.[33]

The Proposed Amendments would require the risk/return summary to provide disclosure to the following effect:

> Additional information about the fund's investments is available in the fund's annual and semi-annual reports to shareholders. In particular, the fund's annual report discusses the

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[29] See infra *notes 91-101 and accompanying text (discussing the criteria for determining whether a particular strategy is a principal strategy and disclosure about concentration policies).*

[30] *Items 2(a) and (b).*

[31] *The Commission proposed that the prospectus risk summary refer to fund shareholder reports. A fund's reports to its shareholders typically contain a discussion by the fund's management of the fund's performance ("MDFP"). The Commission believes that the information in a fund's MDFP, including the discussion of the fund's performance during its most recent fiscal year, could be useful to some investors considering an investment in the fund.*

[32] *Item 1(b). Rule 498, as adopted, requires this disclosure to appear in the profile risk/return summary.* See *Profile Adopting Release,* supra *note 1.*

[33] *The Commission has made a few revisions to the disclosure about the availability of additional information to make it clearer and more understandable for investors. Item 1(b)(1) of Form N-1A, as amended, requires a fund (other than a new fund) to include disclosure to the following effect on the back cover page of its prospectus:*

> *Additional information about the fund's investments is available in the fund's annual and semi-annual reports to shareholders. In the fund's annual report, you will find a discussion of the market conditions and investment strategies that significantly affected the fund's performance during its last fiscal year.*

relevant market conditions and investment strategies used by the fund's investment adviser that materially affected the fund's performance during the last fiscal year. You may obtain these reports at no cost by calling .

b. Risks.

Summary Risk Disclosure. The Proposed Amendments would require the risk/return summary to include a discussion of the principal risks of investing in a fund that summarizes information about those risks set out in the fund's prospectus. Reflecting the Commission's proposed new approach to risk disclosure, this discussion was intended to summarize the risks of a fund's anticipated portfolio holdings as a whole, and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, and total return. Commenters generally supported the summary risk disclosure contemplated by the Proposed Amendments, agreeing that it would be specific and brief and would assist investors in identifying the principal risks of investing in a particular fund. The Commission is adopting this disclosure requirement with modifications to reflect certain commenters' suggestions.[34]

Several commenters asked the Commission to clarify the scope of the proposed summary risk disclosure, arguing that the requirement would not serve its purpose if the risk disclosure simply repeated information from other sections of the prospectus. In the Commission's view, the purpose of the summary risk disclosure in a fund's prospectus is to identify briefly the principal risks of investing in the particular fund and to emphasize those risks reasonably likely to affect the fund's performance. In light of this purpose, the Commission expects a fund, in meeting this requirement, to present only a succinct summary of the principal risks of investing in the fund and not to repeat the fuller discussion of these risks required elsewhere in the prospectus.[35] On the other hand, the Commission believes that it generally would be inconsistent with the summary risk requirement for a fund to include a "laundry list" of generic risk factors that may apply to any fund and that does not identify the risks of investing in the fund.

The Commission proposed to require that the prospectus risk summary identify the types of investors for whom the fund may be an appropriate or inappropriate investment.[36] Commenters either opposed or raised significant concerns about this provision, arguing that it could be viewed as requiring a fund to determine whether its shares, among other things, are a suitable investment for a particular investor.[37] Commenters also stated that the disclosure would tend to be generic and not meaningful or useful for investors.

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[34]*Item 2(c).*

[35]See *discussion of risk disclosure,* infra *Section II.A.3.b.*

[36]*As discussed in the Form N-1A Proposing Release,* supra *note 8, at 10902, the purpose of this disclosure was to help investors evaluate and compare funds based on their investment goals and individual circumstances.*

[37]*As several commenters pointed out, applicable regulatory rules for brokers and other investment professionals require that these determinations be made on the basis of a review of information about the unique circumstances of an individual investor.* See, e.g., *rule 2310(a) of the National Association of Securities Dealers, Inc. ("NASD") Conduct Rules, NASD Manual (CCH) 4261 (suitability of recommendations to customers) and rule 405 of the New York Stock Exchange, 2 N.Y.S.E. Guide (CCH) 2403 (the "know your customer" rule).*

The Commission is persuaded by commenters that disclosure about the appropriateness of funds for particular investors should not be required in all fund prospectuses and has deleted this requirement from the prospectus risk summary. The Commission believes, however, that disclosure indicating whether a fund is appropriate for specific types of investors or is consistent with certain investment goals, even if generic in nature, may be useful for some investors and may provide a means for the fund to distinguish itself from other investment alternatives.[38] Therefore, Form N-1A, as amended, permits, but does not require, a fund to include disclosure in the narrative risk summary about the types of investors for whom the fund is intended or the types of investment goals that may be consistent with an investment in the fund.[39]

Under the Proposed Amendments, a fund could choose to discuss the potential rewards of investing in the fund in the risk summary as long as the discussion provided a balanced presentation of the fund's risks and rewards. One commenter strongly questioned this provision of the proposal, asserting that it would detract from a clear presentation of risks in the risk summary. The Commission has reconsidered this disclosure in light of the intended standardized and summary nature of the risk summary and has concluded that the disclosure should focus solely on the risks of investing in a fund. Thus, the Commission has determined to eliminate the option to describe the rewards of investing in a fund in the risk summary. A fund desiring to add this disclosure elsewhere in its prospectus can do so subject to Form N-lA's general rule with respect to information that is not required to be in a prospectus. Under this general rule, a fund can disclose this information, so long as it is not incomplete or misleading and would not obscure or impede understanding of the information that is required to be in the prospectus.[40]

Special Risk Disclosure Requirements. The Proposed Amendments were intended to simplify the prospectus cover page and to avoid repeating information on the cover page and in the risk summary discussion. In seeking to meet this goal, the Commission proposed to move certain cover page disclosure requirements relating to the risks associated with specific types of funds to the risk summary where, the Commission believed, it would be more meaningful to investors.

Form N-1A currently requires that each money market fund[41] disclose on the cover page of its prospectus that an investment in the fund is neither insured nor guaranteed by the U.S. Government and that there can be no assurance that the fund will be able to maintain a stable net

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[38] *In a recent review of fund prospectuses, the Division found many examples of this type of disclosure, which was usually included in a fund's discussion of the risks associated with an investment in the fund. For example, one fund disclosed that it was not an appropriate investment for investors seeking either preservation of capital or high current income or for those investors unable to assume the increased risks of higher price volatility and currency fluctuations associated with investments in international equities traded in non-U.S. currencies. Another fund urged investors to remember that the fund was an aggressive capital appreciation fund designed for long-term investors for a portion of their investments and was not designed for investors seeking income or conservation of capital. Tax-exempt funds frequently stated that an investment in the fund is not appropriate for Individual Retirement Accounts or other tax-advantaged accounts.*

[39] *Instruction to Item 2(c)(1)(i).*

[40] See *General Instruction C.3(b).*

[41] *For these purposes, a money market fund is defined as a fund that holds itself out to investors as a money market fund and meets the conditions of paragraphs (c)(2), (c)(3), and (c)(4) of rule 2a-7 under the Investment Company Act [17 CFR 270.2a-7]. General Instruction A.*

asset value of $1.00 per share. This required disclosure is intended to alert investors that investing in a money market fund is not without risk.[42] In addition to moving this disclosure to the risk summary, the Proposed Amendments would simplify the technical disclosure that a money market fund may not be able to maintain a stable net asset value.[43] Commenters supported the proposed disclosure for money market funds, and the Commission is adopting it as proposed.[44]

Form N-1A currently requires specific prospectus cover page disclosure for a tax-exempt money market fund that concentrates its investments in a particular state (a "single state money market fund"). Each such fund is required to disclose that it may invest a significant percentage of its assets in a single issuer and that investing in the fund may be riskier than investing in other types of money market funds. This disclosure was intended to make investors aware of special risks that could be associated with an investment in a single state money market fund.[45] In the Form N-1A Proposing Release, the Commission asked whether it should continue to require this disclosure in prospectuses. The Commission noted that this disclosure may exaggerate the risk of investing in a single state money market fund. As the Form N-1A Proposing Release pointed out, although these funds are subject to less stringent issuer diversification provisions under Commission rules than other money market funds, they are subject to credit quality and maturity investment restrictions that are comparable to other money market funds.[46]

In response to the Commission's question regarding single state money market funds, commenters indicated that the special disclosure now required on the cover page of fund prospectuses overstates the risks of investing in single state money market funds, particularly in view of the minimal risk that commenters asserted is associated with these funds. The Commission is persuaded by these comments and has determined not to require the disclosure in Form N-1A. Form N-1A currently requires a fund that is advised by or sold through a bank to disclose on the cover page of its prospectus that the fund's shares are not deposits or obligations of, nor guaranteed or endorsed by, the bank, and that the shares are not insured by the Federal Deposit Insurance Corporation ("FDIC") or any other government agency.[47] This disclosure is intended to

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[42]See *Investment Company Act Release Nos. 17589 (July 17, 1990) [55 FR 30239, 30247] and 18005 (Feb. 20, 1991) [56 FR 8113, 8123] (proposing and adopting revisions to rule 2a-7 for money market funds).*

[43]*The Proposed Amendments would require the following disclosure:*

> *An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund.*

[44]*Item 2(c)(1)(ii).*

[45]*Form N-1A currently does not require this disclosure if, with respect to 100% of its assets, a fund limits its investments in a single issuer to no more than 5% of its assets.*

[46]See *Form N-1A Proposing Release,* supra *note 8, at 10904. Under rule 2a-7, a "national" tax-exempt money market fund generally is limited to investing no more than 5% of its assets in the securities of a single issuer. For a single state money market fund, the 5% single issuer limitation applies with respect to 75% of the fund's assets. This limitation recognizes that single state money market funds concentrate their investments in debt securities issued by a single state (or issuers located within that state), making diversification more difficult to achieve.* See *Investment Company Act Release Nos. 21837 (Mar. 21, 1996) [61 FR 13956] and 22921 (Dec. 2, 1997) [62 FR 64968].*

[47]*1994 GCL,* supra *note 25; Letter to Registrants from Barbara J. Green, Deputy Director, Division of Investment Management, SEC (May 13, 1993) ("Division Bank Letter").*

alert investors that funds advised by or sold through banks are not federally insured.[48] The Commission proposed to move this disclosure to the prospectus risk summary and to simplify the wording of the current disclosure required for funds advised by or sold through banks.[49] Commenters supported the revised disclosure requirements for bank-sold funds, and the Commission is adopting them substantially as proposed.[50]

Risk/Return Bar Chart and Table. The Proposed Amendments would require a fund's risk/return summary to include a bar chart showing the fund's annual returns for each of the last 10 calendar years and a table comparing the fund's average annual returns for the last 1-, 5-, and 10-fiscal years to those of a broad-based securities market index. Commenters generally supported the proposed bar chart and performance table, but had a number of suggestions about the content and presentation of the information in both. The Commission is adopting the proposed bar chart and table requirements with modifications to reflect suggestions of commenters.[51]

The bar chart reflects the Commission's determination that investors need improved disclosure about the risks of investing in a fund. The bar chart is intended to illustrate graphically the variability of a fund's returns (*e.g.*, whether a fund's returns for a 10-year period have changed significantly from year to year or were relatively even over the period) and thus provide

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[48]See *Division Bank Letter*, supra *note 47*. See also *Testimony of Ricki Helfer, Chairman, Federal Deposit Insurance Corporation ("FDIC"), on FDIC Survey of Nondeposit Investment Sales at FDIC-Insured Institutions Before the Subcomm. on Capital Markets, Securities, and Government Sponsored Enterprises of the House Comm. on Banking and Financial Services, 104th Cong., 2d Sess. (June 26, 1996) (citing surveys in October 1995 and April 1996 indicating that approximately one-third of bank customers either thought that, or did not know whether, funds sold through banks were insured).*

[49]*The Proposed Amendments would require a fund that is not a money market fund but is advised by or sold through a bank to disclose that its shares are not federally insured as follows:*

> *An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.*

[50]*Item 2(c)(1)(iii). Some commenters asserted that the proposed disclosure was inconsistent with that required by bank regulators in the Interagency Statement on Retail Sales of Nondeposit Investment Products. See Board of Governors of the Federal Reserve System, FDIC, Office of the Comptroller of the Currency, and Office of Thrift Supervision, Interagency Statement on Retail Sales of Nondeposit Products, 6 Fed. Banking L. Rep. (CCH) 1 70-113, at 82,598 (Feb. 15, 1994) ("Interagency Statement") (requiring disclosure that the fund is not a deposit or other obligation of the bank). The Commission has confirmed with these bank regulators that no such inconsistency exists, because the disclosure required by the Interagency Statement applies to sales material and not to fund prospectuses. In response to suggestions from the bank regulators, the Commission has revised the legend required for funds that are advised by or sold through banks, to read as follows:*

> *An investment in the Fund is not a deposit of the bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.*

The requirement, as amended in this way, is consistent with the requirement now in effect.

[51]*Item 2(c)(2). An example of the bar chart and performance table is attached as Appendix B to this release.*

investors with some idea of the risk of an investment in the fund.[52] The average annual return information in the table should enable investors to evaluate a fund's performance and risks relative to "the market." In the Form N-1A Proposing Release, the Commission requested comment about alternative presentations that could improve fund risk disclosure.[53] In particular, the Commission expressed interest in disclosure that would show a fund's highest and lowest returns (or "range" of returns) for annual or other periods as an alternative, or in addition, to the bar chart. The Commission suggested that a fund could present the information in a separate table or could include it in the performance table.

In response to the Commission's request, some commenters suggested including in a fund's bar chart one or more indexes or other benchmarks (such as 3-month Treasury returns or the rate of inflation) to help investors evaluate the fund's returns by comparisons to other measures of market performance or economic factors.[54] Most commenters, however, opposed requiring additional information in the bar chart, asserting that it could complicate and reduce the effectiveness of the bar chart.

Several commenters supported the inclusion of return information in the bar chart on a quarterly or semi-annual rather than an annual basis. They argued that this change to the bar chart would respond to concerns that investors may not sufficiently appreciate that an investment in a fund may be subject to the risk of a short-term decline in value. This risk, commenters asserted, may not be apparent from the annual returns proposed to be shown in the bar chart. One commenter recommended that the Commission require quarterly returns in the bar chart so that investors would have more information about returns over shorter periods to use in assessing the variability reflected in a fund's past returns. The commenter argued that including returns on an annual basis in the bar chart may not show a significant amount of shorter-term price fluctuation.

The Commission acknowledges that a fund's returns may vary significantly and could decrease in value over short periods and that the annual returns in the bar chart will not necessarily reflect this pattern. On the other hand, the Commission is concerned that requiring quarterly

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[52] *In adopting the bar chart requirement, the Commission does not mean to suggest that all, or even a significant portion of all, fund investors equate variability in a fund's returns with the risks of investing in the fund. As discussed below, the Commission acknowledges that investors have a wide range of ideas of what "risk" means.* See infra *Section II.A.3. Nonetheless, the Commission's bar chart proposal was supported by many investors who expressed strong interest in seeing prospectuses include a version of the bar chart. Focus group participants, for instance, found the bar chart helpful in evaluating and comparing fund investments. Over 75% of individual investors responding to the Risk Concept Release favored a bar chart presentation of fund volatility. Risk Concept Release,* supra *note 18.* See also *ICI, UNDERSTANDING SHAREHOLDERS' USE OF INFORMATION AND ADVISERS (1997) ("ICI SHAREHOLDER USE STUDY") at 20 and 30 (discussing investors' interest in receiving and understanding fund risk information) and ICI RISK SURVEY,* supra *note 21. In addition, all commenters responding to the Commission's initiative to simplify money market fund prospectuses supported the proposal to replace the financial highlights information in money market fund prospectuses with a 10-year bar chart reflecting a money market fund's yield.* See *Summary of Comment Letters on Proposed Amendments to the Rules Regulating Money Market Fund Prospectuses Made in Response to Investment Company Act Release No. 21216, at 2 (File No. S7-21-95).*

[53] See *Form N-1A Proposing Release,* supra *note 8, at 10907.*

[54] *Form N-1A, as amended, permits a fund to use other indexes in the presentation of the average annual return information in the table accompanying the bar chart. Instruction 2(b) to Item 2(c)(2).*

returns over a 10-year period would make the bar chart more complex and less useful in communicating information to investors. In balancing the desire to make typical fund investors aware that fund shares may experience fluctuations over shorter periods with its underlying goal that fund documents communicate information in as straightforward and uncomplicated a manner as possible, the Commission has determined to require a fund to disclose, in addition to the bar chart, its best and worst returns for a quarter during the 10-year (or other) period reflected in the bar chart.[55] The Commission believes that this information will assist investors in understanding the variability of a fund's returns and the risks of investing in the fund by illustrating, without adding unwarranted complexity to the bar chart, that the fund's shares may be subject to short-term price fluctuations.

Presentation of Return Information. The Proposed Amendments would require a fund to include the bar chart and table in the risk section of the prospectus risk/return summary under a separate sub-heading that referred to both risk and performance. Several commenters argued that the separate sub-heading requirement was unnecessary and suggested that a fund should be able to choose whether to include any sub-heading. Consistent with the objective of encouraging funds to develop disclosure formats that are most helpful to investors, Form N-1A, as amended, does not require the sub-heading included in the Proposed Amendments.[56] To help investors use the information in the bar chart and table, Form N-1A, as amended, however, does require a fund to provide a brief narrative explanation of how the information illustrates the variability of the fund's returns.[57]

Bar Chart Return Information. The Proposed Amendments would require that a fund's prospectus bar chart show the fund's annual returns for the last 10 calendar years of the fund's existence. The purpose of the calendar year requirement was to facilitate the comparison of annual returns among funds, which typically have fiscal periods that do not correspond to the calendar year.[58] Unlike the proposed bar chart, the proposed performance table required disclosure of a fund's returns for fiscal year periods. In requiring this disclosure to be made for fiscal year periods, the proposal was consistent with existing disclosure requirements for the presentation of other financial information included in a fund's prospectus.

Several commenters argued that using different time periods for the proposed bar chart and performance table would confuse investors and urged the Commission to minimize potential investor confusion by adopting consistent time periods for this information. The Commission is persuaded by these comments and believes that requiring both the bar chart and the performance table to be based on calendar year periods will promote understandable information in fund prospectuses. Therefore, Form N-1A, as amended, requires calendar year periods for both the

[55]*Item 2(c)(2)(ii).*

[56]*General Instruction C.1(a) to Form N-1A, as amended, encourages funds to use document design techniques that promote effective communication.*

[57]*Item 2(c)(2)(i).*

[58]*The Commission understands that funds increasingly organize themselves as series companies and tend to stagger the financial periods of their series so that audits and financial reporting periods are spread over an entire calendar year.*

bar chart and table.[59] Rule 498, as adopted, also requires the bar chart and table in the profile to show calendar year data so that both the profile and the prospectus of a fund will have virtually the same risk/return information.[60]

The Commission is adopting, as proposed, the requirement that a fund calculate the annual returns in the bar chart using the same method required for calculating annual returns in the financial highlights information included in fund prospectuses.[61] The bar chart does not reflect sales loads assessed upon the sale of a fund's shares, although the average annual return information for the fund in the table would reflect the payment of any sales loads.[62] Commenters generally supported this presentation of annual return information. The Commission believes that, in light of the different types of sales loads that may be charged on funds shares, it would be difficult for funds to compute annual returns for the purposes of the bar chart and to communicate the information effectively to investors.[63] In addition, the Commission has concluded that more precise return information is not necessary for the bar chart to serve the purpose of graphically showing fund annual returns and illustrating the variability of an investment in a fund over a 10-year period.

Bar Chart Presentation. The Proposed Amendments would allow a single bar chart to include return information for more than one fund. Most commenters supported the proposal, agreeing that it would give funds the appropriate amount of flexibility to present the information in the bar chart in a manner designed to assist investors in making investment decisions. Under Form N-1A, as amended, the bar chart may include returns for more than one fund, subject to the general requirement that the information presented in the bar chart appear in a clear and understandable manner.[64]

Multiple Class Funds. Although the Commission proposed to permit return information for more than one fund to be included in a single bar chart, the Proposed Amendments would

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[59] *Item 2(c)(2). Form N-IA, as amended, requires a fund to have at least one calendar year of returns before including the bar chart and requires a fund to modify the narrative explanation accompanying the bar chart and table if the fund does not include the bar chart* (e.g., *by stating that the information gives some indication of the risks of an investment in the fund by comparing the fund's performance with a broad measure of market performance). Form N-1A, as amended, also requires the bar chart of a fund in operation for fewer than 10 years to include calendar year returns for the life of the fund.*

[60] *Rule 498(c)(2)(iii). Unlike Form N-1A, as amended, rule 498, as adopted, requires average annual return information in the performance table in the profile to be as of the most recent calendar quarter and updated as soon as practicable after each quarter of a calendar year.* See *Profile Adopting Release,* supra *note 1. A fund would update the average annual return information included in its prospectus when filing the annual update of its registration statement required by section 10(a)(3) of the Securities Act.*

[61] *Instruction 1(a) to Item 2(c)(2). Form N-1A, as amended, requires a fund to present the corresponding numerical return adjacent to each bar. Item 2(c)(2)(ii).*

[62] *Instruction 2(a) to Item 2(c)(2). Form N-1A, as amended, requires a fund whose shares are sold subject to a sales load to disclose that the load is not reflected in the bar chart and that, if it were included, returns would be less than those shown. Instruction 1(a) to Item 2(c)(2).*

[63] *In contrast, sales loads can be accurately and fairly reflected in annual return information of the type contained in the table by deducting sales loads at the beginning (or end) of particular periods from a hypothetical initial fund investment.*

[64] See *General Instruction C.3(c).*

require a fund offering more than one class of its shares in a prospectus to limit the information in the fund's bar chart to one class. Commenters uniformly supported this approach, and the Commission is adopting it as proposed.[65] Unlike individual funds, classes of a fund represent interests in the same portfolio of securities, and the returns of each class differ only to the extent the classes do not have the same expenses; The Commission believes that including return information for all classes offered through a fund's prospectus is not necessary to provide some indication of the risks of investing in the fund. In addition, the table accompanying such a fund's bar chart would provide return information for each class offered in the prospectus so that investors would be able to identify and compare the performance of each class.[66]

The Proposed Amendments would require the bar chart of a fund offering more than one class of shares through a prospectus to reflect annual return information for the class offered in the prospectus that had the longest performance history over the last 10 years. When two or more classes have returns for at least 10 years, or returns for the same period but fewer than 10 years, the Proposed Amendments would require annual returns for the class with the greatest net assets as of the end of the most recent calendar year. Most commenters addressing the issue opposed this approach. They argued that, if all classes had existed for the same amount of time, the largest class could change from year to year, thus requiring a fund to change the class reflected in the bar chart. According to the commenters, changes in the information each year could be confusing for investors and result in unwarranted administrative burdens for funds. Commenters suggested that the Commission permit a fund having classes with performance histories extending over the same period of time to include the performance of any existing class in the bar chart, maintaining that the effect of expenses on the returns for different classes of shares is not significant.[67] The Commission is persuaded that allowing a multiple class fund in such a case to choose the class reflected in the fund's bar chart will simplify compliance with Form N-1A's requirements and provide investors with sufficient information to evaluate the variability of returns for any class of the fund. Therefore, Form N-1A, as amended, permits a fund to choose the class to be reflected in the bar chart, subject to certain limitations.[68] Under Form N-1A, as amended, the bar chart must reflect the performance of any class that has returns for at least 10 years (*e.g.,* a fund could not present a class in the bar chart with 2 years of returns when another class has returns for at least 10 years). In addition, if two or more classes offered in the prospectus have returns for different periods shorter than 10 years, the bar chart must reflect returns for the class that has returns for the longest period.

Tabular Presentation of Fund and Index Returns. The Proposed Amendments would require a table accompanying a fund's bar chart to present the fund's average annual returns for the last 1-, 5-, and 10-fiscal years (or for the life of the fund, if shorter) and to compare that

[65]*Instruction 3(a) Item 2(c)(2).*

[66]*Instruction 3(c) to Item 2(c)(2).*

[67]*In making this argument, commenters cited rule 18f-3 under the Investment Company Act [17 CFR 270.18f-3], which provides that a class of shares may have different expenses for shareholder service fees, distribution fees, or other expenses actually incurred in a different amount by the class. The rule does not permit expenses for advisory or custodial fees, or other management fees, to vary among classes.*

[68]*Instruction 3(a) to Item 2(c)(2).*

information to the returns of a broad-based securities market index for the same periods. The purpose of including return information for a broad-based securities market index was to provide investors with a basis for evaluating a fund's performance and risks relative to the market. The proposed approach also was consistent with the line graph presentation of fund performance required in MDFP disclosure.[69]

Commenters generally supported the proposed performance table, but had several technical suggestions. The Commission is adopting the performance table with revisions to clarify the disclosure requirements for the table.[70]

One commenter suggested that the Commission allow funds that have existed for more than 10 years to include average annual returns for the life of the fund in the performance table. The Commission agrees that this information could be helpful for typical investors in such a fund. Form N-1A, as amended, permits, but does not require, a fund to include performance information in the table for the life of the fund if it exceeds 10 years.[71]

The Proposed Amendments would require a money market fund, in meeting the proposed performance table requirement, to provide its 7-day yield as of the end of its most recent fiscal year. One commenter questioned this requirement, arguing that it would result in money market funds giving outdated information to investors and suggested that disclosure describing how an investor can obtain the fund's current 7-day yield would be preferable. As amended, Form N-1A gives a money market fund the option of providing in its performance table its 7-day yield ending on the date of its most recent calendar year or disclosing a toll-free (or collect) telephone number that an investor can use to contact the fund to obtain its current 7-day yield.[72]

2. Risk/Return Summary: Fee Table (Item 3)

The Proposed Amendments would continue to require a fee table in the prospectus that summarizes the sales charges and fund operating expenses associated with an investment in a fund. Proposed rule 498 also incorporates the fee table requirement in the risk/return summary included in the profile. Including the fee table in both the prospectus and the profile reflects the Commission's strongly held belief in the importance of fees and expenses in a typical investor's decision to invest in a fund. The fee table is designed to help investors understand the costs of

[69]See *MDFP Adopting Release,* supra *note 15, at 19054.*

[70]*Item 2(c)(2)(ii). Consistent with the Proposed Amendments, Form N-1A, as amended, requires a fund to calculate average annual returns using the same method required to calculate fund performance included in advertisements, which reflects the payment of sales loads and recurring shareholder account fees. Instruction 2(a) to Item 2(c)(2) (incorporating the requirements of Item 21).*

[71]*Item 2(c)(2)(iii). Form N-1A, as amended, permits a fund that has not had the same adviser for the last 10 years to begin the bar chart and performance information in the table on the date the new adviser began to provide advisory services to the fund, so long as certain conditions are met. Instruction 4 to Item 2(c)(2). Form N-1A, as amended, also requires a fund that changes the index shown in the table to explain the reasons for the change and provide information for both the newly selected and the former index. Instruction 2(c) to Item 2(c)(2). Each of these provisions is consistent with the requirement applicable to the MDFP line graph. Instructions 7 and 11 to Item 5(b).*

[72]*Item 2(c)(2)(iii).*

investing in a fund and to compare those costs with the costs of other funds. Commenters generally supported the fee table disclosure, and the Commission is adopting it substantially as proposed.

The Commission proposed certain amendments designed to improve communication of the information in the fee table. The Commission proposed to require a narrative explanation of the purpose of the "Example" that accompanies the fee table.[73] Recognizing the trend that the typical fund investment is increasing in size,[74] the Proposed Amendments would increase the initial hypothetical investment included in the Example from $1,000 to $10,000.

Several commenters criticized the Example, arguing that, because it is an arbitrary approximation of a fund's actual expenses, the Example is not helpful to investors. These commenters recommended that the Commission eliminate the Example from the fee table disclosure.

The Commission recognizes that any example necessarily has limitations. On balance, however, the Commission believes that the Example provides useful information that helps a typical investor understand and compare the expenses of different funds.[75] The Example is a relatively straightforward means of illustrating the effect of costs in investing in a fund over time. Expressing expense amounts solely as a percentage amount, as is done in the fee table, may not give the average investor enough information to assess the likely effect of a fund's expenses on a dollar amount of an investment in the fund. The addition of a clear narrative explanation of the purpose of the Example should increase its effectiveness in assisting investors' understanding of the Example, and the Commission is adopting this disclosure requirement as proposed.[76]

To ensure that all account fees (*e.g.*, administrative fees charged to maintain an account) paid directly by shareholders are disclosed, the Proposed Amendments would require a new line item in the shareholder transaction section of the fee table describing account fees charged by a fund. The Commission is adopting this requirement as proposed.[77] In response to comments on the Proposed Amendments, Form N-1A, as amended, clarifies that the table should include account fees that affect a typical investor in a fund and not miscellaneous fees that apply to only a limited number of shareholders based on their particular circumstances.[78]

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[73]*The Example currently discloses the cumulative amount of fund expenses over 1, 3, 5, and 10 years based on a hypothetical investment of $1,000 and an annual 5% return. The Commission proposed to require funds to include a narrative explanation to the following effect:*

> *This Example is intended to help you compare the cost of investing in the fund to the cost of investing in other mutual funds.*

[74]See *Letter from John C. Bogle, Chairman of the Board, The Vanguard Group, to Barry P. Barbash, Director, Division of Investment Management, SEC (Sept. 16, 1996) (suggesting that few investors have as little as $1,000 invested in a given fund, and that the average fund investment typically amounts to $10,000 to 25,000, with the median investment probably in the range of $6,000 to 7,000).*

[75]See *Fee Table Adopting Release,* supra *note 14, at 3194.*

[76]*Item 3.*

[77]*Form N-1A, as amended, clarifies that a fund should disclose only fees charged by or on behalf of the fund, not fees charged by unrelated third parties. Instruction 1(c) to Item 3.*

[78]*Instruction 2(d) to Item 3. For example, Form N-1A would not require a fund to include in the fee table a fee charged to accounts with small balances (*e.g., *$10 annual fee on accounts less than $2,500).*

The Commission proposed to modify some of the captions in the fee table relating to fees and expenses. The revisions were intended to result in fee tables referring consistently to different types of expenses as "fees." In particular, the Proposed Amendments would change the captions for "sales loads" to "sales fees (loads)." The Proposed Amendments also would revise the caption "12b-1 Fees" to read "Marketing (12b-1) Fees." Commenters generally criticized these changes. They maintained that the caption sales fees (loads) was not typically used by the industry or industry commentators and could be confusing to investors. The commenters recommended that the caption in the fee table refer to "sales charges." Commenters also recommended that the caption "Distribution [and/or Service] (12b-1) Fees" would better describe these fees than the term "Marketing (12b-1) Fees." Commenters said that the types of fees that can be paid in accordance with rule 12b-1 under the Investment Company Act extend beyond marketing fees so that referring to rule 12b-1 fees as marketing fees would be inaccurate.

The Commission believes that the terms suggested by commenters are commonly used by the industry and by the press in covering the industry and may be more easily understood by investors than those proposed. Form N-1A, as amended, modifies the caption for sales fees (loads) to refer to sales charges (loads).[79] The Commission is retaining the reference to loads because many investors are familiar with this term. Form N-1A, as amended, also requires funds to use the captions suggested by the commenters in referring to distribution fees in the fee table.

The Commission proposed to continue to require a fund to reflect in the fee table its operating expenses for the most recent fiscal year, taking into account expense reimbursements and fee waiver arrangements.[80] As required by current Form N-1A, a footnote to the fee table would disclose the amount of expenses that would have been incurred had there been no waiver or reimbursement. One commenter expressed strong opposition to showing expenses in the fee table that are reduced by reimbursements or fee waivers. The commenter asserted that investors would interpret the disclosure to mean that the net fee disclosed in the table is what they-can expect for the life of their investment in the fund, which may not be the case.

The Commission believes that typical investors need clear disclosure of information about fees charged by funds.[81] Reflecting its continuing concern about the quality of disclosure about fees, the Commission has reconsidered the disclosure of expense reimbursement and fee waiver arrangements. The Commission believes that typical investors may tend to overlook or disregard information about a fund's fee structure if it is included in a footnote. Moreover, requiring the

[79] *Item 3.*

[80] *In an expense reimbursement arrangement, the adviser reimburses the fund for any expenses that exceed a predetermined amount. Under a fee waiver arrangement, the adviser agrees to waive a portion of its fees in order to limit fund expenses to a predetermined amount.*

[81] See, e.g., *Testimony of Arthur Levitt, Chairman, SEC, before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce (Mar. 6, 1997) (explaining the Commission's concern about investor confusion with fund fees); Remarks by Steven M.H. Wallman, Commissioner, SEC, before the ICI's 1995 Investment Company Directors Conference and New Directors Workshop, Washington, D.C. (Sept. 22, 1995) (noting investors' confusion about the assessment of advisory fees).*

fee table to show fees that a fund will charge under its contractual arrangement with its investment adviser, without regard to temporary arrangements that may decrease these fees, is consistent with other Form N-1A requirements.[82]

In view of its desire to improve the quality of fee disclosure, the Commission has revised Form N-1A to require a fund to disclose in the fee table its operating expenses, not taking into account expense reimbursements and fee waiver arrangements.[83] To ensure that investors have current information about a fund's expenses, however, Form N-1A, as amended, permits a fund to disclose its operating expenses net of reimbursements and waivers in a footnote to the fee table.[84] The Commission believes that the fee table disclosure of fund expenses, as amended, will give an investor clearer information about the long-term costs of an investment in a fund, while at the same time allowing the fund to provide current information about its operating expenses.

3. Investment Strategies and Risk Disclosure (Item 4)

In the Form N-1A Proposing Release, the Commission discussed its concerns about disclosure of fund investments and risks typically found in many fund prospectuses.[85] This disclosure generally consists of descriptions of the types of securities in which a fund may invest and the risks associated with each of those securities.[86] In the Commission's view, disclosing information about all of the securities in which a fund might invest does not help a typical fund investor evaluate how the fund's portfolio will be managed or the overall risks of investing in the fund. The disclosure also adds substantial length and complexity to fund prospectuses, which discourages investors from reading them.

The Commission has concluded that prospectus disclosure would be more useful to a typical fund investor if it emphasized the principal investment strategies of a fund and the principal risks of investing in the fund, rather than the characteristics and risks of each type of instrument in

[82]See, e.g., *Instruction 2(a)(i) to Item 3 (requiring funds to disclose deferred sales charges even though they apply only to investors leaving the fund)*. See also *"From Security to Self-Reliance: American Investors in the 1990s," Remarks by Arthur Levitt, Chairman, SEC, before the ICI's General Membership Meeting at the Washington Hilton Hotel, Washington, D.C. (May 22, 1996) (citing a survey by the Investor Protection Trust that found that 2 out of 3 investors believed that no-load mutual funds involve no sales charges or fees, as an example of why the Commission should be concerned about the quality of disclosure of fees charged by funds); Testimony of Barry P. Barbash, Director, Division of Investment Management, SEC, Before the Subcomm. on Capital Markets, Securities, and Government Sponsored Enterprises of the House Comm. on Banking and Financial Services, 104th Cong., 2d Sess. (June 26, 1996) (citing a 1994 survey by the American Association of Retired Persons, the Consumer Federation of America, and the North American Securities Administrators, Inc. that found that the vast majority of American bank customers who hold shares of mutual funds are unaware of the risks and fees involved in the sale of mutual funds)*.

[83]*Instructions 3(d)(i) and 5(a) to Item 3*.

[84]*Instructions 3(e) and 5(b) to Item 3. A fund also must disclose the period for which the expense reimbursement or fee waiver is expected to continue, or whether it can be terminated at any time at the option of the fund. The Commission expects that, in the latter case, a fund would provide adequate notice to investors and fund shareholders in advance of the termination of the arrangement*.

[85]See *Form N-1A Proposing Release*, supra *note 8, at 10909*.

[86]*The investments described often include instruments, such as liquid securities, repurchase agreements, and options and futures contracts, that do not have a significant role in achieving a fund's investment objectives*.

which the fund may invest.[87] The Commission believes that funds are appropriately viewed as a means through which a professional money manager provides its services to investors[88] and that, for that reason, the focus of disclosure about a fund's prospective investments should center on the fund's investment objectives and the principal means used by the fund's adviser to achieve those objectives. Consistent with this view, the Proposed Amendments would require prospectus disclosure that is designed to help investors understand how a particular fund's portfolio will be managed. The purpose of the Proposed Amendments was to implement more effectively the Commission's original goal in adopting Form N-1A that the prospectus should describe a fund's "fundamental characteristics."[89] Commenters generally supported the proposed approach to disclosure of the fund's investment operations and attendant risks, and the Commission is adopting it substantially as proposed.

a. Principal Investment Strategies, Investment Objectives, and Implementation of Investment Objectives

To assist investors in determining whether a fund meets their investment needs, Form N-1A, as amended, continues to require prospectus disclosure of a fund's investment objectives.[90] The Commission proposed to shift the focus of disclosure about how a fund intends to achieve its investment objectives away from the current practice of listing all types of securities in which a fund may invest to a discussion of the fund's overall portfolio management.[91] The Commission

[87] *The ICI has supported prospectus disclosure that focuses primarily on a fund's broad investment objectives, practices, and associated risks, and not on particular types of securities in which the fund may invest.* See, e.g., *Letter from Paul Schott Stevens, General Counsel, ICI, to Jonathan G. Katz, Secretary, SEC, at 5 (Apr. 8, 1996); Letter from Paul Schott Stevens, General Counsel, ICI, to Jonathan G. Katz, Secretary, SEC, at 4-6 (July 28, 1995) ("1995 ICI Risk Comment Letter"); Letter from Amy B.R. Lancellotta, Associate Counsel, ICI, to C. Gladwyn Goins, Associate Director, Division of Investment Management, SEC, at 7 (Mar. 7, 1995).*

[88] See *"Can We Make Donkeys Fly?," Remarks by Barry P. Barbash, Director, Division of Investment Management, SEC, before the Business Law Section of the ABA, Washington, D.C., at 13 (Nov. 11, 1994);* see also *1 T. LEMKE, G. LINS & A.T. SMITH III, REGULATION OF INVESTMENT COMPANIES §1.01, at 1-1 (1997).*

[89] See *1982 Form N-1A Proposing Release,* supra *note 13, at 815; 1983 Form N-1A Adopting Release,* supra *note 12, at 39729.*

[90] *Item 4(a). A fund may refer to its investment objectives as investment goals or any other term that clearly communicates the principal investment design of the fund. Form N-1A, as amended, continues to require a fund to disclose in its prospectus when it may change its investment objectives without a shareholder vote.* Id. *Under current practice, some funds disclose in their prospectuses when a shareholder vote is required to change its investment objectives. The Commission believes that disclosure of this sort is of limited significance to the typical fund investor. In the Commission's view, most investors typically would not expect the investment objectives of their funds to change without their approval. Consistent with this view, Form N-1A, as amended, requires a fund to disclose in its SAI, and not in its prospectus, when a shareholder vote is required to change its investment objectives. Item 12(c)(1)(vii).*

[91] *Form N-1A currently requires a fund to disclose the types of securities in which it invests or will invest principally, as well as any "special investment practices and techniques" that the fund will use in connection with investing in those securities. Form N-1A also requires disclosure, subject to certain limitations, about "significant investment policies or techniques" that a fund intends to use. One of those limitations directs a fund to limit prospectus disclosure about practices that place no more than 5% of the fund's assets at risk. Many funds disclose in their prospectuses information about securities and investment practices that do not, and may not ever, place more than 5% of the fund's assets at risk, often to retain the flexibility to exceed the 5% threshold in the future. The Commission proposed to eliminate the 5% standard. Form N-1A Proposing Release,* supra *note 8, at 10909. The standard has been deleted in Form N-1A, as amended.*

proposed to require a fund to disclose in its prospectus the principal strategies that it used to achieve its investment objectives, which would include the particular type or types of securities in which the fund will invest principally. This approach was designed to focus disclosure on a fund's anticipated investment operations rather than on investments that the fund might make. The Commission continues to believe that a clear, concise, and straightforward discussion of investment objectives and strategies is central to effective prospectus disclosure. Therefore, the Commission is adopting the requirement for a fund to disclose how it intends to achieve its investment goals as proposed.[92]

Under Form N-1A, as amended, whether a particular investment strategy (including a strategy to invest in a particular type of security) is a principal investment strategy depends upon the strategy's anticipated importance in achieving the fund's investment objectives and how the strategy affects the fund's potential risks and returns.[93] The Commission believes that a fund should disclose those strategies that are expected to be the most important means of achieving the fund's objectives and that the fund anticipates will have a significant effect on its performance. Form N-1A, as amended, requires a fund, when determining whether a strategy is a principal investment strategy, to consider, among other things, the portion of assets that it expects to commit to the strategy, the portion of assets that it expects to place at risk by the strategy, and the likelihood that it will lose some or all of those assets in implementing the strategy.[94]

The Commission intends that focusing disclosure on a fund's principal investment strategies[95] will improve the fund's prospectus by eliminating discussions of securities and strategies that do not have a significant role in achieving the fund's investment objectives. Under Form N-1A, as amended, for example, it generally will be unnecessary for a fund (other than, for example, a money market fund) to disclose in its prospectus its cash management practices (*e.g.*, entering into overnight repurchase agreements), because these practices are not typically among the principal investment strategies that a fund uses to achieve its investment objectives.[96]

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[92]*Item 4(b). Instruction 1 to Item 4(b)(1) defines a strategy to include any policy, practice, or technique used to achieve a fund's investment objectives.*

[93]*Instruction 2 to Item 4(b)(1). Form N-1A currently directs a fund not to disclose so-called "negative" practices (i.e., practices in which a fund may not or does not intend to engage). Instruction 3 to Item 4(b)(1) retains this limitation by providing that a negative strategy is not a principal investment strategy. Avoiding disclosure about negative strategies is intended to ensure that prospectus disclosure states what the fund will do to achieve its investment objectives, rather than what the fund will not do.*

[94]*Instruction 2 to Item 4(b)(1). As amended, Form N-1A requires a fund to disclose strategies that are not principal strategies in the SAI. Item 12(b).*

[95]*A bond fund, for example, typically would discuss generally the maturities, durations, ratings, and types of issuers of the bonds in which the fund invests principally.*

[96]*Under the disclosure principles incorporated into Item 4 of Form N-1A, as amended, a fund that has a principal investment strategy of allocating its assets among stocks, bonds, and money market instruments also would need to disclose its use of cash equivalents. Whether a fund needs to include disclosure in its prospectus about matters such as holding or trading stock futures and option contracts, engaging in securities lending, purchasing securities on a "when-issued" basis, or investing in liquid or restricted securities will depend on the extent to which these instruments or practices have a significant role in achieving the fund's investment objectives. A fund generally would not need to include disclosure about restricted securities in its prospectus because investments in this type of security usually would not be so significant as to constitute a principal investment strategy of the fund. Whether a fund's use of stock futures, option contracts, or other derivatives would need to be disclosed in the fund's prospectus would depend in large part on whether the strategy poses the risk of substantial gains or losses for the fund.*

The Proposed Amendments would require a fund, in discussing its principal investment strategies in its prospectus, to explain in general terms how the fund's adviser decides what securities to buy and sell. This requirement sought to provide investors with essential information about the fund's investment approach and how the fund's portfolio would be managed. One commenter questioned this requirement, arguing that it could place undue emphasis on a fund's decisions to invest in or sell particular securities and result in boilerplate disclosure. The Commission continues to believe that a general discussion of the methods of analysis and investment strategies that a fund's adviser will use in managing the fund will provide typical investors with information that will help them in deciding whether to invest in a fund. Therefore, the Commission is adopting the proposed disclosure requirement regarding the manner in which the investment adviser determines to buy and sell securities.[97]

Concentration. The Commission proposed to continue to require a fund to disclose in its prospectus any policy to concentrate its investments in any industry or group of industries. This requirement reflects the view that such a policy is likely to be central to a fund's ability to achieve its investment objectives,[98] that a fund that concentrates its investments will be subject to greater risks than funds that do not follow the policy. The Commission's staff has taken the position for purposes of the concentration disclosure requirement that a fund investing more than 25% of its assets in an industry is concentrating in that industry.[99] The Proposed Amendments incorporated this percentage test into Form N-1A.

Commenters supported requiring a fund to disclose in its prospectus its policies on industry concentration,[100] and the Commission continues to believe that 25% is an appropriate

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[97]*Item 4(b)(2). In meeting this requirement, an equity fund could describe, for example, whether it emphasizes value or growth, or blends the two approaches. A value-oriented fund might state that the fund's adviser selects stocks that it considers to be undervalued by recognized measures of economic value such as earnings, cash flow, and book value. Other types of disclosure about a fund's investment philosophy might include whether the fund invests in stocks based on a "top-down" analysis of economic trends or a "bottom-up" analysis based on the financial condition and competitiveness of individual companies.*

[98]*That such a policy can be central to a fund's meeting its investment objective is suggested by section 8(b)(1) of the Investment Company Act [15 U.S.C. 80a-8(b)(1)], which requires a fund to disclose in its registration statement any policy to concentrate its investments in a particular industry or group of industries. Under section 13(a)(3) [15 U.S.C. 80a-13(a)(3)], a fund must obtain shareholder approval to change a policy to concentrate its investments.*

[99]*Guide 19 to Form N-1A.*

[100]*Some commenters questioned an existing position of the Commission's staff regarding the ability of a fund to adopt a policy of shifting between concentrated and non-concentrated status. One commenter requested reconsideration of the staff's long-standing position that a fund cannot, consistent with the provisions of sections 8(b)(1) and 13(a)(3), have an investment policy permitting the fund to concentrate or not concentrate its investments as determined by the fund's board in its discretion. The commenter argued that this position was too rigid and that a fund's board of directors should have the flexibility to shift the fund's concentration policy, subject to making appropriate disclosure to fund shareholders. The Commission recognizes that fund investment practices have changed as a result of the growth of securities markets and assets invested in funds. The Commission believes that it may be appropriate to reconsider the issue raised by the commenter, but has concluded that the issue should not be reconsidered in the context of the revisions of Form N-1A being adopted today. The Commission has requested that the Division review its positions on concentration, consulting with industry representatives as appropriate, with a view toward allowing funds a greater degree of flexibility in establishing concentration policies.*

benchmark to gauge the level of investment concentration that could expose investors to additional risk. Therefore, the Commission is adopting this disclosure requirement as proposed.[101]

Temporary Defensive Positions. The Proposed Amendments would require disclosure about a fund's policy that permits the fund to take "temporary defensive positions" to respond to adverse market, economic, political, or other conditions. The purpose of the requirement was to make investors aware of potential changes in a fund's investments that are not generally contemplated by, or are otherwise inconsistent with, a fund's principal investment objectives and policies. In particular, the Proposed Amendments would require a fund to disclose the percentage of its assets that may be committed to temporary defensive positions (*e.g.*, up to 100% of the fund's assets), the risks, if any, associated with the positions, and the likely effect of these positions on the fund's performance. Although commenters generally supported disclosure that a fund may take temporary defensive positions, they found problematic disclosure of the percentage of assets that may be committed to temporary defensive positions and the likely effect of these positions on the fund's performance. Commenters argued that, to maintain flexibility, a fund typically would disclose that all of its assets could be committed to temporary positions. The commenters maintained that such disclosure was boilerplate and would not be meaningful to investors. In addition, commenters asserted that funds would find it difficult to predict the likely effect of temporary defensive positions on their performance.

The Commission believes that a typical fund investor would want to know about investment positions that a fund can take from time to time that are inconsistent with the fund's central investment focus. On the other hand, the Commission is aware that, in practice, the disclosure about temporary investment positions currently appearing in some fund prospectuses is so lengthy and detailed as to suggest incorrectly that a fund's temporary investment policies are more important than the fund's investment objectives and the principal investment strategies used to achieve them. The Commission believes that disclosure of this sort, which discusses possible but not probable investments of funds, is inconsistent with the fundamental disclosure principles underlying Form N-1A. In the Commission's view, however, disclosure that a fund may take temporary defensive positions to respond to market conditions will alert investors to the possibility that a fund may vary its investments on a temporary basis. Therefore, Form N-1A, as amended, requires a fund to disclose, if applicable, that in response to unfavorable market conditions it may make temporary investments that are not consistent with its principal investment objectives and policies.[102]

Portfolio Turnover. Form N-1A currently requires all funds to state their portfolio turnover rates in their financial highlights tables included in their prospectuses.[103] Under the Proposed Amendments, a fund would be required to supplement the information in its financial highlights table by disclosing certain information about its portfolio turnover rate if it anticipated having a turnover rate of 100% or more in the coming year.[104] The disclosure would be

[101]*Instruction 4 to Item 4(b)(1).*

[102]*Instruction 6 to Item 4(b)(1).*

[103]*Item 3 of Form N-1A. Form N-1A, as amended, retains this requirement. Item 9.*

[104]See *Form N-1A Proposing Release,* supra *note 8, at 10910.*

required to include an explanation of the tax consequences and effect of increased trading costs on the fund's performance.[105] Most commenters questioned or opposed the proposed disclosure about portfolio turnover rate. Some commenters suggested that the Commission move this disclosure to the SAI or require it in the MDFP in fund shareholder reports. Other commenters argued that a fund's portfolio turnover rate may reflect the fund's response to particular market events, or special circumstances affecting the fund's investments, that are difficult to predict. These commenters argued further that the unpredictable nature of fund portfolio turnover rates would lead to generic or boilerplate disclosure that would not be meaningful to investors in assessing various funds. The commenters suggested that Form N-1A should instead require disclosure about portfolio turnover rates as part of a discussion of a fund's principal investment strategies when a fund's investment approach is expected to include active and frequent trading (as opposed to, *e.g.*, a "buy and hold" strategy).

The Commission continues to believe that a discussion about a fund's portfolio turnover in some cases is relevant to typical fund investors. The Commission notes, for instance, that increased portfolio turnover can on some occasions result in tax consequences that can be significant to investors and that can be viewed as a cost to an investor of holding fund shares.

Moreover, investors may find information about portfolio turnover particularly relevant in light of recent changes to the tax laws that reduce the tax rate on capital gains.[106] The Commission agrees with commenters, however, that disclosure about portfolio turnover and its consequences should be made only if an increased portfolio turnover rate is likely to result from the fund's investment objectives and principal investment strategies and would have a significant effect on a fund's returns. Therefore, Form N-1A, as amended, requires a fund to discuss the consequences of its portfolio turnover rate if the fund anticipates that active and frequent trading of portfolio securities will be a likely result of implementing its principal investment strategies.[107]

Classification and Policies. The Commission proposed to move to the SAI disclosure about a fund's legal status as an open-end management company,[108] as well as disclosure relating to certain policies identified under the Investment Company Act, such as borrowing money, issuing senior securities, underwriting securities issued by other persons, investing in real estate or

[105]*The Proposed Amendments would require a fund to disclose its anticipated portfolio turnover rate and what that rate means (*e.g., *that a portfolio turnover rate of 200% is equivalent to the fund buying and selling all of the securities in its portfolio twice in the course of a year). The Proposed Amendments also would require a fund to explain the tax consequences to shareholders of the fund's high portfolio turnover rate. In addition, the Proposed Amendments would require a fund to explain how trading costs associated with the fund's high portfolio turnover may affect the fund's performance.*

[106]See infra *note 164*.

[107]*Instruction 7 to Item 4(b)(1)*

[108]*As explained in the Form N-1A Proposing Release, this information is technical in nature and repetitive of other information required to be disclosed elsewhere in a fund's prospectus. All funds that register on Form N-1A must be classified as management companies under section 4 of the Investment Company Act and subclassified as open-end companies under section 5. 15 U.S.C. 80a-4, -5. Funds may be further subclassified as diversified or non-diversified under section 5.*

commodities, and making loans.[109] Commenters supported moving this disclosure, agreeing that it is not likely to be significant to a typical fund investor. Form N-1A, as amended, requires the disclosure to appear in the SAI.[110]

b. Risk Disclosure

Risk disclosure in fund prospectuses typically consists of detailed, and often technical, descriptions of the risks associated with particular securities in which a fund may invest. Just as disclosure about each type of security in which a fund may invest does not appear to communicate effectively to investors how the fund's portfolio will be managed, disclosure about the risks associated with each type of security in which the fund may invest does not effectively communicate to them the overall risks of investing in the fund. In the Commission's view, disclosing the risks of each possible portfolio investment, rather than the overall risks of investing in a fund, does not help investors evaluate a particular fund or compare the risks of the fund with those of other funds. The Commission proposed, consistent with its conclusion that mere inventories of potential portfolio securities do not assist typical investors in selecting among funds, to modify prospectus disclosure requirements in Form N-1A about the risks associated with specific securities. The Proposed Amendments would require a fund to disclose the risks to which the fund's particular portfolio as a whole is expected to be subject and to discuss the circumstances that are reasonably likely to affect adversely the fund's net asset value, yield, or total return. Commenters generally supported the proposed approach to the disclosure of risk, and the Commission is adopting it as proposed.[111]

The Commission notes that a fund could meet the risk disclosure requirements of Form N-1A, as amended, by including in its prospectus a discussion of the risks of the asset class or classes that the fund expects to hold principally, together with a discussion of the risks to the fund of holding specific types of securities within the asset class or classes. Under such an approach, a fund investing in the equity securities of companies with small market capitalizations, for example, would discuss market risk as a general risk of holding equity securities, as well as

[109] *Section 8 of the Investment Company Act requires a fund to disclose these policies in its registration statement. Section 8 also requires a fund to disclose in its registration statement its policies on concentration and portfolio turnover, see supra notes 100 and 105 and accompanying text, and any other policies that the fund deems fundamental or that may not be changed without shareholder approval. Although they are not required to do so, some funds disclose in their prospectuses their policies with respect to the practices identified in section 8. As noted in the Form N-1A Proposing Release, supra note 8, at 10911, the Proposed Amendments sought to provide a clearer directive to disclose these policies in the SAI. To the extent it is a principal investment strategy of a fund within the meaning of Item 4(b)(1) of Form N-1A, as amended, however, a practice identified in section 8 would be required to be disclosed in the fund's prospectus.*

[110] *Items 12(a) and (c). Form N-1A, as amended, continues to require a non-diversified fund to disclose its non-diversified status in the prospectus.* See *Item 2(c)(iv). In particular, the Form requires a non-diversified fund to describe the effects of non-diversification (*e.g., *by indicating that, compared to diversified funds, the fund may invest a greater percentage of its assets in a particular issuer) and to disclose the risks of investing in the fund.*

[111] *Item 4(c). The requirement that a fund disclose the risks to which its particular portfolio as a whole is subject is intended to elicit risk disclosure specific to that fund. In meeting this requirement, a growth fund, for example, would be required to disclose the risks of the types of growth stocks in which the fund invests or expects to invest, as opposed to describing the general risks of equity securities.*

the specific risks associated with investing in small capitalization companies (*e.g.,* that these stocks may be more volatile and have returns that vary, sometimes significantly, from the overall stock market).[112]

The Commission did not propose to require a fund to disclose information designed to quantify its expected risk levels, citing, among other things, the lack of a broad consensus as to what measure of risk would best serve fund investors.[113] Comments submitted in response to the Commission's Risk Concept Release asserted that investors have too wide a range of investment goals and ideas of what "risk" means to be well served by a single quantitative risk measure. In addition, commenters argued that, if the Commission mandated a risk measure, investors might rely on it as a definitive standard despite the lack of general agreement on how to measure risk. As adopted, the prospectus risk/return summary and amendments to the general risk disclosure requirements of Form N-1A are designed to improve fund risk disclosure without raising the concerns associated with Commission-mandated quantitative information. While it is not adopting specific quantitative risk disclosure requirements, the Commission believes that new approaches to measuring risk are emerging and that quantitative risk information may be useful to some investors.[114] The Commission notes that a fund may include quantitative risk disclosure in its prospectus if the information is presented in a manner consistent with the guidelines on the inclusion of information not required by Form N-1A.[115]

4. Management's Discussion of Fund Performance (Item 5)

The Proposed Amendments would continue to require a fund to provide its MDFP and the related line graph comparing the fund's returns to a broad-based securities market index in either its prospectus or its annual report. The Commission is adopting the MDFP as proposed with minor changes.[116] The Commission notes in support of this decision that a review of MDFP disclosure by the Commission's Division of Investment Management ("Division") indicates that the discussion of fund performance and the line graph have generally provided fund shareholders with useful, comparative information about a fund's performance.

As discussed in the Proposed Amendments, funds typically choose to include the MDFP in their annual reports, rather than in their prospectuses. This choice may be explained, in part, by

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[112] *The Commission emphasizes that this approach is one way, but not the only way, that a fund can seek to use in meeting the risk disclosure requirements of Form N-1A, as amended.*

[113] See *Form N-1A Proposing Release,* supra *note 8, at 10911. The Risk Concept Release requested comment whether quantitative risk measures, such as standard deviation, beta, and duration, would help investors evaluate and compare fund risks. Risk Concept Release,* supra *note 18, at 17176. While more than half of the individual commenters and some industry members expressed a desire for some form of quantitative risk information, commenters did not broadly support any one risk measure. In addition, a number of commenters strongly criticized requiring disclosure of quantitative risk information.* See, e.g., *1995 ICI Risk Comment Letter,* supra *note 87, at 10-16 (questioning, among other things, the feasibility of developing a single, all-encompassing measure of fund risk and whether quantitative information would be understood and accurately used by fund investors).*

[114] See, e.g., *Walbert,* What's the Risk?, *INSTITUTIONAL INVESTOR, June 1997, at 188; Whitford,* Why Risk Matters, *FORTUNE, Dec. 29, 1997, at 147.*

[115] See *General Instruction C.3(b).*

[116] *Item 5.*

the relevance of the MDFP to other current financial information appearing in annual reports.[117] As a result of recent amendments to the Investment Company Act, the Commission has the authority to require additional disclosure in annual and semi-annual reports as necessary or appropriate in the public interest or for the protection of investors.[118] Several commenters recommended that the Commission exercise this authority and require the MDFP to appear in fund annual reports, asserting, among other things, that shareholders read these reports more frequently than prospectuses. Commenters also suggested that, like other information contained in an annual report, the MDFP analyzes a fund's past performance rather than the fund's anticipated future course of action, which is the central focus of a fund's prospectus.

Although it acknowledges that a fund's annual report may be the preferred location for the MDFP disclosure, the Commission is deferring consideration of its requirements as to the placement of the MDFP discussion. The Commission has concluded that MDFP disclosure should be considered as part of a comprehensive reassessment of the Commission's existing rules specifying the disclosure to be included in fund reports to shareholders. The Commission believes that such an initiative would be an important future step in improving the quality of fund disclosure documents and has directed the Division to begin work on proposed amendments to fund periodic reporting requirements. The Commission has asked that, in connection with such a proposal, the Division consider whether certain disclosure required by Form N-1A would be more useful to investors in shareholder reports. In this regard, the Commission notes its preliminary view that an "integrated" approach to registration and reporting requirements could improve the overall information about a fund available to investors.[119]

5. Management, Organization, and Capital Structure (Item 6)

a. Management and Organization

The Commission proposed to abbreviate disclosure in the prospectus about a fund's management and organization and move certain of this information to the SAI. Commenters generally supported the Proposed Amendments, and the Commission is adopting them as proposed with modifications to reflect suggestions of commenters.

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[117]See *Form N-1A Proposing Release*, supra *note 8, at 10912.*

[118]*National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290 (1996) ("Improvements Act"), section 206(f) (amending section 30 of the Investment Company Act [15 U.S.C. 80a-29] to add new paragraph (f)).*

[119]*In the past, the concept of "integrated" disclosure for funds has addressed eliminating duplicative registration requirements under the Investment Company Act and the Securities Act.* See *Investment Company Act Release No. 10378 (Aug. 28, 1978) [43 FR 39548] (adopting integrated registration statements for funds and closed-end investment companies by replacing separate registration statement forms under the Investment Company Act and Securities Act). New disclosure initiatives for funds could expand the concept of integrated disclosure to include an approach similar to that adopted for corporate issuers, which integrates registration statement disclosure requirements with periodic reports.* See *Securities Act Release Nos. 6235 (Sept. 2, 1980) [45 FR 63693] and 6383 (Mar. 3, 1982) [47 FR 11386] (proposing and adopting new forms for the offering of securities under the Securities Act). At least one commenter has cited potential benefits to fund shareholders of an integrated approach to fund disclosure. T. Lemke, Mutual Fund Disclosure Revised, Investment Companies 1989 (Practicing Law Institute's Corporate Law and Practice Course Handbook Series No. 605).*

Management Disclosure. Under existing Form N-1A, all funds must disclose the rate of fees that they pay their investment advisers in their fee tables. As stated above, the Commission has retained this requirement, which the Commission believes is among the core requirements of the Form. The Proposed Amendments would continue to require, in addition to the disclosure contained in the fee table, prospectus disclosure about investment advisory services provided to, and investment advisory fees paid by, a fund. Some commenters recommended eliminating disclosure about the investment advisory fees, which they argued is merely duplicative of the information in the fee table. The Commission disagrees with this argument. The Commission believes that a concise and straightforward description of the services that an investment adviser provides to a fund along with disclosure of the investment advisory fee rate for a recent fiscal year, as well as providing this information in a single place in a prospectus, can help a typical investor understand the management of the fund. Therefore, the Commission is adopting the disclosure requirements as proposed.[120]

In the Form N-1A Proposing Release, the Commission requested comment whether information about the amount of fees paid to a sub-adviser or sub-advisers of a fund helps investors evaluate and compare the fund to other funds. The Commission also asked whether this type of disclosure obscures the aggregate investment advisory fee paid by a particular fund.[121] Most commenters supported disclosure of the aggregate fee only, maintaining that information about individual sub-advisory fees is not relevant to investors because it does not help them compare the fees charged by different funds. The Commission is persuaded that information about sub-advisory fees is not necessary for a typical fund investor, but may be of interest to some investors. Therefore, Form N-1A, as amended, requires prospectus disclosure of the aggregate advisory fees paid by a fund and disclosure in the SAI of the amount of sub-advisory fees paid by the fund.[122]

Portfolio Manager. The Proposed Amendments would continue to require prospectus disclosure indicating the person or persons responsible for the day-to-day management of a fund's portfolio. Under the Proposed Amendments, and as currently permitted by instructions to Form N-1A, a fund could, in meeting this requirement, indicate that a committee was responsible for a fund's portfolio management if, under the organizational arrangements of the fund (or its investment adviser), no one person was responsible for making recommendations to the committee.

One commenter criticized the proposed portfolio manager disclosure requirement, arguing that it may have the effect of creating the false impression that the identity of the individual portfolio manager of a fund is paramount to the fund's performance. According to the commenter, the collective experience, resources, personnel, and reputation of a fund's investment adviser often are of greater importance to the fund's performance than the fund's portfolio manager. The commenter recommended that, to enable funds to describe their management structures more accurately than they can under Form N-1A's existing provisions, the Commission

[120]*Item 6(a).*

[121]See *Form N-1A Proposing Release,* supra *note 8, at 10912.*

[122]*Instruction 3 to Item 6(a)(1) and Item 15(1)(3).*

require disclosure of the identity of a fund's portfolio manager only when a change in the identity of the manager would be material to investors (*e.g.*, when a fund group promotes the identity of individual portfolio managers). The commenter suggested that the Commission, in the alternative, clarify the disclosure obligations of a fund for which the day-to-day responsibilities for the fund's portfolio investments are shared by a committee and certain individuals.

The Commission is not persuaded that it should adopt the commenter's recommendation that the Commission tie portfolio manager disclosure to a fund group's marketing efforts. Such a recommendation is substantially similar to proposals considered and rejected by the Commission when it adopted Form N-1A's existing portfolio manager disclosure requirement.[123] The Commission believes that typical investors in a fund should have clear and succinct information about the individuals who significantly affect the fund's investment operations. In the Commission's experience, Form N-1A's existing requirement appropriately serves this purpose and should not be changed significantly. To the Commission's knowledge, the requirement has not generally resulted in funds inaccurately describing the individuals responsible for their management.

Although the Commission believes that Form N-1A's portfolio manager disclosure requirements should not be changed significantly, the Commission has concluded that it is appropriate to provide additional guidance in Form N-1A as to the disclosure obligations of a fund for which day-to-day management responsibilities are shared. New instructions to Form N-1A's portfolio manager disclosure requirements have been added for this purpose.[124]

Legal Proceedings. The Proposed Amendments would continue to require prospectus disclosure of any material pending legal proceedings involving a fund, its investment adviser, or principal underwriter. The Commission also proposed to expand Form N-1A's legal proceedings disclosure requirement to cover those proceedings contemplated by a governmental authority. In proposing this change, the Commission sought to conform Form N-1A's requirements to those included in other Commission forms applying to other types of issuers.[125]

Some commenters questioned the requirement that a fund disclose contemplated proceedings, arguing that a fund would find it difficult to assess whether proceedings of a governmental entity are in fact contemplated. The Commission is not persuaded by this argument and has adopted the legal proceedings requirement as proposed.[126] In support of its decision, the Commission notes that issuers that have been subject to the requirement appear not to have experienced significant difficulty in complying with it.

Board of Directors. Form N-1A currently requires a fund to include in its prospectus a brief description of the responsibilities of the fund's board of directors under the applicable laws

[123]See *MDFP Adopting Release*, supra *note 15, at 19051-52*.

[124]*Instructions to Item 6(a)(2)*.

[125]See *Item 12 of Form N-2 [17 CFR 274.11 a-1] for closed-end investment companies; Item 103 of Regulation S-K [17 CFR 229.103] for non-investment company issuers*. See also *Investment Company Act Release No. 19155 (Nov. 30, 1992) [57 FR 56862] (modifying Form N-2 to conform to Item 103)*.

[126]*Item 6(a)(3)*.

of the jurisdiction in which the fund is organized. Recognizing that the disclosure provided by a fund in response to this item typically recites the substance of specific legal requirements, the Commission proposed to move this disclosure to the SAI. Commenters supported disclosing the director information in the SAI, arguing that the information does not help a typical investor make a decision to invest in a fund. Form N-1A, as amended, requires a fund to disclose this information in the SAI.[127]

The Commission requested comment in the Form N-1A Proposing Release whether a fund's prospectus should include the names, experience, and compensation of a fund's directors, as well as information, such as addresses and telephone numbers, indicating how a shareholder could contact the directors.[128] The Commission also requested comment whether this information, if required, should be given only for a fund's independent directors, accompanied by disclosure of the number of independent directors in comparison to the number of directors on the fund's board.[129]

Most commenters strongly opposed additional disclosure about directors in the prospectus. While a few commenters supported identifying the directors in the prospectus, most argued that this information is not essential to a typical investor in making a decision about investing in a fund and would only serve to lengthen the prospectus. The commenters recommended that the SAI or annual report to shareholders would be a better place for disclosing the identity of directors.

Commenters addressing the issue uniformly opposed requiring a fund to disclose directors' compensation in the prospectus, arguing that these fees are only a small part of total fund expenses and are not relevant to a typical investor in a making a decision to invest in a fund. The commenters also noted that director compensation is disclosed in a fund's SAI, where it can be used by those investors interested in the information, and in a fund's proxy statement, where it can be assessed by all shareholders of the fund in the context of an election of directors.[130]

All commenters addressing the issue emphatically opposed the disclosure of information in either the prospectus or the SAI indicating how shareholders can contact directors. Commenters, particularly independent directors of funds, argued that this information would result in an unwarranted loss of privacy for board members and numerous calls to directors to which they would be ill-equipped to respond. Commenters also argued that disclosure of this information would serve as a disincentive for qualified individuals to serve as directors and that all investor comments regarding a fund should be directed to representatives of the fund's management, and not to its directors.

The Commission believes that mandating more information about fund directors than is available under its existing disclosure rules may be appropriate in light of independent directors'

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[127]*Item 13(a).*

[128]*Form N-1A Proposing Release* supra *note 8, at 10912.*

[129]*The Investment Company Act contains a number of requirements relating to the composition of a fund's board.* See, e.g., *sections 1O(a) and 15(f) of the Investment Company Act [15 U.S.C. 80a-1O(a), -15(f)].*

[130]*Item 13(d); Item 22(b)(6) of Schedule 14A [17 CFR 240.14a-101].*

role as "watchdogs" of fund shareholders as contemplated by the Investment Company Act.[131] The Commission, however, is not convinced, particularly in light of the overwhelmingly negative comment on this issue, that the prospectus is the appropriate document for this disclosure. Therefore, Form N-1A, as amended, does not require additional information of the sort described in the Proposed Amendments to be provided about a fund's directors. The Commission, however, has directed the Division to consider director disclosure issues as part of an initiative to improve shareholder reports.[132]

Management and Organization. The Commission proposed to move to the SAI two items of disclosure about a fund's management and organization that the Commission believes are only of minimal importance to typical fund investors. The Proposed Amendments would no longer require a fund to disclose in its prospectus the name of any person that controls the fund's investment adviser and the name of any person that controls the fund.[133] The Proposed Amendments also would no longer require a fund to state in its prospectus, if applicable, that the fund engages in brokerage transactions with affiliated persons and allocates brokerage transactions based on the sale of fund shares.[134] The information called for in response to these two items typically results in generic disclosure that restates applicable legal requirements and does not appear to assist investors in deciding whether to invest in a particular fund. Commenters generally supported placing this information in the SAI. Form N-1A, as amended, requires a fund to disclose information in the SAI regarding controlling persons of the investment adviser and brokerage transactions with affiliated persons.[135]

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[131]*These responsibilities of directors include, among other things: (i) evaluating and approving the fund's investment advisory and principal underwriting contracts (sections 15(a), (c) [15 U.S.C. 80a-15(a), (c)]) and the use of fund assets to pay for the distribution of fund shares (rule 12b-1); (ii) selecting the fund's independent public accountants (section 32(a)(1) [15 U.S.C. 80a-31(a)(1)]); and (iii) reviewing and approving transactions with affiliates under various rules (*e.g., *rule 10f-3 [17 CFR 270.10f-3]; rule 17a-7 [17 CFR 270.17a-7]; rule 17e-1 [17 CFR 270.17e-1]). Directors have fiduciary duties to the fund and its shareholders under section 36(a) of the Investment Company Act [15 U.S.C. 80a-35(a)] and under state law.* See *3 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §838 (rev. perm. ed. 1994);* Hanson Trust PLC v. ML SCM Acquisition, inc., *781 F.2d 264, 275 (2d Cir. 1986).* See also Burks v. Lasker, *441 U.S. 471 (1979) (upholding the authority of independent directors to take actions under state law to the extent not inconsistent with the policies of the Investment Company Act and the Investment Advisers Act of 1940 [15 U.S.C. 80b-1,* et seq.*] (the "Advisers Act")).*

[132]*See* supra *note 119 and accompanying text.*

[133]*Transactions between controlling persons and a fund are subject to restrictions under the Investment Company Act.* See, e.g., *section 17 [15 U.S.C. 80a-17] and rules 17a-6 and 17d-1 [17 CFR 270.17a-6, .17d-1].*

[134]*Payment of commissions to affiliated brokers is governed by section 17(e) of the Investment Company Act [15 U.S.C. 80a-17(e)] and rule 17e-1 [17 CFR 270.17e-1].*

[135]*Items 15(a) and 16(b)(1).*

The Commission proposed to move to the SAI disclosure about a fund's form of organization along with the date and state of the fund's incorporation. Because most funds are organized in one of a few states as corporations or business trusts, disclosure about a fund's organization does not appear to help investors evaluate a particular fund or compare the fund to other funds. For that reason, the Commission is adopting its proposal to move information about a fund's organization to the SAI.[136]

The Proposed Amendments would not include the disclosure about a fund's expenses currently required by Form N-1A in the discussion of the fund's management. This information is included in the fee table and the financial highlights table. Additional information about fund expenses also is available in a fund's SAI. Eliminating repetitive information is one of the basic objectives of the Commission's efforts to improve fund disclosure documents. Consistent with this goal, Form N-1A, as amended, does not require this additional information about fund expenses in disclosure about a fund's management.

b. Capital Structure

The Proposed Amendments would continue to require prospectus disclosure about any limits on the transferability of, and material obligations or potential liabilities associated with, a fund's shares. One commenter suggested that disclosure should appear in the SAI rather than in the prospectus, asserting that the information is technical and generally does not vary among funds. The commenter recommended that the Commission instead limit disclosure in a fund's prospectus to unusual provisions that may pose special risks to the fund's shareholders. The Commission agrees that descriptions of all potential restrictions and possible consequences of holding fund shares are of only marginal significance to typical investors in selecting among funds. Form N-1A, as amended, thus requires prospectus disclosure of only unique or unusual restrictions or potential liabilities associated with holding a fund's shares (other than investment risks) that may expose an investor in the fund to significant risks.[137] Under Form N-1A, as

[136]*Item 11(a). The Commission proposed to continue to require a fund to disclose its form of organization and place of incorporation in the prospectus if a fund is organized outside the United States and registered under section 7(d) of the Investment Company Act [15 U.S.C. 80a-7(d)]. Although this type of organization is permitted by the Investment Company Act, only a limited number of funds that are organized and incorporated outside of the United States have registered under the Act. A fund organized in this manner would be subject to certain legal requirements under the Investment Company Act, regardless of whether those requirements were described in the fund's prospectus. Following one of Form N-1A's underlying principles to avoid prospectus disclosure that simply restates applicable legal provisions, the Commission has determined to incorporate this disclosure requirement in Item 11(a) of the SAI.*

[137]*Item 6(b). The prospectuses of funds organized as business trusts under Massachusetts law sometimes include disclosure that, under Massachusetts law, fund shareholders may be held personally liable as partners for the fund's obligations under certain limited circumstances. In adopting Form N-1A in 1983, the Commission stated that disclosure of possible contingent shareholder liability under this form of organization should not be required if a fund believes that, because of arrangements to protect shareholders, the likelihood of loss or expense to shareholders is remote. 1983 Form N-1A Adopting Release,* supra *note 12, at 37933-34.* See *3 T. FRANKEL, THE REGULATION OF MONEY MANAGERS 79 (1980) (for funds organized as Massachusetts business trusts, personal liability generally is considered remote). In connection with the Proposed Amendments, the staff undertook a review of fund prospectus disclosure. The review indicated, among other things, that certain funds continue to include disclosure about Massachusetts business trusts and state that shareholder liability is remote. In the Commission's view, this disclosure appears to be unwarranted, and the Commission encourages funds to re-evaluate whether this disclosure is necessary in light of the Commission's goal to minimize the disclosure of events that have only a remote possibility of affecting an investor's investment in a fund. See Form N-1A Proposing Release, supra note 8, at 10913.*

amended, a fund would be required to discuss in its SAI generally applicable legal provisions relating to holding fund shares.[138]

The Proposed Amendments would move disclosure about shareholder voting rights to the SAI. In explaining this decision, the Commission stated that the Investment Company Act sets out specific rights of fund shareholders,[139] which typically results in this disclosure being generic in nature and of little consequence to investors in evaluating and comparing funds. Commenters generally supported including this information in the SAI, agreeing that it is not essential to an investment decision. Form N-1A, as amended, requires this disclosure in the SAI.[140]

Form N-1A currently requires a fund to describe in its prospectus any class of senior securities issued by the fund, and any "other class" of its shares that is outstanding. In the Commission's experience, disclosure in fund prospectuses made in response to this requirement merely restates legal requirements in the Investment Company Act and its rules, which limit a fund's ability to issue certain classes of shares or senior securities.[141] The Commission concluded that disclosure of this sort is only of minimal significance to a typical investor in deciding whether to invest in a fund, and proposed to delete it from fund prospectuses.[142] Commenters agreed with the Commission's conclusion, and Form N-1A, as amended, does not require prospectus disclosure of information about other classes of fund shares (including senior securities).[143] The SAI would continue to require a fund to disclose the rights of any authorized securities of the fund other than capital stock.[144]

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[138]*Item 17(a).*

[139]*The Investment Company Act requires all fund shares to have equal voting rights and prescribes the vote required for certain significant matters. See, e.g., section 18(i) [15 U.S.C. 80a-18(i)] (equal voting rights); section 15(a) [15 U.S.C. 80a-15(a)] (approval of investment advisory contract); section 16(a) [15 U.S.C. 80a-16(a)] (election of directors); section 13(a) [15 U.S.C. 80a-13(a)] (changes in fundamental investment policies).* See also *section 2(a)(42) [15 U.S.C. 80a-2(a)(42)] (defining "voting security" and a "vote of a majority of the outstanding voting securities" for purposes of the Investment Company Act); rules 18f-2, 18f-3 [17 CFR 270.18f-2, -3] (specifying certain voting rights with respect to series funds and multiple class funds, respectively).*

[140]*Item 17(a).*

[141]*Under section 18(f) of the Investment Company Act, a fund generally is prohibited from issuing senior securities. By its terms, however, this prohibition does not preclude a fund from borrowing from any bank, so long as the borrowing is undertaken in accordance with the requirements of the Investment Company Act.* See *section 18(f)(1) (a fund must have asset coverage of at least 300 percent of all borrowings). In addition, the Commission has taken the position that certain types of portfolio transactions that involve leverage engaged in by a fund would not be deemed senior securities if the fund establishes a segregated account with liquid assets that collateralize 100% of the market value of the obligations under these transactions.* See *Investment Company Act Release No. 10666 (Apr. 18, 1979) [44 FR 25128]; see also Merrill Lynch Asset Management, L.P. (pub. avail. July 2, 1996) (staff no-action letter). Series funds and multiple class funds, each of which may raise issues under section 18(f), are expressly contemplated by section 18(f)(2) of the Investment Company Act and related rules 18f-2 and 18f-3.*

[142]*Under the proposal, a fund, however, would be required to disclose information in its prospectus about any series or class of the fund offered in the prospectus. Form N-1A, as amended, adopts this requirement.* See, e.g., *Item 8(c).*

[143]*Form N-1A, as amended, does not require disclosure in the prospectus of any measures taken by a fund (e.g., formation and maintenance of segregated accounts) to ensure that certain instruments that it holds are not deemed senior securities for purposes of the Investment Company Act's limitations. Form N-1A, as amended, would continue to require a fund that has a fundamental policy to borrow monies or that employs leverage to include disclosure about these practices in its prospectus.* See supra *Section II.A.3.a (discussing required disclosure of principal investment strategies).*

[144]*Item 17(b).*

6. Shareholder Information (Item 7)

a. General Purchase and Sale Information

The Proposed Amendments would retain most of the disclosure requirements concerning a fund's purchase and redemption procedures, dividends, and distributions currently required by Form N-1A. The Commission believes that the required information is relevant to a typical investor contemplating an investment in a fund. In the Form N-1A Proposing Release, the Commission acknowledged that disclosure about purchase and redemption procedures is often quite lengthy and may contribute to the perception that prospectuses are too long and complicated and not worth reading.[145] The Commission also observed, however, that much of the purchase and redemption disclosure typically contained in fund prospectuses is not required by Form N-1A, but is included by funds for marketing or other business purposes. The Commission believes that it is appropriate for a fund to have the option to add disclosure to its prospectus for these purposes, and thus the Commission did not propose to limit prospectus disclosure of funds' purchase and sale procedures to that expressly required by Form N-1A. The Commission is adopting the requirements to disclose purchase, redemption, and other shareholder information substantially as proposed with modifications to reflect commenters' suggestions.[146]

Several commenters on the Form N-1A Proposing Release suggested that the Commission specifically acknowledge as consistent with its rules the ability of a fund at its option to place certain information about purchase and redemption procedures in a separate document that would be delivered to an investor no later than with the confirmation of the investor's purchase of the fund's shares. According to the commenters, this separate document, or "owner's manual," can help streamline prospectus disclosure and provide an efficient means for a fund group to provide disclosure about purchase and redemption procedures that is common to all funds in the group. The Commission believes that this sort of disclosure document is consistent with the disclosure principles underlying the revisions to Form N-1A and that investors may find it easier and less confusing to consult and retain a separate document describing certain procedures relating to purchasing and redeeming fund shares, which are typically mechanical in nature. In the Commission's view, as long as the purchase and sale information in a fund's prospectus is not reduced below the minimum required by Form N-1A, the fund would be able to create and use a separate purchase and sale disclosure document as supplemental sales literature.

A second way in which a fund could create a separate purchase and sale disclosure document would be for the fund to include in its SAI the information to be contained in the document. A fund could set out this information in a separate section of the SAI and make it available, as a separate document, to investors upon request. To accommodate this option, the Commission is revising Form N-1A to include an instruction in the SAI that permits a fund to

[145] *See Form N-1A Proposing Release, supra note 8, at 10914.*

[146] *Item 7. The Commission also is adopting, as proposed, the requirement that a fund disclose in its SAI, and not in its prospectus, information about the fund's principal underwriter and service providers. Item 15. Requiring the information in the SAI does not preclude a fund from including it in the prospectus (e.g., for marketing and other business purposes).*

provide a separate document with additional purchase and sale information that can be made available to fund investors, along with the SAI or as stand-alone document, in response to investor requests.[147]

Form N-1A, as amended, provides a third means for developing a purchase and sale manual. As amended, the Form permits a fund to remove all information regarding its purchase and sale procedures from its prospectus and place the information in a separate document. The use of the separate document in this manner, however, would mean that required prospectus disclosure would appear only in the owner's manual. Therefore, the use of this kind of separate document is conditioned on incorporating it by reference into the fund's prospectus and providing it to investors with the prospectus.[148]

b. Valuation of Fund Shares and Net Asset Value

Valuation. The Commission proposed to eliminate an existing requirement of Form N-1A that a fund disclose in its prospectus that the price at which investors' purchase and redemption requests are effected is calculated on the basis of the fund's current net asset value and that the fund identify the methods used to value its portfolio securities (*e.g.*, market price or fair value).[149] The Commission proposed to take this action principally because, in meeting the requirement, funds typically go beyond the required identification of the methods used and repeat the substance of rules under the Investment Company Act specifying the way in which the net asset value of a fund must be calculated. In addition, the information, presented by a fund usually repeats information required to be included in the SAI. This disclosure has tended to be lengthy and technical and, as discussed below, appears not to have been very informative for investors.

The Commission has re-evaluated the disclosure of information in fund prospectuses about the calculation of net asset value in light of numerous complaints from investors that the Commission received recently regarding the manner in which some funds determined their net asset value. In response to volatility in various markets, some funds recently valued certain of their securities on the basis of fair value rather than on the basis of the last market quotations for the securities.[150] In taking this action, the funds appear to have relied on a long-standing position of the Commission's staff that a fund may (but is not required to) value portfolio securities traded

[147]*Instruction to Item 18(a).*

[148]*Item 7(f).*

[149]*Under the Investment Company Act and its rules, funds generally are required to use market quotations to value portfolio securities. If market quotations are not readily available, the fund must value the securities at "fair value as determined in good faith by the board of directors." Section 2(a)(41) [15 U.S.C. 80a-2(a)(41)]; rule 2a-4 [17 CFR 270.2a4].*

[150]*These funds took this action under circumstances in which stock markets in Asia had closed 13 to 14 hours before the pricing of fund shares in the United States. In that time, several funds identified events that indicated a significant change in the price of securities traded on these markets since the last market quotations. On the basis of this assessment, the funds valued their securities using fair value rather than the market price of the securities.* See *Barnhart,* Asia Aficionados Found Profit in Times of Turmoil, *CHICAGO TRIBUNE, Nov. 23, 1997 at C3; Smith,* Funds: A Hidden Trick Investors Should Know About, *BUSINESS WEEK, Nov. 17, 1997 at 41; Authers,* Now The Funds Are Coming Under Fire, *FINANCIAL TIMES, Nov. 8, 1997 at 2; Wyatt,* The Market Turmoil: Funds; Fidelity Invokes Fine Print and Angers Some Customers, *THE NEW YORK TIMES, Oct. 31, 1997 at D6; Gasparino,* Pricing System Trips Fidelity, Angers Clients, *WALL STREET JOURNAL, Oct. 30, 1997 at C1.*

on a foreign exchange using fair value, rather than the closing price of the securities on the exchange, when an event occurs after the close of the exchange that is likely to have changed the value of the securities.[151] Many investors complained that they were unaware that their funds could use fair value pricing in such a situation. In response to these complaints, the Division undertook a review of the disclosure documents of funds using such fair value pricing and found that, although the funds disclosed the practice in their prospectuses, the funds' discussions of their pricing procedures would have been enhanced if they had followed the principles of plain English.[152] Investors' recent questions about fund pricing procedures confirm the general importance of this information to at least some investors. Thus, the Commission has determined to continue to require that funds identify the methods used to value their assets in their prospectuses.[153] The Commission is, however, adding an instruction in Form N-1A that will encourage funds to discontinue the use of boilerplate disclosure of the technical aspects of valuation and require them to include a statement about the effect of the fund's use of fair value net asset calculation.

Time and Frequency of Calculation of Net Asset Value. As proposed, Form N-1A would continue to require a fund to state in its prospectus when calculations of its net asset value are made and to indicate that the fund uses a forward pricing procedure contemplating that the price at which a purchase or redemption order is effected is based on the next calculation of net asset value after the order is placed.[154] In addition, the Proposed Amendments would continue to require a fund to disclose those days on which the fund prices its shares and the holidays on which shares would not be priced. Commenters supported these disclosure requirements, and the Commission is adopting them as proposed.[155]

Meaning of Net Asset Value. In the Form N-1A Proposing Release, the Commission noted that many funds now define the term "net asset value" in their prospectuses (*e.g.,* net asset value means fund assets minus liabilities divided by the number of outstanding shares).[156] The Commission requested comment whether this disclosure should be required in all fund prospectuses. Commenters on this issue were evenly divided between those who believed that the information would be helpful to investors and those who believed the definition of net asset value would not assist investors in making a decision about investing in a fund. While some

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[151] See *Putnam Growth Fund (pub. avail. Feb. 23, 1981). Fair value pricing in this context is designed to protect the long-term value of fund shares from the actions of short-term investors who might buy or redeem fund shares in an attempt to profit from short-term market movements.*

[152] See *"Remembering the Past: Mutual Funds and the Lessons of the Wonder Years," Barry P. Barbash, Director, Division of Investment Management, SEC, at the 1997 ICI Securities Law Procedures Conference, Washington, D.C. (Dec. 4, 1997).*

[153] *Item 7(a). An instruction to this Item, as adopted, requires a fund to provide a brief explanation of specific policies of the fund concerning use of the fair value method of pricing fund shares. Form N-1A, as amended, requires a fuller explanation of fair value pricing policies in the SAI. Item 18(c).*

[154] *Rule 22c-1 under the Investment Company Act [17 CFR 270.22c-1] requires a fund to adopt "forward pricing" procedures. Under such procedures, a fund must fill an order to buy or redeem its shares based on the net asset value of the shares next calculated after receipt of the order.*

[155] *Item 7(a)(2) and (3). Form N-1A, as amended, allows a fund to identify the days on which the fund will not price its shares through the use of a list of specific days or any other means that effectively communicates the information (e.g., explaining that shares will not be priced on the days on which the New York Stock Exchange is closed for trading).*

[156] See *Form N-1A Proposing Release,* supra *note 8, at 10914.*

investors may find information about the meaning of the term net asset value helpful, the Commission is not persuaded that the information is necessary for most investors. Therefore, the Commission is not adopting a requirement that a fund explain the meaning of net asset value in its prospectus. A fund would continue to have the option of including this information in its prospectus or SAI if the fund concluded that such information would be useful to potential investors in the fund.

c. Restrictions on portability

At the time that the Commission issued the Form N-1A Proposing Release, the Commission's staff was considering a number of complaints received from fund investors about restrictions on the "portability" of their fund shares. To better understand the issues raised by these investors, the staff consulted with, among others, a number of industry trade groups and other industry participants.[157] On the basis of the information compiled by the staff, the Commission understands that, in certain cases, an investor who purchases shares of a fund through a broker-dealer or other financial intermediary may be unable to transfer fund shares held in a brokerage account to an account established at another broker-dealer.[158] In their responses to the staff, industry representatives indicated that the lack of portability of an investor's shares in a fund may be attributed to several factors, including limitations on the transfer of shares sold by broker-dealers affiliated with the investment adviser of the fund, the lack of participation by the fund in a computerized transfer system, and the absence of reciprocal agreements between the fund and broker-dealers. The industry participants, however, supported efforts to increase the portability of fund shares.

The Commission understands that some progress has occurred in eliminating portability restrictions. To the extent that restrictions continue to exist, however, the Commission believes that disclosure of the limits on portability of a fund's shares may be of importance to a typical investor. The Commission notes that this type of disclosure would seem to address the relationship between a broker-dealer or other intermediary and a fund shareholder, rather than the relationship between the fund and the shareholder. For that reason, the Commission is not convinced that the disclosure should be required in fund prospectuses.[159] The Commission has asked its staff to continue discussions with the staff of the National Association of Securities Dealers, Inc. ("NASD") to consider means other than the prospectus to alert investors who purchase shares of funds through broker-dealers of restrictions on portability.[160]

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[157]See *Letter from Jack W. Murphy, Associate Director, Division of Investment Management, SEC, to Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association, Thomas M. Selman, Director, Advertising/Investment Companies Regulation, NASD Regulation, Inc., and Paul Schott Stevens, Senior Vice President and General Counsel, ICI (Dec. 18, 1996).*

[158]*An investor may seek to transfer such an account, for example, when the registered representative or account executive through which the investor purchased the shares becomes affiliated with a new firm.*

[159]*Such disclosure would appear to be inconsistent with the fundamental principle underlying Form N-1A that a fund's prospectus should focus on information about the fund.*

[160]See *discussion* infra *Section II.G about other disclosure issues that the Commission is addressing with the NASD.*

d. Tax Consequences

The Proposed Amendments would revise the tax disclosure required in a fund's prospectus to focus that disclosure on the likely tax consequences to the fund and its shareholders if the fund operates as described in the prospectus. In general, the Proposed Amendments were designed to elicit tax disclosure that is far less complicated than that typically included in fund prospectuses today.[161] Commenters strongly agreed with the goal of the proposed provisions relating to prospectus tax disclosure, which the Commission has determined to adopt substantially as proposed. The Commission notes its strong desire that, in revising their documents to comply with Form N-1A, as amended, all funds pay particular attention to simplifying their existing tax disclosures, which the Commission believes are too complicated and discourage the use of fund prospectuses.

The Commission proposed to move disclosure about a fund's qualification under Subchapter M of the Internal Revenue Code[162] to the SAI, unless the fund does not expect to qualify for Subchapter M treatment. Commenters supported moving this disclosure to the SAI, agreeing that it does not help investors decide whether to invest in a fund. The Commission is adopting this disclosure requirement as proposed.[163]

The Commission proposed to require a description of the tax consequences to shareholders of buying, holding, exchanging, and selling a fund's shares designed to highlight the tax consequences of investing in the fund. The Proposed Amendments would require a fund to state, as applicable, that the fund intends to make distributions to shareholders that may be taxed as ordinary income or capital gains. Under the Proposed Amendments, a fund that expects that its investment objectives or strategies will result in its distributions primarily consisting of ordinary income (or certain short-term capital gains) or long-term capital gains would be required to provide disclosure to that effect.

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[161] *Existing tax-related prospectus disclosure typically includes lengthy and overly technical information about the tax treatment of a fund, and, in some cases, the treatment of specific securities held by a fund. Many prospectuses, for example, include information about the conditions that a fund must meet to qualify for pass-through tax treatment under Subchapter M of the Internal Revenue Code, as well as information about the tax treatment of private activity bonds, foreign currency contracts, and other fund investments. In addition, tax disclosure frequently includes technical jargon in referring, for example, to a fund's status as a "regulated investment company" and the fund's payment of "spillback distributions" and "net investment income." Use of these terms in fund prospectuses would continue to be discouraged.* See *General Instruction C.1(c), which would continue to instruct a fund not to use technical or legal terminology in its prospectus.*

[162] *I.R.C. 851, et seq.*

[163] *Item 19(a). Item 7(e)(3) of Form N-1A, as amended, requires a fund that does not expect to qualify for pass-through tax treatment under Subchapter M to explain in its prospectus the tax consequences of not qualifying (*e.g., *by disclosing that income and gains realized by the fund would be subject to double taxation—that is, both the fund and shareholders could be subject to tax liability). This disclosure would distinguish the fund from other funds and help investors appreciate the tax consequences of investing in the fund. Similarly, a fund that expects to pay an excise tax under the Internal Revenue Code with respect to its distributions is required to disclose in its prospectus the consequences of paying the tax.* See *I.R.C. 4982.*

Commenters generally supported the proposed tax disclosure, and the Commission is adopting it as proposed with one modification to reflect recent changes to the tax laws.[164] In light of these changes, Form N-1A, as amended, requires a fund to disclose that capital gains may be taxable at different rates depending upon the length of time that the fund holds its assets.[165]

The Proposed Amendments would require a fund to state that it will provide each shareholder by a specified date (typically, January 31 of each year) with information about the amount of ordinary income and capital gains, if any, distributed to the shareholder during the prior calendar year. One commenter questioned the need for this requirement, citing that a fund must send this information to investors by a particular date under Internal Revenue Service regulations.[166] The Commission agrees that, in light of these regulations, indicating in a prospectus the date by which a fund will deliver certain tax information is unnecessary. Therefore, Form N-1A, as amended, does not adopt this provision of the Proposed Amendments. The Proposed Amendments would require a tax-exempt fund to inform investors of the special tax consequences associated with the fund. Commenters supported the proposed disclosure, and the Commission is adopting it substantially as proposed.[167]

7. Distribution Arrangements (Item 8)

The Commission proposed changes to Form N-1A to require that all information about a fund's distribution arrangements appear in one section of the fund's prospectus. The Proposed Amendments would require that section to discuss, among other things, sales loads, fees paid under rule 12b-1 plans, and the details of multiple class and master-feeder fund arrangements. The Commission also proposed changes designed to make fund discussions of distribution

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[164]*Item 7(e). Funds subject to this requirement would include, for example, those often described as "tax-managed," "tax-sensitive," or "tax-advantaged," which have investment strategies to maximize long-term capital gains and minimize ordinary income. A fund that has a principal investment objective or strategy to achieve tax-managed results (*e.g., *to maximize long-term capital gains and minimize ordinary income) would need to provide disclosure to that effect in its prospectus risk/return summary. Item 4.*

[165]*Recent changes to the tax laws reduce the maximum rate on the long-term net capital gains on the sale of securities from 28% to 20%, but increase the asset holding period from 12 months to 18 months (except for sales made after May 6, 1997 and before July 29, 1997, which retain long-term gain status). Taxpayer Relief Act of 1997, Pub. L. No. 105-34 (1997). The new laws also classify capital assets held for a period of one year, but less than 18 months, as "mid-term" gains, which are subject to a maximum rate of 28%.*

[166]*The requirement is set forth in I.R.C. 852(b)(3)(c).*

[167]*Item 7(e)(2). Form N-1A, as amended, requires a fund to disclose, if applicable, that: (i) the fund may invest a portion of its assets in securities that generate income that is not exempt from federal or state income tax; (ii) income exempt from federal income tax may be subject to state and local income tax; and (iii) any capital gains distributed by the fund may be taxable. The Commission also proposed that a fund disclose that a portion of the tax-exempt income that it distributes may be treated as tax preference items for purposes of determining whether the shareholder is subject to the federal alternative minimum tax. Form N-1A, as amended, does not require disclosure about the preference items in the prospectus. This disclosure is technical in nature and applies only in limited circumstances, and would not appear to help a typical investor make a decision about investing in a fund.*

arrangements less legalistic and more helpful to investors in evaluating and comparing funds.[168] Commenters generally supported the Commission's conclusion that information about distribution arrangements is particularly important to fund investors, and the Commission is adopting the disclosure requirements relating to those arrangements substantially as proposed.

Rule 12b-1 Plans. The Commission proposed to modify Form N-1A's requirements pertaining to plans designed to meet the requirements of rule 12b-1 under the Investment Company Act to focus prospectus disclosure on the amount of fees paid under the plans and to move detailed, technical disclosure about these plans to the SAI. The Commission proposed to require a fund with a rule 12b-1 plan to state the amount of the fee and to disclose that the plan allows the fund to pay fees for the sale and distribution of its shares. The Commission also proposed an additional requirement designed to result in prospectuses that explain more effectively to shareholders that distribution fees are continuous in nature and that these fees, over time, cumulatively may exceed other types of sales loads.[169] The Proposed Amendments would require a fund to add to its prospectus disclosure to the effect that, because distribution fees are paid out of the fund's assets on an ongoing basis, the fees may, over time, increase the cost-of an investment in a fund and cost investors more than other types of sales loads.

Most commenters supported the proposed disclosure concerning rule 12b-1 plans, although some commenters maintained that disclosure of the amount of rule 12b-1 fees merely duplicated information appearing in the prospectus fee table. The Commission believes that disclosing the amount of the rule 12b-1 fee in connection with other disclosure about the nature of the fees will provide a typical investor with a complete and useful picture of the amounts paid by the fund for distribution. Therefore, the Commission is adopting the disclosure concerning rule 12b-1 fees as proposed.[170]

Sales Loads. The Proposed Amendments would continue to require disclosure of the amount of any sales load charged on an investment in a fund and disclosure indicating when a sales load may be reduced or eliminated (*e.g.*, for larger investments). The Commission proposed

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[168] *Typical fund shareholders appear to regard information about fees paid by funds under various distribution arrangements as important information in making investment decisions.* See *ICI SHAREHOLDER USE STUDY,* supra *note 52, at 21 (1997) (over 70% of survey respondents considered sales charge and fee information before making their most recent purchase).*

[169] *The Commission's proposed disclosure would replace similar disclosure required by the rules of the NASD. Rule 2830(d)(4) of the NASD Conduct Rules,* supra *note 37, at 4624 (requiring a fund with a rule 12b-1 plan to disclose adjacent to the fee table that long-term shareholders may pay more than the maximum front-end sales charge allowed by the NASD). In light of the revisions to Form N-1A contemplated by the Proposed Amendments, the NASD has proposed to eliminate its similar disclosure. NASD Notice to Members 9748, at 393 (Aug. 1997).*

[170] *Item 8(b); Item 15(g). The Proposed Amendments also would require a fund that pays a service fee outside of a rule 12b-1 plan to disclose the amount and purpose of the fee in the section of its prospectus describing sales loads and rule 12b-1 fees charged by the fund. One commenter questioned the need for this disclosure, asserting that this type of service fee is not appropriately characterized as a distribution fee and would be disclosed in the fee table. The Commission is persuaded that additional disclosure of these fees is unnecessary, and Form N-1A, as amended, does not require prospectus disclosure of them. A fund would disclose service fees paid outside a rule 12b-1 plan in the fee table and in the SAI. Instruction 3(b) to Item 3; Item 20(c).*

to move other technical disclosure about sales loads to the SAI, including disclosure about dealer reallowances, sales load waivers, and breakpoints applicable to the sale of a fund's shares. The Commission believes that this detailed and technical information tends to obscure information about the amount of sales loads charged by a fund and does not help investors evaluate and compare funds. The Commission also proposed to eliminate disclosure about fees charged by third parties (*i.e.*, banks, broker-dealers, or other persons) in connection with the purchase of a fund's shares.[171] Commenters generally supported the proposed approach to disclosure about sales loads, and the Commission is adopting the amendments as proposed.[172]

Multiple Class and Master-Feeder Fund Arrangements. The Commission proposed to combine, in one place in the prospectus, disclosure about the distribution and service arrangements of multiple class and master-feeder funds. Commenters generally supported this treatment of these arrangements, which the Commission is adopting substantially as proposed, with modifications to reflect commenters suggestions.

The Commission proposed to eliminate the requirement that a feeder fund discuss the possibility and consequences of its no longer investing in the master fund. It is the Commission's understanding that distribution arrangements currently used by many funds contemplate feeder funds having the authority to change the master funds in which they are invested. In recognition of this development, the Commission is modifying Form N-1A to require such a feeder fund to describe briefly the circumstances under which it may change its investment in a master fund.[173]

One commenter suggested additional changes to streamline prospectus disclosure about multiple class funds and master-feeder funds. The commenter recommended that the Commission eliminate existing requirements for a fund to disclose information in its prospectus about additional classes or feeders that are not offered in the same prospectus. The commenter also recommended that the Commission modify the proposed disclosure about conversions or exchanges from one class to another to require disclosure only if the conversion or exchange is mandatory or automatic. The Commission agrees that the disclosure about multiple class funds or master-feeder funds in a prospectus should focus on the class or fund offered in that prospectus. Form N-1A, as amended, reflects this position.[174]

8. Financial Highlights Information (Item 9)

Condensed Financial Information. The Proposed Amendments would continue to require a fund to include in its prospectus a summary of certain financial information. To provide funds with greater ability to present prospectus disclosure in a format that conveys information

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[171]See also *Interagency Statement,* supra *note 50; rule 2230 of the NASD Conduct Rules,* supra *note 37, at 4213-14; rule 204-3(a) under the Advisers Act [17 CFR 275.204-3(a)]; Item 1 of Form ADV, Part II [17 CFR 279.1] for fee disclosure requirements applicable to banks, broker-dealers and investment advisers, respectively.*

[172]*Item 8(a); Item 13(e) (sales load arrangements for affiliated persons); and Item 15(f) (dealer reallowances).*

[173]*Item 8(c)(4). A feeder fund that does not have the authority to change its master fund would not need to discuss in its prospectus the possibility and consequences of its no longer investing in the master fund. Instruction to Item 8(c)(4).*

[174]*Item 8(c).*

effectively to investors, the Proposed Amendments would permit this information to be disclosed anywhere in the prospectus, rather than on a particular page of the prospectus, as currently required. The Commission also proposed changes to the financial highlights table to assist investors in understanding the information contained in it. Commenters supported the Proposed Amendments and endorsed in particular the proposal to permit a fund to choose the location in its prospectus for the financial highlights table. The Commission is adopting revisions to the financial highlights table requirement substantially as proposed.

In the Form N-1A Proposing Release, the Commission acknowledged that additional changes could improve the financial highlights information and stated that it intended to revisit fund financial disclosure in a separate future rulemaking initiative addressing financial statement requirements generally.[175] For the purposes of its evaluation of the financial highlights information, the Commission requested comment on simplifying and updating this information. This request elicited a number of suggestions ranging from support for the table to recommendations that it be moved to the SAI or eliminated. The Commission will consider these comments as part of its financial statement initiative.

The Commission is, however, adopting some of the commenters' recommendations that would simplify the financial highlights table. One commenter recommended that the Commission change the period covered by the financial highlights table from 10 to 5 years to parallel the period covered by financial information currently required to be in fund annual reports. The Commission has adopted this recommendation[176] because it believes that financial information for a 5-year period will help investors evaluate a fund and, at the same time, respond to concerns that the current table complicates the prospectus and is confusing to investors. Investors interested in historical return information about a fund beyond that contained in the amended financial highlights table can look to the bar chart that the Commission is requiring to be included in prospectuses, which shows the funds returns over a 10-year period.[177]

One commenter urged the Commission to eliminate the requirement that a fund disclose its average commission rates in the financial highlights table, arguing that these rates are technical information that typical investors are unable to understand. Industry analysts support this view and have informed the Commission staff of their conclusion that the average commission rate information in the table is only of marginal benefit to them and typical fund investors.

At this time, the Commission believes that there continues to be some merit in ensuring that information about the average commission rates paid by funds is publicly available. The

[175] See *Form N-1A Proposing Release*, supra *note 8, at 10918*.

[176] *Instruction 1(a) to Item 9(a)*.

[177] *Item 2(c)(2). Form N-1A permits a fund to incorporate by reference the financial highlights information into its annual report if it is delivered with the prospectus. Item 9(b). One commenter recommended that the Commission eliminate total return information from the financial highlights table because the bar chart shows a fund's returns. The Commission has not followed this recommendation because returns in the financial highlights table will be reflected for a fund's fiscal year periods, which may not be the same as the calendar year periods reflected in the bar chart. The Commission also notes that including returns in the financial highlights table will enable a fund to satisfy the updating requirements of section 10(a)(3) under the Securities Act.*

Commission believes, however, that a fund prospectus appears not to be the most appropriate document through which to make this information public. Therefore, Form N-1A, as amended, does not require disclosure of average commission rates in the financial highlights table. The Commission will consider adding such a requirement to Form N-SAR, which funds file with the Commission semi-annually to report information on their current operations.[178]

Calculation of Performance Data. The Commission proposed to eliminate the Form N-1A requirement that a fund that includes performance information in certain of its advertisements include a brief explanation in its prospectus of how it calculates its performance. This disclosure requirement is intended to facilitate funds using advertisements in accordance with rule 482 under the Securities Act; such an advertisement is an omitting prospectus under section 1O(b) of the Securities Act and, as an omitting prospectus, is required to contain information "the substance of which" is contained in the prospectus. Recent legislation added section 24(g) to the Investment Company Act, which authorizes the Commission to adopt rules permitting a fund to use a summary or omitting prospectus that includes information the substance of which is not required to be included in the prospectus.[179] With this new authority, the Commission intends to re-evaluate fund advertising rules with the goal of, among other things, proposing to amend rule 482 to eliminate the "substance of which" requirement.

Consistent with the Proposed Amendments, Form N-1A, as amended, does not require a fund to duplicate in its prospectus the explanation of how it calculates its performance required to appear in the fund's SAI.[180] So long as the SAI is incorporated by reference in the prospectus, the rule 482 "substance of which" requirement will be satisfied for this information or any other information that a fund may wish to include in a rule 482 advertisement.

9. Front and Back Cover Pages (Item 1)

The Commission proposed to simplify the disclosure currently required on the front cover page of the prospectus. The Proposed Amendments would require only three items of cover-page disclosure: a fund's name; the date of the prospectus; and the standard Commission disclaimer about the securities offered in the prospectus.[181] To unclutter the front cover page and avoid repeating information contained in the proposed risk/return summary at the beginning of the prospectus, the Proposed Amendments would no longer continue to require a fund to include on the front cover a brief statement of the fund's investment objectives, a statement that the prospectus sets forth concise information that the investor should know before investing, and a statement that the prospectus should be retained for future reference.[182] Commenters generally supported the proposed front cover page disclosure requirements, and the Commission is adopting them

[178] *17 CFR 274.101. The Division expects to submit recommendations to the Commission on revising Form N-SAR in the near future.*

[179] See *Improvements Act,* supra *note 118, at section 204.*

[180] *Item 21.*

[181] *This disclaimer is required by rule 481(b)(1) under the Securities Act [17 CFR 230.481(b)(1)].*

[182] See *Form N-1A Proposing Release,* supra *note 8.* See *also SEC, Report of the Task Force on Disclosure Simplification (1996) (recommending that many legal warnings be eliminated to make the cover page more inviting and that any necessary legal warnings be set out in a more readable style and format); Plain English Release,* supra *note 20, at 6372.*

with revisions reflecting the suggestions of commenters. Several commenters maintained that the Commission should allow a fund to include certain information on the front cover page of its prospectus, such as its investment objectives or a brief (*e.g.,* one sentence) description of its operations. The Commission agrees, and Form N-1A, as amended, permits, but does not require, a fund to include additional information on the front cover page, subject to the Form's general rule covering the presentation of information not otherwise required to be included in the prospectus.[183]

Several commenters criticized the Commission's standard disclaimer regarding the securities offered by a prospectus and questioned other disclosure that is required on the front cover page of a fund prospectus.[184] The commenters recommended that the Commission eliminate the legend, maintaining that it is not meaningful to a typical investor and is not essential to such an investor's decision to invest in a fund.

The Commission has not adopted this recommendation because it believes that every prospectus should clearly alert investors that a registration statement filed with and made effective by the Commission does not represent approval by the Commission of the securities described in the prospectus. This view is reflected in the requirement that all issuers filing registration statements under the Securities Act include the disclaimer legend on their prospectuses.[185] The Commission recognizes that the disclaimer used to date is technical in nature and may be difficult to understand. In its recent plain English initiatives, the Commission adopted amendments to simplify the legend, which apply to fund prospectuses.[186] The Commission proposed to consolidate disclosure regarding the availability of additional information about a fund on the back cover page of its prospectus.[187] The Proposed Amendments would require the back cover page to state that the SAI includes additional information about the fund that is available without charge upon request, and to explain how shareholder inquiries regarding the fund can be made. Under the proposal, the back cover page would also include a statement whether and from where information is incorporated by reference into the prospectus. Commenters generally supported

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[183]*Instruction to Item 1(a); see also General Instruction C.3(b). Form N-1A currently requires special disclosure on the front cover page of a feeder fund prospectus describing the master-feeder fund structure and explaining how it differs from a traditional mutual fund. 1993 GCL,* supra *note 25, at II.H(a). Consistent with simplifying cover page disclosure, Form N-1A, as amended, does not require this disclosure on the front cover page, but does require disclosure about a fund's master-feeder structure in the body of the fund's prospectus in response to Item 8(c).*

[184]*Rule 481(b)(1) (requiring disclosure that indicates that neither the Commission nor any state securities commission has approved the securities or passed on the adequacy of disclosure in the prospectus).*

[185]*Item 501 of Regulation S-K [17 CFR 229.501].*

[186]See *Plain English Release,* supra *note 20, at 6372 (revising Item 501(b) of Regulation S-K and making conforming changes to rule 481(b)(1)).*

[187]*The Proposed Amendments also would require a fund to include on the back cover page of its prospectus a statement that information about the fund is available at the Commission's Public Reference Room and on the Commission's Internet site. Some commenters questioned this proposal, asserting that the information is not essential to making a decision to invest in a fund and would clutter the back page of prospectuses. The Commission is not persuaded by these arguments and has adopted this requirement as proposed. Item 1(b)(3). The Commission notes that the requirement is consistent with those imposed on all registrants filing registration statements under the Securities Act and reflects recent changes adopted in the Plain English Release,* supra *note 20, at 6381 (amending Item 101(e)(2) of Regulation S-K under the Securities Act [17 CFR 229.101(e)(2)]).*

these amendments, and the Commission is adopting the back cover page requirements as proposed, with modifications to reflect commenters' suggestions.[188]

To ensure prompt delivery of a requested SAI, the Proposed Amendments would require a fund to send its SAI to requesting investors within 3 business days of a request. Those commenters addressing this requirement generally supported it, although one commenter argued that, to provide funds some leeway in responding to unforeseen circumstances, funds should be subject to a "reasonably prompt" mailing standard, which would be deemed normally to be within 3 days of request. The Commission believes that prompt mailing of the SAI is essential to the disclosure format contemplated by Form N-1A and is adopting the 3-business day mailing requirement as proposed.[189]

Several commenters raised concerns about requests for additional information about a fund when the fund's shares are sold through financial intermediaries, such as broker-dealers or banks. Commenters recommended that Form N-1A permit funds to indicate in their prospectuses that investors may contact an intermediary to obtain the SAI and other additional information. The Commission acknowledges that many funds use intermediaries in distributing or servicing their shares and that investors may look to these intermediaries for information about the funds. Thus, the Commission has revised Form N-1A to permit a fund to state on the back cover of its prospectus that additional information about the fund is available from a financial intermediary.[190] The Commission notes, however, that such a fund retains the obligation to ensure that information is sent to investors within 3 business days of an investor request. The Commission expects that funds will fulfill this obligation through contractual arrangements with broker-dealers, banks, or other financial intermediaries.

Some commenters had suggestions about certain technical disclosure information that the Commission proposed to include on the back cover page of the prospectus. The Proposed Amendments, for example, would move the requirement to disclose the date of the SAI to the back cover page of the prospectus. Several commenters criticized this requirement, asserting that the date of the SAI is not essential to an investor's decision to invest in a fund and that requiring the SAI date on the back cover of a prospectus would necessitate the reprinting of prospectuses of funds that share a common SAI whenever a new fund is added to the group covered by the SAI. In light of these comments and the obligation imposed on funds to send investors who request an SAI the most current version of the document, the Commission has deleted from Form

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[188] *Item 1(b). The Commission proposed to require disclosure in a fund's discussion of risk in the prospectus risk/return summary that additional information about a fund's investments is available in the fund's shareholder reports. In response to commenters' suggestions, the Commission is requiring that this disclosure be made on the back cover page of a fund's prospectus together with other references to the availability of additional information about the fund. Item 1(b)(1).* See supra *Section II.A.1.*

[189] *Instruction 3 to Item 1(b)(1). The Commission's Office of Compliance Inspections and Examinations will, as a part of its routine periodic inspections of a fund's operations, examine the fund's compliance with the 3-business day mailing requirement. Failure to comply with the requirement could result in action by the Commission to ensure compliance, including an enforcement action in an appropriate case.*

[190] *Instruction 2 to Item 1(b)(1).*

N-1A, as amended, the requirement to show the date of a fund's SAI on the back cover of the fund's prospectus.[191]

B. Part B—Statement of Additional Information

The Commission proposed a number of technical and conforming revisions to the SAI disclosure requirements to reflect the proposed changes in the prospectus disclosure requirements. The Commission is adopting these revisions as proposed. As discussed in the Form N-1A Proposing Release, the Commission intends to consider the SAI requirements as part of a future initiative and propose amendments to simplify and update SAI disclosure following the same disclosure principles underlying the revisions to Form N-1A being adopted today.

C. Part C—Other Information

The Commission proposed amendments to Part C of Form N-1A to eliminate certain filing requirements no longer deemed necessary. Commenters supported the proposed amendments, and the Commission is adopting them as proposed with certain modifications to reflect the suggestions of commenters.[192] The Proposed Amendments would continue to require newly organized funds to file updated financial statements within 4 to 6 months of the effective date of the registration statement. The Commission asked for comment whether the requirement should be retained. All commenters responding to the request said that the Commission should eliminate this requirement. Commenters argued that the information is of little value to investors in a new fund because it covers a fund's operations for a short start-up period that does not usually reflect the fund's expected operations. Commenters also argued that the cost of providing this information places a heavy burden on new funds, which typically have smaller amounts of assets under management than larger funds. According to the commenters, these costs can have a significant and disproportionate effect on a small fund's expense ratio.

The Commission believes that financial statements for the initial operations of a fund may not provide information that is significant to a typical fund investor. In addition, an investor interested in financial information about a fund's initial operations can obtain the information by requesting the fund's most recent shareholder report, which is generally available 6 to 8 months

[191] *To enable the Commission's staff to respond efficiently to investor inquiries, the Proposed Amendments would require a fund to disclose the fund's name, Commission file number and, if the fund is a series of a registrant, the registrant's name on the back cover page. Some commenters maintained that the information presented in meeting this requirement could be confusing to investors and is not relevant to a typical investor in considering whether to invest in a fund. The Commission is modifying the requirement so that a fund will only need to disclose its Commission file number in small print* (e.g., *8-point modern type) at the bottom of the back cover page of its prospectus. Item 1(b)(4).*

[192] *Form N-1A, as amended, does not require the filing of (i) model retirement plans that are used to offer fund shares; (ii) schedules showing the calculation of performance information; and (iii) voting trust agreements. One commenter suggested additional changes to the Part C requirements, asserting that much of the information in this part of the registration statement does not serve any important purpose and imposes administrative burdens on funds. The commenter recommended, among other things, that the Commission no longer require a fund to include a table showing the number of holders of each class of a fund's shares in its registration statement. In support of its recommendation, the commenter pointed out that this information is required to be filed by funds on their Forms N-SAR. The Commission is persuaded by this argument and has amended Form N-1A to delete the requirement that a fund's registration statement include a table of holders of fund shares.*

after the fund commences operations and begins selling shares to investors. For these reasons, the Commission has concluded that the costs associated with the 4 to 6 month update are not outweighed by the benefits that the information may provide to some investors. Therefore, Form N-1A, as amended, does not require the filing of updated financial statements for a newly organized fund.

D. General Instructions

1. Reorganizing and Simplifying the Instructions

The General Instructions to Form N-1A currently provide guidance on the use and content of the Form. The Proposed Amendments were intended to update and reorganize the General Instructions to make the Instructions easier to use. Commenters generally supported these revisions, which the Commission is adopting substantially as proposed. As adopted, the General Instructions consist of the following topics: (A) Definitions; (B) Filing and Use of Form N-1A; (C) Preparation of the Registration Statement; and (D) Incorporation by Reference.

The Proposed Amendments added several definitions to standardize certain terms as used in Form N-1A. Under the proposal, the term "Fund" would be defined as a registrant or a series of the registrant. The Proposed Amendments also included definitions of the terms "Registrant" and "Series" as used in Form N-1A. The Commission is adopting all three definitions as proposed.[193]

Proposed General Instruction B incorporated a more user-friendly, question-and-answer format regarding the filing and use of Form N-1A and replaced current Instructions A through D and F. The Commission is adopting General Instruction B as proposed.

General Instruction C to Form N-1A, as proposed, would set out the requirements for preparing the registration statement in an understandable format and would replace existing Instruction G to the Form. As proposed, the new Instruction emphasized the need to provide clear and concise prospectus disclosure and permitted a fund to include in its prospectus or SAI information not otherwise required by Form N-1A, so long as the information is not misleading and does not, because of its nature, quantity, or manner of presentation, obscure the information required to be included.[194] The Commission is adopting Instruction C substantially as proposed.[195]

2. Plain English Disclosure

The Commission is adopting amendments to General Instruction C clarifying that funds must comply with rule 421 under the Securities Act, which sets out the Commission's recently

[193] See *General Instruction A.*

[194] See *Form N-1A Proposing Release,* supra *note 8, at 10918.*

[195] *The Commission is deleting other instructions to the current Form N-1A, which permit information to be added to the prospectus and SAI.* See, e.g., *Item 1(b) of the current Form N-1A (permitting other information to be included on the cover page of the prospectus). Instruction C of Form N-1A, as amended, provides this guidance for purposes of all fund disclosure. The Commission also is deleting specific Instructions in current Part A that call for brief and concise prospectus disclosure, because Instruction C includes this requirement for purposes of all prospectus disclosure.*

adopted plain English requirements.[196] Rule 421(b) sets out general requirements that the entire prospectus be clear, concise, and understandable and provides guidance on how to draft prospectuses that meet this standard.

Under Form N-1A, as amended, a fund would need to draft the front and back cover pages and the risk/return summary of a fund prospectus in accordance with the provisions of rule 421(d).[197] In meeting these requirements, a fund will need to use plain English principles in the organization, language, and design of these sections of their prospectuses. Funds also will comply substantially with the following six principles of clear writing:

- short sentences;
- definite, concrete, everyday language;
- active voice;
- tabular presentation or bullet lists for complex material, wherever possible;
- no legal jargon or highly technical business terms; and
- no multiple negatives.

The compliance dates for rule 421(d) and Form N-1A, as amended, will be the same. Therefore, when a fund files a new or amended registration statement in order to comply with Form N-1A, as amended, it must also comply with the plain English rule.[198]

3. Disclosure Guidelines

The Commission has revised General Instruction C to reflect clearly the basic disclosure principles underlying the Commission's initiatives being adopted today. The Commission believes that applying these principles consistently in developing fund disclosure documents will result in high quality documents that effectively communicate information to investors.

General Instruction C, as amended, includes a set of drafting guidelines that are designed to improve prospectus disclosure. The Instruction encourages funds to avoid cross-references in their prospectuses to their SAIs or shareholder reports. Repeated cross-references to the SAI and shareholder reports can add unnecessary length and complexity to fund prospectuses and often preclude prospectuses from disclosing information effectively to investors.

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[196] *General Instruction C.1(e).*

[197] *Items 1(a) (Front Cover Page), 1(b) (Back Cover Page), 2 (Risk/Return Summary: Investments, Risks, and Performance), and 3 (Risk/Return Summary: Fee Table).*

[198] See infra *Section II.H for a discussion of the effective and compliance dates for Form N-1A, as amended. The compliance date for investment companies other than funds is October 1, 1998. See Plain English Release,* supra *note 20, at 6370. Unit investment trusts and closed-end investment companies must comply with the plain English rule only for new registration statements. Variable annuity issuers filing on Forms N-3 and N4, and variable life insurance issuers filing on Forms N-8B-2 and S-6 must comply with rule 421(d) for new and updated registration statements. The Commission also has proposed new Form N-6 for variable life insurance issuers that incorporates the Commission's plain English requirements. Investment Company Act Release No. 23066 (Mar. 13, 1998).*

General Instruction C provides guidance on the use of Form N-1A by more than one fund and by a multiple class fund. Fund prospectuses frequently contain information for multiple series and classes that offer investors different investment alternatives and distribution arrangements. When information in them is presented clearly, prospectuses offering more than one fund may make it easier for investors to compare funds and may be more efficient for funds and investors by eliminating the need to provide investors with multiple prospectuses containing repetitive information. Instruction C generally enables a fund to organize information about multiple funds and classes in a format of its choice that is consistent with the goal of communicating information to investors effectively.[199]

4. Modified Prospectuses for Certain Funds

Proposed Instruction C would permit a fund that is offered as an investment alternative in a participant-directed defined contribution plan to modify its prospectus for use by participants in the plan. Under the Proposed Amendments, a prospectus used to offer fund shares to plan participants could omit certain information required by proposed Items 7 (shareholder information) and 8 (distribution arrangements). This prospectus disclosure would largely be irrelevant to plan participants; investments that can be made by participants, and the distributions participants receive (including the tax consequences of distributions), are governed by statutory requirements and by the terms of individual plans.[200] Commenters generally supported permitting prospectuses to be modified for plan participants, asserting that it would allow funds to provide meaningful disclosure specifically designed for plan participants who invest in funds. The Commission is adopting the provisions in Instruction C relating to prospectuses for plan participants with modifications to reflect suggestions of commenters.

Instruction C, as proposed, would permit funds to tailor disclosure for prospectuses to be used for investments in defined contribution plans qualified under the Internal Revenue Code. One commenter suggested that the Commission permit funds that serve as investment options for variable insurance contracts to use modified prospectuses that set out purchase and sale procedures, distributions, and tax consequences applicable to these funds. In response to the commenter's suggestions, the Commission is permitting prospectuses to be tailored for funds offered through variable insurance contracts in furthering its goal of providing investors with more useful disclosure documents.[201]

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[199] *General Instruction C.3(c). A fund, for example, may decide that using a horizontal rather than vertical presentation for the fee table would present the required fee information most effectively. A fund may find that using different formats in its prospectus risk/return summary would communicate the required information effectively. Depending on the number and type of funds offered in the prospectus, for example, a fund may find it useful to group the required information for all funds together under each caption or to present the information sequentially for each fund.* See *John Hancock Funds, Inc. (pub. avail. June 28, 1996) (using a two-page disclosure format for each of 7 funds offered in a single prospectus).*

[200] *In addition to plans under rule 401(k) of the Internal Revenue Code [26 U.S.C. 401(k)], these plans include those under section 403(b) [26 U.S.C. 403(b)] (available to employees of certain tax-exempt organizations and public educational systems) and section 457 [26 U.S.C. 457] (available to employees of state and local governments and other tax-exempt employers).*

[201] *General Instruction C.3(d).*

5. Incorporation By Reference

Proposed General Instruction D would replace an existing instruction to Form N-1A that addresses incorporation by reference in a fund's prospectus of information in the fund's SAI. When the Commission adopted the two-part disclosure format for Form N-1A, the Commission intended that Part A of the registration statement provide investors with a simplified prospectus that, standing alone, would meet the requirements of section 10(a) of the Securities Act.[202] Part B, the SAI (which is available to investors upon request), includes additional information that the Commission has determined may be useful to some investors and should be available to all investors, but is not necessary in the public interest or for the protection of investors to be in the prospectus.[203] Form N-1A currently permits, but does not require, a fund to incorporate the SAI by reference into the prospectus. The two-part disclosure format has been widely used by funds, and the Commission has found that the current approach to incorporation by reference is consistent with the intended purpose of Form N-1A and should be retained.[204]

Proposed Instruction D would continue to permit, but not require, a fund to incorporate the SAI by reference into the prospectus. Commenters supported this approach to incorporation by reference, and the Commission is adopting Instruction D substantially as proposed.[205] The revised Instruction clarifies that incorporating information by reference from the SAI is not permitted as a response to an item of Form N-1A requiring information to be included in the prospectus. Permitting the SAI to be incorporated by reference into the prospectus was meant to allow funds to add material that the Commission determined not to require in the prospectus, not to permit funds to delete required information from the prospectus and place it in the SAI. Form N-1A, as amended, provides funds with clearer directions for allocating disclosure between the prospectus and the SAI. Funds can discuss items of information required to appear in the prospectus in greater detail in the SAI, which may be incorporated by reference into the prospectus.

The Commission notes that section 19(a) of the Securities Act[206] and section 38(c) of the Investment Company Act[207] protect a fund from liability under these Acts for actions taken in good faith in conformity with any rule of the Commission. The amendments to Form N-1A are

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[202] *1983 Form N-1A Adopting Release,* supra *note 12, at 37930.*

[203] Id. See White v. Melton, *757 F. Supp. 267 (S.D.N.Y. 1991) (citing the 1983 Form N-1A Adopting Release, supra note 12, as authority for the principle that certain matters are required to appear in the prospectus and that others may be appropriately disclosed in the SAI, which may be incorporated by reference into the prospectus).*

[204] See *Form N-1A Proposing Release,* supra *note 8, at 10920 (citing the 1982 Form N-1A Proposing Release as suggesting that prohibiting incorporation by reference of the SAI into the prospectus or, alternatively, requiring delivery of the SAI with the prospectus, would "vitiate the Commission's attempt to provide shorter, simpler prospectuses").*

[205] *General Instruction D, as adopted, includes technical revisions to simplify its requirements. The specific instruction regarding incorporation by reference of condensed financial information from reports to shareholders in existing General Instruction E has been incorporated in Item 9 of Form N-1A, as amended (financial highlights table). The existing instruction allowing incorporation of financial information in response to Item 23 of Form N-1A from reports to shareholders has been deleted as unnecessary because the Form does not limit incorporation of information into the SAI. The requirement that a shareholder report incorporated by reference into the SAI be delivered with the SAI has been added in Item 10(a)(iv).*

[206] *15 U.S.C. 77q(a).*

[207] *15 U.S.C. 80a-38(c).*

designed to provide better guidance to funds as to what information should be in the prospectus and the SAI to assist funds seeking to act in good faith in conformity with Form N-1A.[208]

6. Form N-1A Guidelines and Related Staff Positions

The Guidelines to current Form N-1A (the "Guides") were prepared by the Division and published by the Commission when it adopted the Form in 1983.[209] The Guides, which generally restate Division positions that may affect fund disclosure, were intended to assist funds in preparing and filing their registration statements. Additional Division positions on disclosure matters have been included from time to time in Generic Comment Letters prepared by the Division ("GCLs").[210] Although certain Guides have been revised and new ones added in connection with the adoption of various rules, the Guides collectively have not been reviewed since 1983. Certain Division positions in the Guides and GCLs have become outdated.[211] Other Guides and GCLs explain or restate legal requirements and may encourage generic disclosure about fund operations that does not appear to help investors evaluate and compare funds.[212] In addition, the presentation of information in 35 Guides and 7 GCLs is not organized in the most useful or effective manner.

To address these issues, Form N-1A, as amended, incorporates certain disclosure requirements from the Guides and GCLs. Other disclosure requirements in the Guides and the GCLs have not been incorporated in Form N-1A because, among other things, they are outdated or result in disclosure about technical, legal, and operational matters generally common to all funds. In addition, Form N-1A does not incorporate certain requirements calling for specific disclosure about certain types of fund investments because these requirements have tended to standardize disclosure about certain securities without regard to how a particular fund intends to use the securities in achieving its investment objectives. Generalized disclosure of this sort is inconsistent with the goal of the amendments to prospectus disclosure being adopted today to provide investors with information about how a particular fund's portfolio will be managed and elicit disclosure tailored to a fund's particular investment objectives and strategies.[213]

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[208] See *1983 Form N-1A Adopting Release,* supra *note 12, at 37930.*

[209] *1983 Form N-1A Adopting Release,* supra *note 12, at 37938 (stating that publication of the Guides was not intended to elevate their status beyond that of staff guidance). The Commission initially adopted guidelines in 1972 to assist funds in preparing and filing registration statements. Investment Company Act Release Nos. 7220, 7221 (June 9, 1972) [37 FR 12790] ("Guides Releases").*

[210] See *1993 GCL and 1994 GCL,* supra *note 25.*

[211] See, e.g., *Guide 9 (Short Sales) (a new interpretive position of the Commission's staff as to limits under the Investment Company Act on short sales entered into by funds was set out in Robertson Stephens Investment Trust (pub. avail. Aug. 24, 1995)); Guide 30 (Tax Consequences) (each series is now treated as a separate entity for tax purposes and may not, as suggested by the Guide, offset gains of one series against losses of another); 1990 GCL,* supra *note 25, at I.B (undertakings); 1991 GCL,* supra *note 25, at II.A.2 (country, international, and global funds); and 1992 GCL,* supra *note 25, at II.F (segregated accounts).*

[212] See, e.g., *Guides 8 (Senior Securities, Reverse Repurchase Agreements, Firm Commitment Agreements and Standby Commitment Agreements), 9 (Short Sales), 15 (Qualification for Treatment Under Subchapter M of the Internal Revenue Code), and 28 (Valuation of Securities Being Offered); 1994 GCL, supra note 25, at III.C (redemption fees); and 1995 GCL, supra note 25, at II.A (MDFP disclosure).*

[213] See supra *Section II.A.3.*

Information in the Guides and GCLs about legal requirements (including information about fund organization and operations), interpretive positions, and descriptions of filing procedures will be updated and reorganized in a new Investment Company Registration Guide ("Registration Guide").[214] The Commission has instructed the Division to make the Registration Guide available as soon as practicable. While the Commission believes that the Registration Guide will be a useful tool for funds in preparing their filings, Form N-1A, as amended, includes all of the requirements necessary for funds to prepare new or amend existing registration statements.[215]

E. Technical Rule Amendments

When it proposed to amend Form N-1A, the Commission proposed several technical rule amendments. These rule amendments generally were intended to implement the recommendations of the Commission's Task Force on Disclosure Simplification that apply to funds.[216] The Commission is adopting these amendments substantially as proposed.[217] The Commission also is adopting conforming amendments to several rules and a form to correct references to items in Form N-1A that have been redesignated or reorganized in Form N-1A, as amended.[218]

F. Administration of Form N-1A

While generally praising the Proposed Amendments and their goals, some commenters voiced concern that, unless administered appropriately, Form N-1A, as amended, would not lead to more useful and understandable disclosure documents for fund investors. Some commenters argued that, over time, the Commission's staff has interpreted Form N-1A's existing requirements so narrowly as to prevent funds from adopting formats in which information could be effectively communicated to investors. Other commenters asserted that the Commission's staff, in interpreting the provisions of existing Form N-1A, has consistently required lengthy and complex disclosure that may discourage investors from reading fund prospectuses.[219]

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[214] *The Guides have not been republished with Form N-1A, as amended. Neither the Guides nor the GCLs will apply to registration statements prepared on the amended Form. The Commission also is rescinding the Guides Releases,* supra *note 209.*

[215] *The Registration Guide will address topics discussed in the GCLs relating to closed-end investment companies and unit investment trusts, and other matters not relevant to Form N-1A (e.g. proxy disclosure). Information traditionally addressed in the GCLs will be considered when the Registration Guide is updated, unless the nature of the information warrants immediate dissemination. The Registration guide will serve as a "small entity compliance guide," which the Commission is required to publish under the Small Business Regulatory Enforcement Fairness Act (5 U.S.C.S. 601 note (Supp. July 1996)).*

[216] *SEC, REPORT OF THE TASK FORCE ON DISCLOSURE SIMPLIFICATION (1996).*

[217] *The Commission is amending rules 495 and 497 [17 CFR 230.495 and .497] to eliminate their cross-reference sheet requirements. The Commission also is amending rule 8b-11 [17 CFR 270. 8b-11] to modify signature requirements to provide more flexibility for issuers filing on paper. The Commission adopted amendments to rule 481, which is applicable to funds, in the Plain English Release,* supra *note 20.*

[218] See *amendments to rules 483, 485, 304, 14a-101 [17 CFR 230.483, .485, 232.304, 240.14a-101] and Form N-14 [referenced in 17 CFR 239.23].*

[219] *Several commenters referred to this aspect of staff disclosure interpretations as resulting in "disclosure creep." According to these commenters, the disclosure that proved problematic typically related to complex instruments in which some funds invested such as options, futures, and junk bonds. The commenters said that, in response to difficulties experienced by funds investing in these instruments, the staff often required all funds holding these instruments to amend their prospectuses to add lengthy and overly technical discussions of the instruments.*

The Commission acknowledges that some interpretations relating to Form N-1A disclosure taken by the staff in the past have contributed to fund prospectuses becoming dense and less inviting to read by shareholders.[220] The Commission believes, however, that funds, their counsels and other advisors also have contributed to this result. In seeking to minimize potential liabilities under the federal securities laws, many funds appear to have made the use of clear formats and concise and understandable language in fund prospectuses only a secondary concern, at best. Funds also appear to have added material to their prospectuses not otherwise required by Form N-1A to facilitate marketing or other business objectives. The Commission firmly believes that achieving the goals underlying the amendments to Form N-1A being adopted today necessitates discipline on the part of the Commission and its staff, as well as on the part of funds and their advisors. In exercising discipline, all parties involved in the disclosure process should look not only to the Form N-1A disclosure requirements, as amended, but also to the disclosure principles reflected in the Form. The Commission has instructed its staff to adhere to those principles closely when providing comments on registration statements filed on Form N-1A and in interpreting provisions of the Form.[221] The Commission strongly encourages funds and their advisors to follow closely the principles in drafting language and designing formats for use in fund prospectuses.

Throughout the period during which the Form N-1A and profile initiatives were developed, the Commission staff worked with numerous fund groups to create innovative disclosure materials and new and improved prospectuses.[222] The results of these efforts have been commended by many as achieving a significant improvement over existing disclosure documents.[223] Many of the efforts were furthered by the willingness of the staff to interpret Commission disclosure requirements in a manner consistent with the goal of enabling funds to communicate more effectively to

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[220]See *Levitt Article*, supra *note 5, at 37 ("We recognize that we share responsibility for the state of the modern prospectus. Our passion for full disclosure has resulted in fact-bloated reports, and prospectuses that are more redundant than revealing.")*.

[221]*The Commission has also generally instructed the staff to avoid as much as possible using disclosure requirements as a means of regulating the conduct of funds, which are subject to extensive substantive regulation under the Investment Company Act.*

[222]See, e.g., *Levitt Article, supra note 5 (discussing various Commission initiatives to work with mutual funds and other corporate issuers to improve prospectus disclosure); Connors,* Mutual Fund Prospectus Simplification: The Time Has Come, *THE INVESTMENT LAWYER, Vol. 3, No. 8, Aug. 1997, at 14 (describing the Commission's role in the development of the simplified John Hancock prospectus).*

[223]See, e.g., *Dow Jones Newswires,* State Street Rewrites Prospectuses to Help Ease Investors' Task, *THE WALL STREET JOURNAL, Nov. 14, 1997, at 1B (commenting on State Street's new plain English prospectus); Kelley,* John Hancock Builds a Better Mousetrap, *MORNINGSTAR MUTUAL FUNDS, Sept. 13, 1996, at 52 (commenting on the improvements in John Hancock's new prospectus); McTague,* Simply Beautiful: Shorn of Legalese, Even Prospectuses Make Sense, *BARRON'S Oct. 7, 1996, at F10 (concerning the recent efforts of the John Hancock funds and other fund groups to simplify their prospectuses); Morcau,* Prospectuses are Getting Easier to Read, *INVESTOR'S BUSINESS DAILY, Dec. 15, 1997, at B1 (noting improvements in the prospectuses from Vanguard, State Street, Dreyfus, and other fund groups); Williamson,* State Street Launches Redesigned Prospectus, *PENSIONS & INVESTMENTS, Dec. 8, 1997, at 36 (commenting on State Street's simplified and redesigned prospectus); Zweig,* Our 1997 Mutual Fund Awards: Picks, Pans and Some Tips Too, *MONEY, Vol. 26, No. 13, 1997, at 35 (commending USAA and State Street for producing prospectuses in clear, simple English).*

investors information essential in considering an investment in a fund.[224] The Commission's staff will continue to exercise this approach in interpreting the provisions of Form N-1A, as amended, and in reviewing fund filings under the revised disclosure requirements.[225]

G. Coordination with the NASD

As discussed in the Form N-1A Proposing Release, some rules of the NASD restrict the ability of NASD members to engage in various activities relating to funds unless certain disclosures are made in fund prospectuses.[226] NASD Conduct Rule 2830, for example, generally does not allow underwriters to pay compensation to broker-dealers for selling shares of a fund, unless the compensation arrangements are disclosed in the fund's prospectus.[227] Certain commenters expressed concern that these and other NASD prospectus disclosure requirements appear to be inconsistent with the Commission's broad initiatives to improve fund disclosure, and encouraged the Commission to coordinate its regulatory efforts with the NASD.

The Commission believes that it is of the utmost importance that all disclosure contained in fund prospectuses conforms to the principles of effective communication reflected in Form N-1A, as amended. The Commission has discussed these principles with the NASD staff, which has agreed to evaluate all of the NASD's existing requirements for consistency with these principles and to propose to the Commission that those rules be changed as necessary to achieve greater consistency. In addition, to the extent that it imposes prospectus disclosure requirements in the future, the NASD will seek to do so in accordance with the Commission's disclosure principles.[228]

H. Effective Dates and Transition Period

As discussed in the Form N-1A Proposing Release,[229] the Commission is providing for a transition period after the effective date of the amendments to Form N-1A that gives funds sufficient time to update their prospectuses or to prepare new registration statements under the revised

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[224] *John Hancock Funds, Inc.*, supra *note 199; see also 1997 Profile Letter, 1996 Profile Letter, and 1995 Profile Letter*, supra *note 16; National Association for Variable Annuities (pub. avail. June 4, 1996); Fidelity Institutional Retirement Services Company, Inc. (pub. avail. Apr. 5, 1995).*

[225] *The Commission recognizes that, in interpreting these provisions, the staff will have to balance the goal of furthering the effective communication of information to investors with the goal of presenting prospectuses in formats designed to permit investors to compare the operations of one fund to those of other funds.*

[226] See *Form N-1A Proposing Release*, supra *note 8, at 10916-17.*

[227] See, e.g., *rule 2830(l)(1)(C) of the NASD Conduct rules*, supra *note 37, at 4627 (prohibiting the offer, payment, or arrangement of "concessions" in connection with retail sales of investment company securities unless the arrangement is disclosed in the investment company's prospectus). The NASD has proposed to eliminate the provision in Conduct Rule 2830 that necessitates prospectus disclosure concerning these non-cash arrangements.* See *Securities Exchange Act Release No. 38993 (Sept. 5, 1997) [62 FR 47080]. Moreover, the NASD staff has assured the Commission's staff that the NASD staff will reconsider the appropriateness of requiring prospectus disclosure concerning cash compensation, in light of the Commission's Form N-1A initiatives.* Id. *at 47086. In addition, the NASD has proposed to eliminate certain prospectus disclosure concerning the effects of asset-based sales charges.* See supra *note 169.*

[228] *The Commission also encourages the NASD to follow as much as possible the disclosure principles underlying the Form N-1A in considering and proposing disclosure requirements under NASD rules that apply to fund advertisements.*

[229] See *Form N-1A Proposing Release*, supra *note 8, at 1091.*

See John Hancock Funds, Inc., supra note 199; see also 1997 Profile Letter, 1996 Profile Letter, and 1995 Profile Letter, supra note 16; National Association for Variable Annuities (pub. avail. June 4, 1996); Fidelity Institutional Retirement Services Company, Inc. (pub. avail. Apr. 5, 1995).

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Form N-1A requirements. All new registration statements or post-effective amendments that are annual updates to effective registration statements filed on or after December 1, 1998 must comply with the amendments to Form N-1A.[230] The final compliance date for filing amendments to effective registration statements to conform with the new Form N-1A requirements is December 1, 1999. The same compliance dates apply to the new plain English disclosure requirements for fund prospectuses. A fund may, at its option, prepare documents in accordance with the requirements of Form N-1A, as amended, at any time after the effective date of the amendments.

[230] *To simplify compliance with the revised prospectus disclosure requirements, the Commission is specifying the effective date as June 1, 1998.*

Securities and Exchange Commission Q&A Letter on New Form N-1A (October 2, 1998)

October 2, 1998

Craig S. Tyle, Esq.
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Investment Company Institute
1401 H Street, N.W.
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Dear Mr. Tyle:

In the time that has passed since the Commission adopted amendments to Form N-1A and the new profile rule, members of the fund industry have asked us a variety of questions seeking clarification or interpretations of certain new disclosure rules. In our May 19, 1998 letter to you, we answered a number of those questions. The purpose of this letter is to set out our views about various issues raised with us since we last wrote to you. We believe our responses will be of interest to the entire fund industry and ask that you distribute our letter to the membership of the Investment Company Institute. We also will make this letter and our May letter available on the Commission's web site (http://www.sec.gov/rules/othrindx.htm).

For the convenience of the industry, we have used a question-and-answer format in this letter. We begin with issues arising with respect to Form N-1A.

Form N-1A

Bar Chart and Performance Table

1) **Q:** Should the disclosure of a fund's highest and lowest return for a quarter during the 10 calendar years or other period of the bar chart be for calendar quarters or fiscal quarters?

A: Consistent with the other information in the bar chart and the performance table, the highest and lowest quarterly performance information should be based on calendar quarters.

2) **Q:** Item 2(c)(2)(ii) of Form N-1A requires that, if a fund's fiscal year is other than a calendar year, it must include year-to-date return information as of the end of the most recent quarter in a footnote to the bar chart. If such a fund does not have a full calendar year of performance information, must it provide year-to-date return information?

A: No. As with the bar chart itself, year-to-date return information is not required, and is not permitted, until a fund has annual return information for at least one calendar year.

3) **Q:** May a load fund include in the performance table returns reflecting both the sales load and load-waived returns?

A: No. Instruction 2(a) to Item 2(c)(2) requires calculation of average annual total returns in accordance with Item 21(b)(1). That Item requires a fund to include the maximum sales loads (including deferred sales loads) and recurring account fees in the calculation of average annual total returns.

4) **Q:** Must a money market fund include the performance table in its prospectus and, if so, must the table include a comparison to a broad-based securities market index?

A: Item 2(c)(2)(iii) of Form N-lA requires a fund, including a money market fund, that has annual return information for at least one calendar year to include the performance table in its prospectus. While the performance table generally must include the returns of an appropriate broad-based securities market index, consistent with the requirements of Item 5, Management's Discussion of Fund Performance, a money market fund need not compare its performance to a broad-based securities market index. A money market fund may, at its option, include information for one or more other indices as permitted by Instruction 6 to Item 5(b).

5) **Q:** May a non-money market fund that does not disclose yield information in its risk/return summary provide a telephone number that investors can use to obtain current yield information?

A: Yes. Instruction 2(d) to Item 2(c)(2) of Form N-lA requires a non-money market fund that discloses yield to provide a toll-free (or collect) telephone number that investors can use to obtain current yield information. This requirement does not preclude a non-money market fund that does not disclose yield in its prospectus from providing a telephone number for that purpose. Thus, a non-money market fund, like a money market fund, has the option of providing yield information in its prospectus or disclosing a telephone number that investors can use to obtain current yield information.

Fee Table

6) **Q:** May funds with fees and/or expenses that are subject to reimbursements or waivers show the net amount of those fees or expenses in the fee table?

A: Yes, under certain circumstances. If a fund's fees in the fee table are subject to a contractual limitation that requires reimbursement or waiver of expenses, a fund may add two lines to the fee table: one line showing the amount of the reimbursement or waiver, and a second line showing the fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. A fund should place these additional lines immediately under the "Total Annual Fund Operating Expenses" line of the fee table and should use appropriate descriptive captions. A footnote to the fee table should describe the contractual arrangement. A fund could, for example, use a format such as the following:

Annual Fund Operating Expenses (expenses that are deducted from Fund assets)

Management Fees	xx %
Distribution [and/or Service](12b-1) Fees	xx %
Other Expenses	xx %
_____	xx %
_____	xx %
_____	xx %
Total Annual Fund Operating Expenses	xx %
Fee Waiver [and/or Expense Reimbursement]	xx %
Net Expenses	xx %

Fee waivers or expense reimbursements that are not contractually imposed may be disclosed only in a footnote to the fee table. The Commission stated in its release adopting amendments to Form N-lA ("Form N-lA Adopting Release") that disclosure of the gross level of fund operating expenses would give investors clearer information about the long-term costs of an investment in a fund.[231] The Commission was concerned that allowing a fund to show operating expenses net of the waiver or reimbursement would lead investors to focus on costs resulting from temporary or discretionary waiver and reimbursement arrangements rather than long-term costs. In meeting the provisions of Form N-lA, a fund for which the investment adviser (or other party) intends to reimburse expenses or waive fees, but is not contractually obligated to do so, may include a footnote to the fee table showing fund operating expenses net of waivers or reimbursements. We recognize that circumstances may require modifications to the fee table. When such circumstances arise, we will work with a fund as it develops a presentation that is appropriate for the fund and meets the spirit of the new requirements.

Purchase and Sale Information

7) **Q:** The Form N-lA Adopting Release states that "as long as the purchase and sale information in a fund's prospectus is not reduced below the minimum [disclosure] required by Form N-1A, the fund would be able to create and use a separate purchase and sale disclosure document as supplemental sales literature." What is the minimum disclosure required in the prospectus?

A: The minimum disclosure required in a prospectus depends upon the facts and circumstances specific to a particular fund. The following types of disclosures, however, are examples of those that would not be required to appear in the prospectus: (1) a description of every possible way to purchase or redeem fund shares; (2) a description of every restriction or process related to purchasing or redeeming fund shares (*e.g.,* requirements that checks be drawn in U.S. dollars, and disclosure about share certificates); and (3) detailed information about various types of accounts, such as different types of tax-deferred accounts. Among the information that would be required is disclosure of any material restrictions that a fund imposes on the right of redemption and disclosure of minimum investment requirements.

[231] *Investment Company Act Release No. IC-23064 (Mar. 13, 1998).*

8) **Q:** Item 18(a) of Form N-lA provides that a fund may incorporate purchase and redemption information required by Item 18(a) into its Statement of Additional Information ("SAI") by reference to a separate disclosure document that may be provided to investors with the SAI or separately. If a fund elects to provide purchase and redemption information in a separate disclosure document that it incorporates by reference into the SAI, can the SAI, in turn, be incorporated by reference into the fund's prospectus without violating the Commission's rule that restricts double incorporation by reference? Are the delivery requirements for this separate document the same as for the complete SAI?

A: Rule 10(d) generally prohibits double incorporation by reference—an incorporation by reference that is twice removed from the primary document. Funds that choose to incorporate the SAI into the prospectus should include, rather than incorporate, the information required by Item 18(a) in a separate section of the SAI and provide that section individually and apart from the SAI to investors who request additional purchase and redemption information. Since the purchase and redemption information would be a separable section of the SAI and not a separate document, the fund would avoid double incorporation by reference when the SAI is incorporated by reference into the prospectus.

Item 1 of Form N-lA requires a fund that receives a request for the SAI or the shareholder report to send the requested document within 3 business days of receipt of the request. The same delivery requirement would apply to a request for a separate section of the SAI containing additional information on purchase and redemption procedures. We note that a fund that chooses to use these SAI disclosure options must provide a complete SAI to investors who request the SAI and do not limit their request to information on purchase and redemption procedures.

Compliance

9) **Q:** May a post-effective amendment that is not yet required to comply with amended Form N-lA reflect some, but not all, of the amended requirements?

A: Generally, no. The staff would not object, however, if, prior to updating its entire registration statement, a fund chose to: (i) move the 10-year financial highlight table from the front of the prospectus and delete average commission rate information from that table; (ii) move from the prospectus to the SAI disclosure about technical, legal, or operational matters as permitted by Form N-1A, as amended; (iii) omit, as exhibits to its registration statement, model retirement plans used to offer fund shares, schedules showing the calculation of performance information, and voting trust agreements; or (iv) omit the table showing the number of holders of each class of fund shares from Part C of its registration statement.

Three-Day Mailing Requirement

10) **Q:** Must a fund ensure that a third-party intermediary selling its shares complies with the requirement to send the SAI, annual or semi-annual report (and, in the case of the profile, the prospectus) to an investor within 3 business days of receipt of a request?

A: Yes, if the third-party intermediary is named in the prospectus (or profile) or otherwise acts as an agent of the fund. In the Form N-lA Adopting Release and the release adopting the profile rule ("Profile Adopting Release"),[232] the Commission stated that funds are required to mail SAIs and prospectuses to investors within 3 days of a request because prompt delivery of those documents to investors is essential to the disclosure formats contemplated by Form N-lA and the profile. Recognizing that many funds are distributed through financial intermediaries and that investors may look to those intermediaries to provide information, the Commission allowed a fund to indicate in its prospectus or profile that an investor may obtain an SAI or shareholder report (or, in the case of the profile, the prospectus) from a financial intermediary. When a financial intermediary is named in the prospectus (or profile) as a party to contact in order to obtain information or when a financial intermediary otherwise acts as an agent for a fund, the fund remains obligated to ensure that the information is sent to investors within 3 business days of receipt of a request. In those cases, the fund can contract with intermediaries to ensure their compliance with the 3-day mailing requirement.

A fund, however, is not responsible for ensuring that a third-party intermediary complies with the 3-day mailing requirement if: (1) the third-party intermediary is not an agent of the fund; (2) the prospectus or profile provides the fund's toll-free (or collect) telephone number for investors to call to obtain a copy of the specified documents from the fund; (3) the prospectus or profile does not mention that intermediary as a source for obtaining these documents and does not generally instruct investors to contact an intermediary to obtain documents; and (4) an investor directly contacts the third-party intermediary to request one or more of these documents.

Rule 498

Profile Filings

11) **Q:** Must a fund that has previously filed a definitive form of profile with the Commission subsequently file the updates to the bar chart and performance table as required by rule 498(c)(2)(iii)?

A: Yes. Rules 497(k)(1)(iii)(A) and (B), respectively, require a fund that has filed a definitive form of profile with the Commission to file any subsequent material and non-material changes to the information disclosed under rules 498(c)(2)(i)-(iii). The Instruction to rule 498(c)(2)(iii) gives a fund the option to reflect updated performance information to the bar chart and the performance table by affixing a label or sticker to the profile or by other reasonable means. If a fund updates the bar chart and the performance table in accordance with the Instruction, the fund should file the label, sticker, or "other reasonable means" of updating performance information under the applicable sub-paragraph of rule 497(k)(1)(iii). If a fund reflects updated performance information to the bar chart and the performance table by reprinting and distributing the entire form of profile, however, the fund should refile the complete, revised definitive form of profile under the applicable sub-paragraph of rule 497(k)(1)(iii).

[232] *Investment Company Act Release No. IC-23065 (Mar. 13, 1998) (adopting profile rule).*

12) **Q:** Under what sub-paragraph of rule 497(k)(1)(iii) must a fund that has previously filed a definitive form of profile with the Commission file routine updates to the bar chart, the performance table, and the fee table required by rule 498(c)(2)?

A: Those kinds of updates should be filed under rule 497(k)(1)(iii)(B). A fund should submit routine updates to the bar chart, the performance table, and the fee table in the profile on EDGAR form type 497K3B.

13) **Q:** If a fund has filed a definitive form of profile with the Commission and subsequently tailors the definitive profile for use by investors in participant-directed defined contribution plans, must the fund file a new form of profile under rule 497(k)(1)(i) and observe a 30-day waiting period?

A: No. Rule 498(d) permits a registrant to modify certain information included in a profile to be used for a fund that is offered as an investment option for certain defined contribution plans, tax-deferred arrangements, or variable contracts. If a profile modified under rule 498(d) contains material changes to the information disclosed under rules 498(c)(2)(i)-(iii), the fund must file the revised definitive form of profile under rule 497(k)(1)(iii)(A) on EDGAR form type 497K3A. Conversely, if a profile modified under rule 498(d) contains non-material changes to the information disclosed under rules 498(c)(2)(i)-(iii) (*e.g.,* routine updates to the bar chart, performance table, and fee table; omission of, or changes to, the disclosure required by rules 498(c)(2)(vi)-(ix); changes to the profile legend), the fund must file the revised definitive form of profile under rule 497(k)(1)(iii)(B) on EDGAR form type 497K3B. In each instance, the definitive form of profile reflecting modifications under rule 498(d) must be filed with the Commission no later than the fifth business day after the profile's first date of use.

14) **Q:** If a fund uses a separate application to purchase fund shares with the profile, must the fund file that application with the Commission?

A: Yes. A fund that uses a separate application with the profile must file the application with its profile in three circumstances:

(1) when it files its first profile under rule 497(k)(1)(i) (EDGAR form type 497K1),

(2) when it files its definitive form of profile under rule 497(k)(1)(ii) (EDGAR form type 497K2), and

(3) whenever it revises the form of application used with the profile. In this case, the profile should be refiled with the revised application under rule 497(k)(1)(iii)(B) (EDGAR form type 497K3B).

Registrants are reminded that, under rule 498(c)(3), an application used with a profile must note with equal prominence that an investor has the option of purchasing fund shares after reviewing the profile or after requesting and reviewing the fund's prospectus (and other information).

Specific Requirements

15) **Q:** May a fund modify the legend required by rule 49B(c)(1)(iv) that should appear on the cover page or at the beginning of the profile?

A: No. In contrast to the disclosure required by rule 498(c)(2)(ii) which allows some flexibility in the wording of a required legend, a fund must include the rule 498(c)(1)(iv) legend verbatim on the cover page or at the beginning of the profile.

16) **Q:** If a fund reprints its profile when it updates its performance, should the reprinted profile reflect the date that the profile was first used, and the date that the profile was revised, or should the profile reflect only the date of the reprint?

A: The profile should reflect only the date of the reprint.

17) **Q:** What is contemplated by the requirement to provide a brief summary of services available to typical investors in a fund (see rule 498(c)(2)(ix) and related Instruction)?

A: A fund may comply with this requirement by listing the services commonly used by a typical fund investor. We recognize that available services vary among different fund groups and therefore believe it is appropriate to provide funds with flexibility to determine which services to disclose.

18) **Q:** If a fund group decides to include more than one fund in a profile, does the same combination of funds that is described in the profile have to appear in a prospectus for the funds?

A: No. There is no requirement that profiles maintain a one-to-one correlation with prospectuses. For example, a single profile may be used to offer multiple funds, each having a separate prospectus; or multiple profiles may be used to offer funds included in a single prospectus.

19) **Q:** May a fund include information in the profile other than the disclosure specified by rules 498(c)(2)(i)-(ix)?

A: Generally, no. The profile is intended to be a standardized summary of key information in a fund's prospectus. Consistent with this purpose, rule 498(b) limits profile disclosure to information required or not precluded by paragraph (c) of the rule. Based on the limitations imposed by rule 498(b), a fund could not include in the profile, for example, a list of the fund's top ten portfolio holdings, cumulative performance information, or a discussion of the potential rewards of investing in the fund, since these items are inconsistent with maintaining the profile as a standardized summary. Funds are reminded, however, that they must include sufficient information in the profile necessary to avoid material misstatements or materially misleading disclosure.

20) **Q:** May a fund include in a profile performance information appearing in a fund's prospectus under the Nicholas Applegate[233] and Bramwell[234] no-action letters?

A: No, for the reasons outlined in our answer to question 19. Performance information that is consistent with the Nicholas Applegate and Bramwell no-action letters is neither required nor permitted by rule 498 and may not be included in a profile.

21) **Q:** If a fund's fiscal year is other than a calendar year, the fund must include its year-to-date return information as of the end of the most recent quarter in a footnote to the bar chart in the prospectus. See rule 498(c)(2)(iii) (incorporating Item 2(c)(2)(ii) of Form N-lA). Given that the profile is updated quarterly, is it necessary for a fund to include the footnote to the bar chart in the profile?

A: No. Because the performance table is updated quarterly, a fund may omit the footnote to the bar chart in a profile.

22) **Q:** Rule 498(c)(2)(iii) requires funds to "[u]pdate the return information as of the end of each succeeding calendar quarter as soon as practicable after the completion of the quarter." Which return information must be updated quarterly?

A: As indicated in the Profile Adopting Release, a fund must update quarterly the return information in its performance table (*i.e.*, the fund's average annual total returns and the returns of any index included in the table).

23) **Q:** Under rule 498(c)(2)(iii), at what point must a new fund include the performance table in its profile?

A: A fund that has annual returns for at least one calendar year must include the performance table in the profile. See rule 498(c)(2)(iii) (incorporating Item 2(c)(2)(iii) of Form N-lA).

24) **Q:** The Instruction to rule 498(c)(2)(iii) provides that a fund may update the performance table by affixing a label or sticker, or by other reasonable means. Based on this Instruction, could a fund update the performance table by including the updated performance information in a cover letter introducing the profile?

A: No. Although the Instruction to rule 498(c)(2)(iii) states that a fund may update performance information by affixing a label or sticker, or by other reasonable means, a profile may not incorporate information by reference to another document. Cross-references in a profile to

[233] *Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996) (fund to include in its prospectus performance information of private accounts managed by the fund's investment adviser that had substantially similar investment objectives, policies, and strategies).*

[234] *Bramwell Growth Fund (pub. avail. Aug. 7, 1996) (fund to include in its prospectus standardized total return information of another registered investment company previously managed by the fund's portfolio manager that had substantially similar investment objectives and policies).*

another document are also restricted. These restrictions were intended to ensure that the profile is a self-contained disclosure document. For these reasons, we believe that a fund may not update its profile with a separate document, even if that separate document is a letter that accompanies the profile.

25) **Q:** Instruction 2(c) to Item 2(c)(2) of Form N-lA states that, if a fund selects an index that is different from the index used in the performance table for the immediately preceding period, the fund must explain the reason(s) for the selection of a different index and provide information for both the newly selected and the former index. Given that rule 498(c)(2)(iii) incorporates Item 2(c)(2)(iii) of Form N-lA, must a fund that changes an index previously used in the profile's performance table comply with the Form N-lA Instruction?

A: No. Consistent with the profile's intended purpose as a standardized summary of key information in a fund's prospectus, we would not object if a fund omitted the explanation and information specified in Instruction 2(c) to Item 2(c)(2) of Form N-lA from the performance table in the profile.

26) **Q:** Must a fund describe all sales load waivers in the profile?

A: No. Under rules 498(c)(2)(vi) and (vii), a fund that offers them should include a statement that waivers are available for initial sales loads and for sales loads or charges assessed upon redemption. It need mention specifically only those waivers that would apply to a typical purchaser.

Using the Profile with Rule 482 Materials

27) **Q:** If an advertisement designed to meet the requirements of rule 482 under the Securities Act of 1933 does not accompany a profile, may the advertisement include language inviting an investor to request and read a profile prior to investment?

A: Funds may add language to a rule 482 advertisement that invites an investor to request a profile or a prospectus, so long as the advertisement refers to both the profile and the prospectus and the reference to the profile is no more prominent than the reference to the prospectus.

28) **Q:** May rule 482 material be bound to or wrapped around the profile?

A: Yes, if it is clear that the wrapper is not part of the profile and each document complies with the rule regulating its content as a stand-alone document.

29) **Q:** Assume that a full page of newspaper copy combines a profile with a rule 482 advertisement for the same fund. Should the profile be separated from the rule 482 advertisement?

A: Yes. As discussed in response to question 24, the Commission intended that the profile be a short, summary, self contained disclosure document. In our view, in light of this purpose, rule 482 advertisements and profiles should not appear as a single document in newspaper copy. We would not object, however, if both documents are used together in newspaper copy so long as the boundaries of each document are distinct and each document includes its required content.

We hope this information will be helpful to members of the Investment Company Institute and others as they prepare profiles and registration statements on Form N-lA, as amended. In the future, we intend to provide additional guidance as necessary. If you have any questions, please contact the Office of Disclosure and Review, Division of Investment Management at (202) 942-0586. Questions about specific filings should be directed to the staff member responsible for reviewing that fund's documents.

Sincerely,

Barry D. Miller
Associate Director

Securities and Exchange Commission Q& A Letter on New Form N-1A (May 19, 1998)

May 19, 1998

Craig S. Tyle, Esq.
General Counsel
Investment Company Institute
1401 H Street, N.W.
Washington, DC 20005-2148

Dear Mr. Tyle:

Since the adoption of amended Form N-1A and rule 498 on March 13, 1998,[235] the Division of Investment Management has received many questions from mutual funds and their counsel regarding the Form and the rule. We are in the process of compiling a list of frequently asked questions and the answers that we have provided to these questions. We plan to make the list available in the near future and will send you a copy that we would ask that you share with your members. We believe, however, the immediate dissemination of answers to some of these questions may be helpful to registrants as they prepare to file new registration statements and fund profiles. The following is a discussion of these questions and answers.

Rule 485(a) Filing

We have been asked whether a post-effective amendment to a registration statement that has been updated to comply with the requirements of Form N-1A, as amended, should be filed under paragraph (a) or (b) of rule 485. As explained below, funds should file these post-effective amendments under rule 485(a).

The amendments to Form N-1A require registration statement disclosure that is, in some cases, revised, and in other cases, such as the information required by Item 2 of the risk/return summary, completely new. When a post-effective amendment to a registration statement is filed to make non-material changes, or when an amendment is filed to update or change certain specified routine items, rule 485(b) provides for automatic effectiveness of the post-effective amendment. Amendments that make other changes to disclosure must be filed under rule 485(a). Because post-effective amendments filed to comply with the requirements of amended Form N-1A will likely involve substantial changes to disclosure that do not fall within the scope of rule 485(b), funds should file these amendments under rule 485(a).

We recognize that the Commission will receive substantially more post-effective amendments filed under rule 485(a), particularly in 1999. Consequently, we encourage registrants to request selective review of their filings when appropriate.[236]

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[235] *Investment Company Act Release No. IC-23064 (Mar. 13, 1998) ("Form N-1A Adopting Release"); Investment Company Act Release No. IC-23065 (Mar. 13, 1998).*

[236] See *Investment Company Act Release No. IC-13768 (Feb. 15, 1984).*

Preparation of a Profile Before the Amended Prospectus

Noting that the profile includes a risk/return summary that is substantially the same as the risk/return summary in a fund's prospectus, some registrants have asked whether a fund must revise its prospectus to comply with amended Form N-1A before filing a profile with the Commission. Although a fund must have an effective registration statement and a current prospectus under section 10(a) of the Securities Act before it may use a profile, there is no requirement that a fund first update its registration statement to comply with the requirements of amended Form N-1A. As a practical matter, we anticipate, however, that funds would prepare revised prospectuses and profiles concurrently because the profile will summarize information that is required by amended Form N-1A to be in a fund's prospectus.

Filing and Use of the Profile

Some funds have asked whether they may file a profile with the Commission before June 1, 1998, the effective date of rule 498, so that they may use a profile shortly after the rule becomes effective. We are in the process of making changes to the Commission's EDGAR system to accommodate the filing of the profile. We anticipate that new form types will not be available until June 1, 1998. Thus, the Commission will not accept profile filings before that date.

In determining when a registrant will be able to first use a profile, funds should note that rule 497(k)(1) provides, generally, that a fund may not distribute a new form of profile to any person unless it has been on file with the Commission for 30 days. A fund may not be able to use the profile after 30 days, however, when a new profile is filed in connection with an initial registration statement, a post-effective amendment that adds a series of a fund to a registration statement, or when the profile reflects changes to a prospectus included in a post-effective amendment filed to update a registration statement under rule 485. In these cases, the profile may be used on the later of 30 days after it is filed or the date that the registration statement or post-effective amendment becomes effective.

Three-day Requirement

Instruction 3 to Item 1(b)(1) of Form N-1A, as amended, requires a fund that receives a request for the Statement of Additional Information ("SAI"), the annual report, or the semi-annual report, to send the requested document within three business days of receipt of the request. An instruction to rule 498(c)(1)(v) contains a similar requirement and also requires a fund to send the prospectus upon request within three business days. We have been asked whether a fund must begin to comply with these requirements on June 1, 1998. A fund must begin to comply with the three business day requirement at the time its registration statement under amended Form N-1A becomes effective or when it begins to use a profile.

The Form N-1A Adopting Release noted that the Commission's Office of Compliance Inspections and Examinations will examine fund compliance with the three business day requirement. We have been asked what a fund would need to show the staff to establish compliance

with this requirement. A fund should show that it maintains policies and procedures, internally and with financial intermediaries through which shares of the fund may be purchased or sold, that assure that the fund honors requests for the prospectus, SAI, and annual/semi-annual reports within the three business day period. The fund also should be able to demonstrate that its policies and procedures in fact result in the timely distribution of documents subject to the three business day requirement.

4 to 6 Month Undertaking

Item 32(b) of current Form N-1A requires that a new fund undertake to file a post-effective amendment containing updated financial statements within 4 to 6 months of the effective date of its registration statement ("4 to 6 month undertaking"). Newly organized funds filing a registration statement on current Form N-1A before December 1, 1998, and funds with pending or effective registration statements that have made a 4 to 6 month undertaking have asked whether they must comply with this requirement. The funds base their request on the Commission's decision to omit the requirement from amended Form N-1A.

In the Form N-1A Adopting Release, the Commission stated that the costs associated with the 4 to 6 month update are not outweighed by the benefits that the information may provide to some investors. The Commission also noted that an investor interested in financial information about a fund's initial operations can obtain the information by requesting the fund's most recent shareholder report, which is generally available 6 to 8 months after the fund commences operations and begins selling shares to investors. For these reasons, the Commission decided that amended Form N-1A should not require the filing of updated financial statements for a new fund.

We would not object if any newly organized investment company or series filing a registration statement on Form N-1A before December 1, 1998 omits the 4 to 6 month undertaking. In addition, we would not object if an investment company or series with a pending or effective registration statement that includes a 4 to 6 month undertaking does not file the update. Our determination not to object under these circumstances is premised upon the fund providing an investor with an annual or semi-annual report upon request.

We hope that this information will be helpful to registrants. If you have any questions, please contact Markian Melnyk, Deputy Chief of the Office of Disclosure Regulation at (202) 942-0592. Thank you for communicating these positions to your membership.

Sincerely,

Barry D. Miller
Associate Director

Role of Independent Directors of Investment Companies
[Release Nos. 33-7932; 34-43786; IC-24816]
January 2, 2001

SUMMARY: The Commission is adopting amendments to certain exemptive rules under the Investment Company Act of 1940 to require that, for investment companies that rely on those rules: independent directors constitute a majority of their board of directors; independent directors select and nominate other independent directors; and any legal counsel for the independent directors be an independent legal counsel. We also are adopting amendments to our rules and forms to improve the disclosure that investment companies provide about their directors. These amendments are designed to enhance the independence and effectiveness of boards of directors of investment companies and to better enable investors to assess the independence of those directors.

DATES: Effective Date: February 15, 2001, except that the rescission of §270.2a19-1 under the Investment Company Act will become effective May 12, 2001.

Compliance Date: Section III of this release contains information on compliance dates.

FOR FURTHER INFORMATION CONTACT: For information regarding the Investment Company Act rule amendments, contact Jaea F. Hahn, Attorney, Martha B. Peterson, Special Counsel, or C. Hunter Jones, Assistant Director, Office of Regulatory Policy, (202) 942-0690, or regarding the disclosure amendments, contact Kimberly Browning, Attorney, Peter M. Hong, Special Counsel, or Kimberly Dopkin Rasevic, Assistant Director, Office of Disclosure Regulation, (202) 942-0721, at the Division of Investment Management, Securities and Exchange Commission, 450 5th Street, N.W., Washington, DC 20549-0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the "Commission") is adopting new rules 2a19-3 [17 CFR 270.2a19-3], 10e-1 [17 CFR 270.10e-1], and 32a-4 [17 CFR 270.32a-4] and amendments to rules 0-1 [17 CFR 270.0-1], 10f-3 [17 CFR 270.10f-3], 12b-1 [17 CFR 270.12b-1], 15a-4 [17 CFR 270.15a-4], 17a-7 [17 CFR 270.17a-7], 17a-8 [17 CFR 270.17a-8], 17d-1 [17 CFR 270.17d-1], 17e-1 [17 CFR 270.17e-1], 17g-1 [17 CFR 270.17g-1], 18f-3 [17 CFR 270.18f-3], 23c-3 [17 CFR 270.23c-3], 30d-1 [17 CFR 270.30d-1], 30d-2 [17 CFR 270.30d-2], and 31a-2 [17 CFR 270.31a-2] under the Investment Company Act of 1940 [15 U.S.C. 80a] ("Investment Company Act" or "Act"); amendments to Forms N-1A [17 CFR 274.11A], N-2 [17 CFR 274.11a-1], and N-3 [17 CFR 274.11b] under the Investment Company Act and the Securities Act of 1933 [15 U.S.C. 77a-aa] ("Securities Act"); and amendments to Schedule 14A [17 CFR 240.14a-101] under the Securities Exchange Act of 1934 [15 U.S.C. 78a-mm] ("Exchange Act"). The Commission also is rescinding rule 2a19-1 under the Investment Company Act [17 CFR 270.2a19-1].

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EXECUTIVE SUMMARY

The Commission is adopting new rules and amendments to rules and forms to enhance the independence and effectiveness of independent directors of investment companies ("funds"). First, we are adopting amendments to require, for funds relying on certain exemptive rules, that:

- independent directors constitute a majority of the fund's board of directors;
- independent directors select and nominate other independent directors; and
- any legal counsel for the fund's independent directors be an independent legal counsel.

Second, the rules and amendments:

- prevent qualified individuals from being unnecessarily disqualified from serving as independent directors;
- protect independent directors from the costs of legal disputes with fund management;
- permit us to monitor the independence of directors by requiring funds to keep records of their assessments of director independence;
- temporarily suspend the independent director minimum percentage requirements if a fund falls below a required percentage due to an independent director's death or resignation; and
- exempt funds from the requirement that shareholders ratify or reject the directors' selection of an independent public accountant, if the fund establishes an audit committee composed entirely of independent directors.

Finally, we are requiring that funds provide better information about directors, including:

- basic information about the identity and business experience of directors;
- fund shares owned by directors;
- information about directors that may raise conflict of interest concerns; and
- the board's role in governing the fund.

Together, these new rules and amendments are designed to reaffirm the important role that independent directors play in protecting fund investors, strengthen their hand in dealing with fund management, reinforce their independence, and provide investors with greater information to assess the directors' independence.

I. BACKGROUND

Mutual funds are organized as corporations, trusts, or limited partnerships under state laws, and thus are owned by their shareholders, beneficiaries, or partners.[237] Like other types of corporations, trusts, or partnerships, a mutual fund must be operated for the benefit of its owners.[238]

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[237]*For simplicity, this release focuses on mutual funds (i.e., open-end funds). The amendments we are adopting, however, apply to all management investment companies, except where noted.*

[238]See *generally James M. Storey & Thomas M. Clyde, Mutual Fund Law Handbook § 7.2 (1998); Allan S. Mostoff & Olivia P. Adler,* Organizing an Investment Company-Structural Considerations, *in The Investment Company Regulation Deskbook § 2.4 (Amy L. Goodman ed., 1997).*

Unlike most business organizations, however, mutual funds are typically organized and operated by an investment adviser that is responsible for the day-to-day operations of the fund. In most cases, the investment adviser is separate and distinct from the fund it advises, with primary responsibility and loyalty to its own shareholders.[239] The "external management" of mutual funds presents inherent conflicts of interest and potential for abuses that the Investment Company Act and the Commission have addressed in different ways.[240]

One of the ways that the Act addresses conflicts between advisers and funds is by giving mutual fund boards of directors, and in particular the disinterested directors,[241] an important role in fund governance.[242] In relying on fund boards to represent fund investors and protect their interests, Congress avoided the more detailed regulatory provisions that characterize other regulatory schemes for collective investments.[243] The Commission has similarly relied extensively on independent directors in rules we have adopted that exempt funds from provisions of the Act.[244]

Millions of Americans are today invested in mutual funds, which have experienced a tremendous growth in popularity over the past twenty years.[245] In light of this growth, and our growing reliance on independent directors to protect fund investors, last year we undertook a review of the governance of investment companies, the role of independent directors, our rules that rely on oversight by independent directors, and the information that funds are required to provide to shareholders about their independent directors.

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[239]*As a result of their extensive involvement, and the general absence of shareholder activism, investment advisers typically dominate the funds they advise.* See *Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24082 (Oct. 14, 1999) [64 FR 59826 (Nov. 3, 1999)] ("Proposing Release") at n.10 and accompanying text.*

[240]*An investment adviser's shareholders often have an interest in a mutual fund that is quite different from the interests of the fund's own shareholders. For example, while fund shareholders ordinarily prefer lower fees (to achieve greater returns), shareholders of the fund's investment adviser might want to maximize profits through higher fees.* See *Proposing Release,* supra *note 3, at nn.11-25 and accompanying text, for a discussion of the comprehensive regulatory scheme established by the Act to address conflicts of interest between funds and their investment advisers.*

[241]*We refer to directors who are not "interested persons" of the fund as "independent directors" or "disinterested directors."* See *section 2(a)(19) of the Act [15 U.S.C. 80a-2(a)(19)](defining "interested person").*

[242]*The Investment Company Act establishes a system of "checks and balances," and relies on independent directors to "oversee the fund's operations so as to prevent abuses of investors." James M. Storey & Thomas M. Clyde, The Uneasy Chaperone 34 (2000). Directors also have broad responsibilities to monitor compliance with securities, corporate and other laws. Robert A. Robertson,* Board Oversight of Mutual Fund Compliance Operations, *Rev. Sec. & Comm. Reg., Oct. 24, 2000, at 1.*

[243]*For example, in Japan, funds may be structured only in the form of securities investment trusts, which are primarily subject to regulation under the Securities Investment Trust Law. There is no board of directors or board of trustees, and under the Securities Investment Trust Law, a "trustor company" manages the trust assets on behalf of the beneficiaries of the trust. The Japanese Ministry of Finance approves the terms and conditions of securities investment trusts, and plays a supervisory role in the day-to-day operations of the trusts. See Yoshiki Shimada et al.,* Regulatory Frameworks for Pooled Investment Funds: A Comparison of Japan and the United States, *38 Va. J. Int'l L. 191 (1998).*

[244]See *Proposing Release,* supra *note 3, at nn. 24-25 and accompanying text.*

[245]*Approximately 82.8 million individuals in 48.4 million households in the United States invest in funds. Investment Company Institute, Mutual Fund Fact Book 41 (2000).*

We held a Roundtable discussion at which independent directors, investor advocates, executives of fund advisers, academics, and experienced legal counsel offered a variety of perspectives and suggestions.[246] After evaluating the ideas and suggestions offered by Roundtable participants last year, we proposed a package of rule and form amendments that were designed to reaffirm the important role that independent directors play in protecting fund investors, strengthen their hand in dealing with fund management, reinforce their independence, and provide investors with better information to assess the independence of directors.[247]

We received 142 comment letters on our proposals, including 86 letters from independent directors.[248] Commenters generally commended our efforts to enhance the independence and effectiveness of fund directors, although many offered recommendations for improving portions of the proposals. Many of these letters were helpful to us in formulating the final rules and amendments, which we are today adopting.

We have reason to believe that our efforts to improve the governance of mutual funds on behalf of mutual fund investors have already borne fruit. Our Roundtable discussions and proposed rules have provoked a great deal of discussion among directors, advisers, counsel, and investors about governance practices and policies. After our Roundtable, an advisory group organized by the Investment Company Institute ("ICI") made recommendations regarding fund governance in a "best practices" report ("ICI Advisory Group Report").[249] Many boards, we understand, have adopted the recommendations set forth in the ICI Advisory Group Report. Some groups of independent directors have hired independent counsel for the first time. Director nomination and selection procedures have been revised.

During the last year, Commissioners and members of the staff began meeting with independent directors and sharing ideas and concerns regarding the governance of mutual funds.[250] Former Commission Chairman David Ruder established the Mutual Fund Directors Education Council, a broad-based group of persons interested in fund governance and operations,[251] whose

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[246] See *SEC, Notice of Sunshine Act Meetings (Feb. 18, 1999) [64 FR 8632 (Feb. 22, 1999)]; see also Transcripts from the Roundtable on the Role of Independent Investment Company Directors, Feb. 23-24, 1999 ["Roundtable Transcripts"]. The Roundtable Transcripts are available to the public in the Commission's public reference room and the Commission's Louis Loss Library. They are also available on the Commission's Internet web site http://www.sec.gov/offices/invmgmt/rountab.htm.*

[247] See *Proposing Release*, supra *note 3*.

[248] *The comment letters and a summary of the comments prepared by Commission staff are available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. (File No. S7-23-99). The comment summary is also available on the Commission's Internet web site http://www.sec.gov/rules/extra/brownin1.htm*

[249] See *Investment Company Institute, Report of the Advisory Group on Best Practices for Fund Directors: Enhancing a Culture of Independence and Effectiveness (June 24, 1999).*

[250] See, *e.g., Arthur Levitt, Chairman, SEC, Remarks at the Mutual Fund Directors Education Council Conference (Feb. 17, 2000) (transcript available at http://www.sec.gov/news/speeches/spch346.htm); Paul Roye, Director, Division of Investment Management, SEC, What Does It Take To Be an Effective Independent Director of a Mutual Fund?, Address at the ICI Workshop for New Fund Directors (Apr. 14, 2000) (transcript available at http://www.sec.gov/news/speeches/spch364.htm).*

[251] *Members of the Council include independent directors, corporate governance experts, investor advocates, academics, industry members, and investment management attorneys.*

purpose is to foster the development of educational activities designed to promote the efficiency, independence, and accountability of independent fund directors. The American Bar Association formed a task force to examine the role of counsel to independent directors, and the task force released a report offering guidance to counsel and fund directors regarding standards of independence for counsel, and guidelines for reducing potential conflicts of interest ("ABA Task Force Report").[252] All of these initiatives have focused attention on the important role of independent directors, and their importance in promoting and protecting the interests of fund shareholders.

II. DISCUSSION

A. Amendments to Exemptive Rules to Enhance Director Independence and Effectiveness

We are amending ten rules that exempt funds and their affiliates from certain prohibitions of the Act (the "Exemptive Rules").[253] As discussed further below, the amendments add conditions to the Exemptive Rules to require that, for funds that rely on the rules, (i) independent directors constitute a majority of the board, (ii) independent directors select and nominate other independent directors, and (iii) any legal counsel for the independent directors be an independent legal counsel.[254]

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[252] *ABA, Report of the Task Force on Independent Director Counsel, Subcommittee of Investment Companies and Investment Advisers, Committee on Federal Regulation of Securities, Section of Business Law: Counsel to the Independent Directors of Registered Investment Companies (Sept. 8, 2000).*

[253] *The Exemptive Rules are:*

Rule 10f-3 (permitting funds to purchase securities in a primary offering when an affiliated broker-dealer is a member of the underwriting syndicate);

Rule 12b-1 (permitting use of fund assets to pay distribution expenses);

Rule 15a-4(b)(2) (permitting fund boards to approve interim advisory contracts without shareholder approval where the adviser or a controlling person receives a benefit in connection with the assignment of the prior contract);

Rule 17a-7 (permitting securities transactions between a fund and another client of the fund's adviser);

Rule 17a-8 (permitting mergers between certain affiliated funds);

Rule 17d-1(d)(7) (permitting funds and their affiliates to purchase joint liability insurance policies);

Rule 17e-1 (specifying conditions under which funds may pay commissions to affiliated brokers in connection with the sale of securities on an exchange);

Rule 17g-1(j) (permitting funds to maintain joint insured bonds);

Rule 18f-3 (permitting funds to issue multiple classes of voting stock); and

Rule 23c-3 (permitting the operation of interval funds by enabling closed-end funds to repurchase their shares from investors).

[254] *We discuss each of these conditions below.* See infra *Sections II.A.1, II.A.2, and II.A.3.*

Most commenters supported our goal of enhancing the independence and effectiveness of independent directors of funds that choose to rely on the Exemptive Rules.[255] Some commenters questioned the need to amend the rules, because each rule already requires independent directors to separately approve some of the fund's activities under the rule.

We selected these rules because they require the independent judgment and scrutiny of independent directors in overseeing activities that are beneficial to funds and investors, but involve inherent conflicts of interest between the funds and their managers.[256] The amendments are designed to increase the ability of independent directors to perform their important responsibilities under each of these rules.

1. Independent Directors as a Majority of the Board

a) Board Composition Requirements

We are amending the Exemptive Rules to require that the boards of funds relying on the rules have a majority of independent directors.[257] A majority requirement will permit, under state law, the independent directors to control the fund's "corporate machinery," *i.e.* to elect officers of the fund, call meetings, solicit proxies, and take other actions without the consent of the adviser.[258] As a result, independent directors who comprise the majority of a board can have a more meaningful influence on fund management and represent shareholders from a position of

[255] *We have revised the amendments to rule 15a-4, which permits fund boards to approve interim advisory contracts without shareholder approval. Funds have relied on that rule when an advisory contract terminated in unforeseeable circumstances, such as the death of the fund's investment adviser. After we issued the Proposing Release, we amended rule 15a-4 to further permit interim advisory contracts in foreseeable circumstances, when an adviser or controlling person receives a benefit in connection with the termination of the prior advisory contract (e.g., in the context of an adviser merger).* See *Temporary Exemption for Certain Investment Advisers, Investment Company Act Release No. 24177 (Nov. 29, 1999) [64 FR 68019 (Dec. 6, 1999)]. Three commenters argued that the availability of the rule in unforeseeable circumstances should not depend on the fund's compliance with the conditions that we proposed to add to the Exemptive Rules. In addition, one commenter further argued that funds that do not comply with the new conditions could be constrained from terminating an adviser because they are unable to enter into an interim advisory contract without obtaining an exemptive order. In light of these comments, we have determined to amend only the paragraph of rule 15a-4 that permits interim advisory contracts in foreseeable circumstances.* See *rule 15a-4(b)(2).*

[256] *As we noted in the Proposing Release, the Exemptive Rules provide exemptive relief that affords funds increased flexibility, cost reductions, and the ability to operate for the maximum benefit of investors. At the same time, these rules involve inherent conflicts of interest between funds and their managers, and therefore rely on independent directors to monitor those conflicts. While the Exemptive Rules have greatly expanded the responsibilities of fund boards, most have not contained conditions to enhance director independence and effectiveness.* See *Proposing Release,* supra *note 3, at n.30 and accompanying text. In the future we will be reluctant to issue exemptive orders premised on the oversight of independent directors, if the fund does not meet the new conditions we are today adopting.*

[257] *The independent directors thus would need to comprise more than half of the membership of the board. The Investment Company Act generally requires that independent directors constitute at least 40 percent of the board. Section 10(a) of the Act [15 U.S.C. 80a-10(a)]. Section 10(b)(2) of the Act [15 U.S.C. 80a-10(b)(2)] requires, in effect, that independent directors comprise a majority of a fund's board if the fund's principal underwriter is an affiliate of the fund's adviser. Section 15(f)(1) of the Act [15 U.S.C. 80a-15(f)(1)] provides a safe harbor for the sale of an advisory business if directors who are not interested persons of the adviser constitute at least 75 percent of a fund's board for at least three years following the assignment of the advisory contract.*

[258] See *Proposing Release,* supra *note 3, at text following n.44.*

strength.[259] In short, a board with a majority of independent directors can be more effective in representing investors than a board with a majority of "inside" directors.[260] Commenters were supportive of this proposal.[261] We are allowing funds ample time to implement the new majority independence condition. The compliance date for the majority independence condition is July 1, 2002. Although most funds already have a majority of independent directors, the transition period will allow sufficient time for those that do not, to carry out the selection, nomination, and election of new independent directors in accordance with the amended rules.[262]

b) Suspension of Board Composition Requirements

We are adopting new rule 10e-1, which temporarily suspends the board composition requirements of the Act and our rules, if a fund fails to meet those requirements because of the death, disqualification, or bona fide resignation of a director. For a fund that relies on one or more of the Exemptive Rules, rule 10e-1 will provide relief if the fund no longer has a majority of independent directors because of the sudden loss of one or more directors.[263]

Rule 10e-1 suspends the board composition requirements for 90 days if the board can fill a director vacancy, or 150 days if a shareholder vote is required to fill a vacancy.[264] We have extended the time period when only board action is required (from the 60 day period we proposed) in response to comments that additional time would be needed for independent directors to select and nominate candidates, and for the board to elect new directors.[265]

2. Selection and Nomination of Independent Directors

We are adopting, as a condition of the Exemptive Rules, a requirement that the independent directors of funds relying on those rules select and nominate[266] any other independent directors.[267]

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[259]See *Proposing Release,* supra *note 3, at nn.36-44 and accompanying text.*

[260]See Burks v. Lasker, *441 U.S. 471, 484 (1979) (discussing the "independent watchdog" function of independent directors).*

[261]*In the Proposing Release, we proposed two alternative board composition standards: (i) a simple majority and (ii) a two-thirds supermajority, as recommended by the ICI Advisory Group Report. We are adopting a simple majority independence standard, which most commenters supported.*

[262]See infra *Section II.A.2 (Selection and Nomination of Independent Directors).*

[263]*Without the relief provided by rule 10e-1, the consequence of losing an independent director and failing to have a majority of independent directors would be significant and immediate because funds would lose the ability to rely on the Exemptive Rules.*

[264]*Section 10(e) of the Act [15 U.S.C. 80a-10(e)] currently suspends the Act's board composition requirements for 30 days, if a fund's board may fill a director vacancy, or 60 days, if a shareholder vote is required to fill a vacancy. Section 10(e) also authorizes the Commission to issue rules or orders prescribing longer periods for filling board vacancies.*

[265]*The time periods begin to run when the fund no longer meets the applicable board composition requirement, even if the fund is not yet aware that it no longer meets the requirement. Funds and directors should be mindful of their responsibilities to maintain the required percentage of independent directors, and should monitor director independence (and other composition issues) accordingly. A fund also could avoid problems posed by the time constraints of rule 10e-1 by maintaining a greater percentage of independent directors than the simple majority required by the Exemptive Rules.* See *ICI Advisory Group Report,* supra *note 13, at 10-12 (recommending as a best practice that funds have a two-thirds majority of independent directors).*

[266]*Selection and nomination refers to the process by which board candidates are researched, recruited, considered, and formally named.*

[267]*Rules 12b-1 and 23c-3 already require funds relying on those rules to commit the selection and nomination of independent directors to the discretion of those directors. We are amending rules 12b-1 and 23c-3 to conform their language regarding self-selection and nomination to the language of the other Exemptive Rules.*

Commenters supported the proposal, and many specifically agreed that the self-selection and self-nomination of independent directors fosters an independent-minded board that focuses primarily on the interests of a fund's investors rather than its adviser.[268] Several commenters asked that we clarify the extent to which fund shareholders or a fund's adviser may participate in the selection and nomination process under the amendments. Control of the selection and nomination process at all times should rest with a fund's independent directors.[269] These amendments are not intended to supplant or limit the ability of fund shareholders under state law to nominate independent directors. The adviser may suggest independent director candidates if the independent directors invite such suggestions, and the adviser may provide administrative assistance in the selection and nomination process. Independent directors, however, should not view participation by shareholders and investment advisers in this process as precluding or excusing the independent directors from the responsibility to canvass, recruit, interview, and solicit independent director candidates.

3. Independent Legal Counsel

We are adopting amendments to each of the Exemptive Rules to require that any legal counsel for the fund's independent directors be an "independent legal counsel."[270] We believe that the

[268]See *Kenneth E. Scott,* What Role Is There for Independent Directors of Mutual Funds?, *2 Vill. J. L. & Inv. Mgmt. 1, 4 (2000) ("Independence [of a director] is a reflection of how you got on the board and how you can be taken off."). The self-selection and self-nomination condition applies prospectively, i.e., to independent directors elected after the effective date of the rules. Thus, current independent directors who were not selected and nominated by other independent directors may continue to serve as independent Several commenters asked that we clarify the extent to which fund shareholders or a fund's adviser may participate in the selection and nomination process under the amendments. Control of the selection and nomination process at all times should rest with a fund's independent directors.[33] These amendments are not intended to supplant or limit the ability of fund shareholders under state law to nominate independent directors. The adviser may suggest independent director candidates if the independent directors invite such suggestions, and the adviser may provide administrative assistance in the selection and nomination process. Independent directors, however, should not view participation by shareholders and investment advisers in this process as precluding or excusing the independent directors from the responsibility to canvass, recruit, interview, and solicit independent director candidates directors until the end of their terms, but any new independent directors must be selected and nominated by the incumbent independent directors.* See *Proposing Release,* supra *note 3, at n.69 and accompanying text.*

[269]See *The Robinson Humphrey Co., Inc., SEC No-Action Letter (Sept. 4, 1976) (analyzing the term "selected and proposed for election" in section 16(b) of the Act [15 U.S.C. 80a-16(b)] and concluding that independent directors had not been properly selected by other independent directors).*

[270]See *amended rules 10f-3(b)(11)(ii); 12b-1(c)(2); 15a-4(b)(2)(vii)(B); 17a-7(f)(2); 17a-8(c)(2); 17d-1(d)(7)(v)(B); 17e-1(c)(2); 17g-1(j)(3)(ii); 18f-3(e)(2); and 23c-3(b)(8)(ii). We rely on the concept of "independence" both in this rule and in our auditor independence rule.* See *Revision of the Commission's Auditor Independence Requirements, Securities Act Release No. 7919 (Nov. 21, 2000) [65 FR 76008 (Dec. 5, 2000)] (adopting release); Revision of the Commission's Auditor Independence Requirements, Securities Act Release No. 7870 (June 30, 2000) [65 FR 43148 (July 12, 2000)] (proposing release). It is important to note, however, that we use the concept in distinct ways in these two rules. In adopting amendments to the auditor independence rule, our goal was to reduce the potential for conflicts of interest that impair the auditor's ability to conduct an objective and impartial audit. Under rules of professional responsibility, attorneys have an obligation zealously to represent their clients.* See *Model Code of Professional Responsibility EC 7-1; see also Model Rules of Professional Conduct ["ABA Model Rules"] Rules 1.2(d), 1.3 and 3.1 (1998). With respect to the independent counsel provisions in this rule, we use "independence" to refer to the limits on relationships with third parties that might affect counsel's capacity to provide zealous representation in advising and representing a fund's independent directors.*

conflicts involved in the transactions and arrangements permitted by the Exemptive Rules make it critical that independent directors, when they seek legal counsel, be represented by persons who are free of significant conflicts of interest that might affect their legal advice.[271]

The Commission received many comments on this proposal. Most fund management companies, and a number of independent directors and their lawyers, opposed the proposed amendments. Many argued that the selection of counsel was a matter that should be left to independent directors. Some argued that the bar association rules of professional conduct are adequate to assure independence of counsel. Others argued that imposing the independent counsel requirement could deny independent directors competent counsel from larger law firms with many potential conflicts.

Given the vital role of independent directors in the resolution of conflicts between the fund and its investment adviser, it is important that they have access to counsel who is free from conflicting loyalties. This is particularly true when directors are called upon to exercise judgment in certain key areas of their responsibilities such as approving the advisory contract or a distribution plan, approving a merger, monitoring the allocation of fund brokerage, or valuing fund securities.[272] Yet, as we observed in the Proposing Release, some independent directors have relied on counsel who has simultaneously represented the fund's adviser, or who does substantial legal work for the adviser or its affiliates.[273] We continue to be concerned by these conflicts and how they affect the ability of directors to carry out their responsibilities under the Act and the Exemptive Rules.

Funds also should be concerned when counsel to the independent directors have these types of conflicts of interest. The appearance of a conflict undermines the confidence investors have in the independence of their fund's directors to represent investors' interests. Directors who accept these conflicts strengthen the argument that more drastic changes are necessary in the way

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[271] *The amendments we are today adopting do not require that independent directors retain an independent counsel, but only that any person who acts as legal counsel to the independent directors be an "independent legal counsel." We requested comment on whether to* require *independent counsel for independent directors. Some commenters supported a requirement while others argued that independent directors should decide for themselves whether they need counsel. We have determined that not requiring independent counsel is the appropriate course at this time. We continue to believe, however, that a likely result of our rule amendments will be that many fund directors seek independent counsel.* See *ABA Task Force Report,* supra *note 16, at 3 ("The complexities of the Investment Company Act, the nature of the separate responsibilities of independent directors and the inherent conflicts of interest between a mutual fund and its managers effectively require that independent directors seek the advice of counsel in understanding and discharging their special responsibilities.").*

[272] *We believe that independent directors' access to independent counsel is also of key importance when directors address questions of the appropriateness and legality (under sections 17(a) and 17(d) of the Act) of proposed transactions between the fund and its promoter, adviser, or principal underwriter (or any other affiliated person). These matters (and those described in the text above) go to the core of matters addressed by the Act and the relationship between the fund, its adviser, and shareholders and may require the directors to deny fund management's wishes. Independent counsel can assist directors in understanding management proposals, their legal implications, and the obligations of directors under the law. When a lawyer for the independent directors - however learned and well-intentioned - also represents the fund's adviser, he may be reluctant to recommend courses of action to the directors that are opposed by the adviser.*

[273] See *Proposing Release,* supra *note 3, at n.80 and accompanying text.*

mutual funds are governed.[274] Fund advisers also should be concerned when independent directors engage counsel with substantial conflicts, because the adviser and the funds may be denied a significant defense in any lawsuit charging that its advisory fee or other payments or transactions are excessive or inappropriate.[275]

While we are persuaded that Commission rulemaking is necessary, we appreciate the concerns that the independent directors expressed in their comment letters on the proposed amendments. Many were concerned that the proposal did not afford them sufficient flexibility in selecting counsel. Some misunderstood our proposal as permitting counsel to have conflicts that are only extremely small or remote. That was not our intention, which we have clarified in revising the proposed amendments.

Under the final rule amendments, reliance on each of the Exemptive Rules would be conditioned on any legal counsel for a fund's independent directors being an "independent legal counsel."[276] A person[277] is considered an independent legal counsel if (i) the independent directors determine that any representation of the fund's investment adviser, principal underwriter, administrator (collectively "management organizations") or their control persons[278] during the

[274]See *Letter from Phillip Goldstein, Independent Director, Clemente Strategic Value Fund, to Jonathan G. Katz, Secretary, SEC (Feb. 1, 2000), File No. S7-23-99 ("shareholders of open-end funds . . . derive no benefit from independent directors"); Letter from George W. Karpus, President, Karpus Investment Management, to Arthur Levitt, Chairman, SEC (Jan. 21, 2000), File No. S7-23-99 (independent directors are not really independent, they are "house" directors "rubberstamping" management decisions); Letter from Weschler, Harwood, Halebian & Feffer, to Jonathan G. Katz, Secretary, SEC, (Jan. 14, 2000), File No. S7-23-99 ("There does not appear to be any credible evidence to support the view that independent directors are cost effective from the standpoint of public investors."). See also Samuel S. Kim, Note,* Mutual Funds: Solving the Shortcomings of the Independent Director Response to Advisory Self-Dealing Through Use of the Undue Influence Standard, *98 Colum. L. Rev. 474 (1998).*

[275]*When deciding excessive advisory fee cases, courts have cited directors' reliance on independent counsel as a factor evidencing director independence and conscientiousness.* See Schuyt v. Rowe Price Prime Reserve Fund, Inc., *663 F. Supp. 962, 965, 982, 986 (S.D.N.Y.) (noting that "[d]uring all relevant times, the independent directors . . . had their own counsel" who was an "important resource" and whose advice "the record indicates the directors made every effort to keep . . . in mind as they deliberated"),* aff'd, *835 F.2d 45 (2d Cir. 1987);* Gartenberg v. Merrill Lynch Asset Management, Inc., *528 F. Supp. 1038, 1064 (S.D.N.Y. 1981) (noting that the "non-interested Trustees were represented by their own independent counsel . . . who acted to give them conscientious and competent advice"), aff'd, 694 F.2d 923 (2d Cir. 1982).*

[276]*As noted above, the amendments as adopted do not require that independent directors retain legal counsel, but only that any person who acts as legal counsel to the independent directors be an "independent legal counsel." See* supra *note 35 and accompanying text. An attorney "acts as legal counsel" if an attorney-client relationship is established between counsel and the independent directors. We do not view a counsel as representing a fund's investment adviser merely because the counsel accepts payment of fees from the adviser for legal services performed on behalf of the fund or its independent directors as permitted by relevant legal ethics rules.* See *Proposing Release,* supra *note 3, at n.87.*

[277]*We are adopting as proposed the definition of "person" as any natural person or a company (including a partnership or other association) as well as a partner, co-member, or employee of any person. Rule 0-1(a)(6)(iv)(A) [17 CFR 270.0-1(a)(6)(iv)(A)]. Thus, the independent directors should examine any conflicting representations of their individual attorney, as well as conflicting representations of that attorney's law firm, partners, and employees.*

[278]*We are adopting as proposed the definition of "control person" as any person-other than a fund-directly or indirectly controlling, controlled by, or under common control with any of the fund's management organizations. Rule 0-1(a)(6)(iv)(B) [17 CFR 270.0-1(a)(6)(iv)(B)].*

past two fiscal years is or was sufficiently limited[279] that it is unlikely to adversely affect the professional judgment of the person in providing legal representation,[280] and (ii) the independent directors have obtained an undertaking from the counsel to provide them information necessary for their determination, and to update promptly that information if the counsel begins, or materially increases, the representation of a management organization or control person.[281]

The final amendments rely on the independent directors to determine whether a person is an independent legal counsel. They must make this determination no less frequently than annually, and the basis for the determination must be recorded in the board's meeting minutes.[282] If the independent directors obtain information that their counsel has begun to represent a management organization or control person, they must determine whether this new representation—together with any other representations of management organizations and control persons—is unlikely to adversely affect the counsel's professional judgment.[283] In order to prevent the fund from losing the availability of the exemptions in these circumstances, the rule provides that counsel can still be considered "independent legal counsel" for up to three months, which will provide time for the independent directors to make a new determination about the counsel or to hire a new independent legal counsel.[284]

In determining whether a counsel is an "independent legal counsel" under the rule, the judgment of the directors is not unbounded; it must be reasonable.[285] The independent directors should consider all relevant factors in evaluating whether the conflicting representations are

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[279]*We have used the phrase "sufficiently limited" instead of "so limited," which we used in the proposal, to provide directors somewhat greater latitude than the proposal. It is our intent, therefore, that the scope of the rule be construed by reference to our discussion in this release and not the Proposing Release.*

[280]*Rule 0-1(a)(6)(i)(A) [17 CFR 270.0-1(a)(6)(i)(A)]. As we stated in the Proposing Release, because the interests of a fund, its shareholders, and its independent directors are nearly always aligned, the independent legal counsel condition does not require independent directors to assess a counsel's representation of the fund itself.* See *Proposing Release,* supra *note 3, at n.94 and accompanying text. We do not consider counsel to the fund or to the fund's adviser to be legal counsel to the independent directors by virtue of the independent directors receiving and relying on advice from such counsel. However, the independent directors should be aware that they do not have their own counsel in those circumstances.*

[281]*Rule 0-1(a)(6)(i)(B) [17 CFR 270.0-1(a)(6)(i)(B)]. A lawyer generally has an obligation to inform his or her client of changes in the nature of conflicts.* See *ABA Model Rules, Rule 1.7 (stating that a client may waive a conflict of interest only after consultation);* see also *ABA Comm. on Ethics and Professional Responsibility, Formal Op. 93-372 (1993) (a client's generic waiver of future conflicts would be invalid if the circumstances of a representation change so that the client's previous waiver was not fully informed when given); ABA Task Force Report,* supra *note 16 (providing specific guidance to independent directors of funds when selecting and using legal counsel, and to counsel who advise independent directors). However, a lawyer's obligations in this regard envision that the lawyer assess the effect of the potential conflict first before informing the client, see ABA Model Rules, Rule 1.7(a)(1), and in any event may vary among different jurisdictions. The provision in our final rule concerning counsel's undertaking is intended to enable the independent directors to obtain the information they need in order to make their own determination about the independence of their counsel.*

[282]*We would not expect that the board meeting minutes would include detailed information such as law firm billing records. We would, however, expect the minutes to include material information the board considered and relied on in making its determination.*

[283]*Rule 0-1(a)(6)(iii). This provision also would apply when conflicts arise as a result of a law firm merger, the hiring of a new partner or associate, the merger of two financial services firms, or as a result of a material increase in the scope or nature of the legal counsel's representation of a management organization.*

[284]Id.

[285]*Rule 0-1(a)(6)(i).*

"sufficiently limited."[286] For example, independent directors should consider (i) whether the representation is current and ongoing; (ii) whether it involves a minor or substantial matter; (iii) whether it involves the fund, the adviser, or an affiliate, and if an affiliate, the nature and the extent of the affiliation; (iv) the duration of the conflicting representation; (v) the importance of the representation to counsel and his firm (including the extent to which counsel relies on that representation economically); (vi) whether it involves work related to mutual funds;[287] and (vii) whether the individual who will serve as legal counsel was or is involved in the representation.[288] Applying these factors, we do not believe that independent directors could ordinarily conclude that a lawyer whose firm simultaneously represents the fund's adviser and independent directors in connection with matters as important to fund shareholders as the negotiation of the advisory contract[289] or distribution plan, or other key areas of conflict between the fund and its adviser, is an "independent legal counsel."[290]

We admonish directors to consider that your decision in selecting an independent counsel is not merely a matter of personal preference (as some commenters suggested), but an important exercise of your business judgment as an independent director.[291] The final rule makes it clear, however, that you are entitled to rely on information provided by counsel in forming your judgment.[292]

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[286]*By adopting these rules, we do not intend to regulate the legal profession or to suggest that the existence of a professional relationship between the independent directors' counsel and a management organization would necessarily violate applicable codes of legal ethics. Moreover, we do not intend to create a presumption that a lawyer having such a professional relationship did not provide proper, objective legal advice, or that the board's reliance on its counsel was improper, or that any determination the board made based on counsel's advice was itself improper.*

[287]*Whether counsel's representation of a management organization (or control person) is unrelated to a fund is a relevant factor for independent directors to consider when determining if the counsel may provide impartial advice to the independent directors. However, it is not a conclusive factor. Even if legal services are unrelated to a fund, those services may be so substantial, significant, or integral to the business of the management organization (or control person) that the independent directors could determine that the counsel is not an "independent legal counsel."*

[288]*We do not intend this list of factors to be an exhaustive or mandatory list of factors the directors must consider.* See, e.g., *ABA Task Force Report,* supra *note 16, at 5-9 (providing guidance on factors that boards may wish to consider when assessing the quality and independence of their counsel).*

[289]*After analyzing the factors, independent directors may, however, conclude that a counsel's representation of a fund's administrator or sub-adviser does not impede that counsel's ability to serve as an "independent counsel" to the independent directors. In evaluating whether representation of an administrator (or its control person) is "sufficiently limited" for the person to be an "independent counsel," we believe a board could differentiate between an administrator that merely performs ministerial tasks and one that has sponsored, organized, or promoted the fund. Independent directors could reach a similar conclusion regarding a sub-adviser. The Act does not distinguish an adviser from a sub-adviser.* See *section 2(a)(20) of the Act [15 U.S.C. 80a-2(a)(20)]. However, we believe that independent directors, in evaluating a counsel's conflicts, could give consideration to the nature of a sub-advisory relationship.*

[290]*The ABA Task Force Report acknowledges that there are circumstances, such as litigation or other "obvious adversarial situations," in which joint or multiple representations may never be appropriate. ABA Task Force Report,* supra *note 16, at 8. We agree, but believe that there are additional circumstances, due to the unique conflicts that are inherent in the structure of investment companies, in which independent directors should not accept joint and multiple representations.*

[291]*As discussed below, the compliance date for the legal counsel provision is July 1, 2002.* See infra *Section III.*

[292]See *rule 0-1(a)(6)(ii). The independent directors are entitled to rely on that information unless they know or have reason to believe that the information is materially false or incomplete.* Id. *As a result, if counsel begins or materially increases the representation of a fund management organization but does not inform the independent directors, the independent directors can rely on the previous representation they received so that counsel's change in representation will not trigger the requirement that the independent directors make a new determination within three months.* See *rule 0-1(a)(6)(iii).*

B. Limits on Coverage of Directors under Joint Insurance Policies

We are adopting an amendment to rule 17d-1(d), which permits funds to purchase "errors and omissions" joint insurance policies for their officers and directors.[293] Currently, many of these policies contain exclusions when parties sue each other. As a result, independent directors of funds may not be covered against lawsuits by the adviser and consequently may be reluctant to take actions necessary to protect fund investors, out of concern for personal liability. Under the amendment, which we are adopting as proposed, rule 17d-1(d) is available only if the joint insurance policy does not exclude coverage for litigation between the adviser and the independent directors.[294] Commenters supported the proposed amendments, and agreed that they would allow independent directors to faithfully carry out responsibilities without concern for personal financial security.

C. Independent Audit Committees

We are adopting new rule 32a-4 exempting funds from the Act's requirement that shareholders vote on the selection of the fund's independent public accountant if the fund has an audit committee composed wholly of independent directors.[295] The rule will permit continuing oversight of the fund's accounting and auditing processes by an independent audit committee, in place of the shareholder vote. Commenters agreed that the shareholder ratification has become largely perfunctory, and that an independent audit committee could exercise more meaningful oversight.

Under the new rule, a fund is exempt from having to seek shareholder approval of its independent public accountant, if (i) the fund establishes an audit committee composed solely of independent directors that oversees the fund's accounting and auditing processes,[296] (ii) the fund's board of directors adopts an audit committee charter setting forth the committee's structure, duties, powers, and methods of operation, or sets out similar provisions in the fund's charter or bylaws,[297] and (iii) the fund maintains a copy of such an audit committee charter.[298] Some commenters questioned whether the proposed rule would require the audit committee to supervise

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[293]*Paragraph (d) of rule 17d-1 provides an exemption from paragraph (a) of the rule, which prohibits a fund affiliate from participating in any joint enterprise, joint arrangement, or profit sharing plan without first obtaining an omission order.*

[294]See *rule 17d-1(d)(7)(iii). The amendments would prohibit exclusions for (i) bona fide (i.e., non-collusive) claims made against any independent director by another person insured under the joint insurance policy, and (ii) claims in which the fund is a co-defendant with an independent director in a claim brought by a co-insured.*

[295]See *section 32(a)(2) of the Act [15 U.S.C. 80a-31(a)(2)].*

[296]*Rule 32a-4(a).*

[297]*Rule 32a-4(b).*

[298]*Rule 32a-4(c). Commenters suggested that we permit the audit committee provisions to be set forth in the charter or bylaws of the fund. The final rule permits the fund either to adopt an audit committee charter or to set forth audit committee provisions in the fund's charter or bylaws. Rule 32a-4(b).*

a fund's day-to-day management and operations. The rule does not require, nor did we intend, that an audit committee perform daily management or supervision of a fund's operations.[299]

D. Qualification as an Independent Director

In addition to the amendments to enhance the independence of fund boards, we are adopting a new rule to prevent qualified individuals from being unnecessarily disqualified from being considered an independent director. We are also rescinding a rule that has become unnecessary.

1. Ownership of Index Fund Securities

We are adopting new rule 2a19-3, which conditionally exempts an individual from being disqualified as an independent director solely because he or she owns shares of an index fund that invests in the investment adviser or underwriter of the fund, or their controlling persons.[300] As proposed, the exemption would have been available if the value of securities issued by the adviser or underwriter (or controlling person) did not exceed five percent of the value of any index tracked by the index fund. The purpose of this condition was to assure that an independent director's indirect interest in the adviser's securities would not be substantial enough to impair his or her independence and create a conflict of interest.[301] In response to some commenters' concerns that monitoring the five percent limit would be very difficult, we revised the rule so that it provides relief if a fund's investment objective is to replicate the performance of one or more "broad-based" indices.[302]

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[299]See *Audit Committee Disclosure, Exchange Act Release No. 41987 (Oct. 7, 1999) [64 FR 55648 (Oct. 14, 1999)] at text following n.26 ("We recognize that how audit committees function may vary from company to company, and companies need flexibility to determine all of the specific duties and functions of their audit committees.").*

[300]*Section 2(a)(19) of the Act disqualifies an individual from being considered an independent director if he or she knowingly has any direct or indirect beneficial interest in a security issued by the fund's investment adviser or principal underwriter, or by a controlling person of the adviser or underwriter. If a fund seeks to replicate the performance of a securities market index that includes securities of the fund's adviser (or principal underwriter or a controlling person of the adviser or principal underwriter), an issue could arise whether the director knowingly has an indirect beneficial interest in the securities of the adviser (or principal underwriter or controlling person).* See *Proposing Release,* supra *note 3, at n.138 and accompanying text.*

[301]*The new rule does not address an independent director's ownership of securities of an actively managed fund that owns shares of the fund's adviser, underwriter or any of their controlling persons. As we discussed in the Proposing Release, we do not believe an independent director who owns shares of an actively managed fund would ordinarily "knowingly" have an indirect beneficial interest in the issuers of securities the fund holds, and thus ownership of such fund would not cause a director to be an "interested person" as defined by section 2(a)(19) of the Act.* See *Proposing Release,* supra *note 3, at n.140.*

[302]*As we stated in the context of Form N-1A, a "broad-based index" is an index that "provides investors with a performance indicator of the overall applicable stock or bond markets, as appropriate. An index would not be considered to be broad-based if it is composed of securities of firms in a particular industry or group of related industries."* See *Disclosure of Mutual Fund Performance and Portfolio Managers, Investment Company Act Release No. 19382 (Apr. 6, 1993) [58 FR 19050 (Apr. 12, 1993)] at n.21.*

2. Affiliation with a Broker-Dealer

We are rescinding rule 2a19-1, which provides relief from the section of the Act that defines when a fund director is considered to be independent.[303] We had proposed to amend that rule to permit a slightly greater percentage of fund independent directors to be affiliated with registered broker-dealers, under certain circumstances. After our proposal, however, Congress passed the Gramm-Leach-Bliley Act, which amended section 2(a)(19) of the Investment Company Act and established new standards for determining independence under the circumstances we addressed in our proposal.[304] These amendments to the Act obviate the need for the exemptive relief provided by rule 2a19-1, and therefore we are rescinding the rule.[305]

E. Disclosure of Information about Fund Directors

We believe that shareholders have a significant interest in knowing who the independent directors are, whether the independent directors' interests are aligned with shareholders' interests, whether the independent directors have any conflicts of interest, and how the directors govern the fund. This information helps a mutual fund shareholder to evaluate whether the independent directors can, in fact, act as an independent, vigorous, and effective force in overseeing fund operations.

In reevaluating our current disclosure requirements, we concluded that, while our fundamental approach has been sound, there are several gaps in the information that shareholders currently receive about directors. We therefore proposed amendments to close these gaps. The proposal would require funds to:

- Provide basic information about directors to shareholders annually so that shareholders will know the identity and experience of their representatives;
- Disclose to shareholders fund shares owned by directors to help shareholders evaluate whether directors' interests are aligned with their own;
- Disclose to shareholders information about directors that may raise conflict of interest concerns; and
- Provide information to shareholders on the board's role in governing the fund.

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[303] *Sections 2(a)(19)(A)(v) and (B)(v) of the Act provide that no person can be an independent director if he or she is, or is affiliated with, a registered broker-dealer.*

[304] *Section 213(a)(1) of the Gramm-Leach-Bliley Act incorporates the conditions of current rule 2a19-1(a)(1) under the Act. As amended, section 2(a)(19) now permits an independent director to be an affiliate of a broker-dealer, but not if the director or his or her affiliate has executed portfolio transactions for, engaged in principal transactions with, or distributed shares for the fund or certain related funds or accounts within the past six months. Pub. L. No. 106-102, §213, 113 Stat. 1338, 1397-98 (1999), to be codified at 15 U.S.C. 80a-2(a)(19)(A)(v) and (B)(v).*

[305] *Under the Administrative Procedure Act [5 U.S.C. 553(b)], notice of proposed rulemaking is not required if the agency for good cause finds "that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Section 213 of the Gramm-Leach-Bliley Act established new standards for determining independence under the circumstances addressed by rule 2a19-1, and the rule is no longer necessary. The Commission therefore finds that proposing the rescission of rule 2a19-1 for public comment is unnecessary.*

We are adopting the disclosure amendments with several modifications designed to tailor the amendments more closely to our goal of providing shareholders with better information to evaluate the independent directors.

1. Basic Information

We are adopting the requirement to disclose basic information about directors in an easy-to-read tabular format, as proposed.[306] The table will be required in three places: the fund's annual report to shareholders, SAI, and proxy statement for the election of directors. The table will require for each director: (1) name, address, and age; (2) current positions held with the fund; (3) term of office and length of time served; (4) principal occupations during the past five years; (5) number of portfolios overseen within the fund complex; and (6) other directorships held outside of the fund complex.[307] The table also requires for each interested director, as defined in Section 2(a)(19) of the Investment Company Act, a description of the relationship, events, or transactions by reason of which the director is an interested person.

Commenters generally supported the proposal, although several commenters opposed as unnecessary the requirement to describe in the table the relationships, events, or transactions that make certain directors "interested persons." Funds are currently required to disclose this information in the proxy statement for the election of directors, and we are adopting this requirement as proposed.[308] We believe it is important that shareholders be provided with an explanation of why certain directors are "interested persons."[309]

2. Ownership of Equity Securities in Fund Complex

We are adopting with modifications the requirement to disclose the amount of equity securities of funds in a fund complex owned by each director.[310] Commenters generally agreed with the Commission that disclosure of this information would be useful to shareholders in assessing whether directors' interests are aligned with those of shareholders.

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[306]*Item 22(b)(1) of Schedule 14A; Items 13(a) and 22(b)(5) of Form N-1A; Item 18.1 and Instruction 4.e. to Item 23 of Form N-2; Item 20(a) and Instruction 4(v) to Item 27 of Form N-3. For convenience in discussing the requirements, we are not specifically referring to nominees for election as directors. The requirements, however, are applicable to nominees in proxy statements for the election of directors. The disclosure requirements in Item 22 of Schedule 14A also are applicable to information statements prepared in accordance with Regulation 14C and Schedule 14C [17 CFR 240.14c-101].*

[307]*In response to privacy concerns raised by several commenters, we wish to clarify that a director may provide the address of the fund or the fund's adviser in the table and need not provide his personal address.*

[308]*Instruction 4 to Item 22(b)(1) of Schedule 14A; Instruction 2 to Item 13(a) of Form N-1A; Instruction 2 to Item 18.1 of Form N-2; Instruction 2 to Item 20(a) of Form N-3.*

[309]*As discussed below, however, we are excluding interested directors from the new conflicts of interest disclosure requirements which we proposed in order to give shareholders better information about independent directors.* See infra *note 84 and accompanying text.*

[310]*Item 22(b)(5) of Schedule 14A; Item 13(b)(4) of Form N-1A; Item 18.7 of Form N-2; Item 20(f) of Form N-3.*

a) Disclosure of Amounts Owned by Directors

Many commenters expressed concern about the proposed requirement that funds disclose the exact dollar amount of securities directors own in a fund complex. These commenters argued that this disclosure would discourage potential directors from agreeing to serve, in order to avoid intrusions into their privacy, and might cause existing directors to reduce or sell their holdings to avoid publicity about their investments. As an alternative, many suggested that we require funds to disclose directors' equity ownership using specified dollar ranges, rather than exact dollar amounts. These commenters noted that using dollar ranges would provide shareholders with sufficient information to assess whether directors' interests were aligned with their own, making disclosure of exact dollar amounts unnecessary.

We are persuaded by these comments and have modified the proposal to require disclosure of a director's holdings of securities using dollar ranges rather than an exact dollar amount. Funds will be required to disclose directors' equity ownership using the following ranges: None; $1-$10,000; $10,001-$50,000; $50,001-$100,000; or over $100,000. We believe that disclosure of directors' holdings using these dollar ranges will provide investors with significant information to use in evaluating whether directors' interests are aligned with their own, while protecting directors' legitimate privacy interests.

b) "Beneficial Ownership"

We received a number of comments requesting clarification about the types of director holdings that would be disclosed under the proposal. Based on these comments, we reevaluated our proposal to require disclosure of securities owned beneficially and of record by each director. Under the proposal, "beneficial ownership" would have been determined in accordance with rule 13d-3 of the Exchange Act, which focuses on a person's voting and investment power.[311] In light of our objective of providing information about the alignment of directors' and shareholders' interests, we believe that disclosure of record holdings should not be required and that the focus of "beneficial ownership" should be on whether a director's economic interests are tied to the securities, rather than his ability to exert voting power or to dispose of the securities. Therefore, we are modifying the proposal to require disclosure of "beneficial ownership" in accordance with the definition contained in rule 16a-1(a)(2) under the Exchange Act.[312] This definition, consistent with our goal, emphasizes the economic incidence of ownership.

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[311] *17 CFR 240.13d-3.*

[312] *17 CFR 240.16a-1(a)(2). We also have modified the proposal requiring disclosure of securities owned by an independent director and his immediate family members in an investment adviser or principal underwriter and persons controlling, controlled by, or under common control with an investment adviser or principal underwriter. This requirement is intended to illuminate potential conflicts of interest, and we therefore believe that any record or beneficial securities ownership in these entities should be disclosed, whether the beneficial ownership results from voting power, investment power, or economic interests. Therefore, we have revised the proposal to require disclosure of securities owned if covered by the definition of "beneficial ownership" contained in either rule 13d-3 or rule 16a-1(a)(2). Item 22(b)(6) and Instruction 2 to Item 22(b)(6) of Schedule 14A; Item 13(b)(5) and Instruction 2 to Item 13(b)(5) of Form N-1A; Item 18.8 and Instruction 2 of Item 18.8 of Form N-2; Item 20(g) and Instruction 2 of Item 20(g) of Form N-3.*

c) Disclosure of Ownership in Funds the Director Oversees within the Same "Family of Investment Companies"

We proposed to require aggregate disclosure of a director's holdings in a fund complex, rather than separate disclosure of a director's holdings in a particular fund. We were concerned that fund-specific information might have limited meaning because of the many reasons that a director could have for not holding shares of any specific fund, *e.g.,* that its investment objective did not fill a need in the director's portfolio. Several commenters recommended, however, that disclosure of a director's holdings should be made on a fund-by-fund basis, rather than a complex-wide basis, arguing that it would be more relevant to disclose to shareholders a director's ownership of the specific funds on whose board the director serves. Other commenters agreed that disclosure of a director's holdings should be on an aggregate basis as proposed, but recommended that the disclosure be limited to a director's aggregate ownership in the funds overseen by a director within a fund complex. These commenters argued that disclosure in this manner is more useful to investors than complex-wide disclosure in assessing whether a director's interests are aligned with their own.

We are persuaded by these comments and have modified the proposal to require disclosure of: (1) each director's ownership in each fund that he oversees; and (2) each director's aggregate ownership in any funds that he oversees within a fund family. We believe that a director's ownership in a particular fund provides the most direct indication of his alignment with the interests of shareholders in that fund. We continue to believe, however, that disclosure of a director's aggregate ownership will provide shareholders with relevant information about the director's alignment with shareholders. In addition, a director could have many reasons for not holding shares of a specific fund, *e.g.,* that its investment objectives do not match the director's. Disclosure of aggregate ownership will help prevent any inappropriate negative inference about fund management that a fund shareholder could draw from the fact that a director does not hold shares of a particular fund.

For purposes of determining a director's holdings in a fund complex, the Commission proposed to define "fund complex" as two or more funds that (1) hold themselves out to investors as related companies for purposes of investment and investor services; or (2) have a common investment adviser or an investment adviser that is an affiliated person of the investment adviser of any of the other funds.[313] Many commenters argued that this definition would result in disclosure of holdings in funds that are too remotely related to funds on whose board the director serves to demonstrate alignment with fund shareholders (*e.g.,* for a director serving on the board of a fund with a sub-adviser, the director's ownership in any other funds that the sub-adviser serves would be disclosed, regardless of whether the funds are otherwise related). These commenters recommended that the Commission adopt a narrower definition of "family of

[313]Cf. *redesignad Item 22(a)(1)(vi) of Schedule 14A (definition of fund complex).*

investment companies," which includes only funds that share the same investment adviser or principal underwriter and hold themselves out to investors as related companies for purposes of investment and investor services.[314] We agree with commenters that the proposed "fund complex" definition could result in disclosure of information having little bearing on a director's alignment with shareholders, and are adopting the narrower definition of "family of investment companies."[315]

d) Date of Disclosure

The equity ownership information must be included in the SAI and any proxy statement relating to the election of directors. For the proxy statement, the equity ownership information must be provided as of the most recent practicable date, as proposed, in order to ensure that shareholders receive up-to-date information when they are asked to vote to elect directors.[316] For the SAI, we have modified the proposal to require that the equity ownership information be provided as of the end of the last completed calendar year.[317]

We believe that this modified time period requirement facilitates our goal that investors receive equity ownership information to evaluate whether directors' interests are aligned with their own, while imposing less of a burden on directors, especially those who serve multiple funds with staggered fiscal years.

3. Conflicts of Interest

We are adopting our proposals on conflicts of interest disclosure, with modifications that tailor the requirements more closely to our goals and address commenters' concerns that some aspects of the proposal were overbroad.[318] We proposed to require funds to disclose in the proxy statement and SAI three types of circumstances that could affect the allegiance of fund directors to their shareholders: positions, interests, and transactions and relationships of directors and their immediate family members with the fund and persons related to the fund. The rules we adopt today follow this basic approach.

A number of commenters recommended alternatives to the proposed conflicts of interest disclosure requirements, including: (i) requiring funds to maintain records of potential conflicts of interest of directors; (ii) permitting independent directors to determine for themselves whether or not conflicts of interest exist that affect the "independence" of other independent directors; and (iii) limiting conflicts of interest disclosure to the proxy statement for the election of directors. After careful consideration of these alternatives, we have determined that they would not constitute an adequate substitute for disclosure to shareholders.

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[314]Cf. *Item H of Form N-SAR [17 CFR 274.101] (definition of "family of investment companies").*

[315]*Item 22(a)(1)(iv) of Schedule 14A; Instruction 1(a) to Item 13 of Form N-1A; Instruction 1.a to Item 18 of Form N-2; Instruction 1.a to Item 20 of Form N-3.*

[316]*Instruction 1 to Item 22(b)(5) of Schedule 14A.*

[317]*Instruction 1 to Item 13(b)(4) of Form N-1A; Instruction 1 to Item 18.7 of Form N-2; Instruction 1 to Item 20(f) of Form N-3.*

[318]*Items 22(b)(4), 22(b)(6), 22(b)(7), 22(b)(8), 22(b)(9), and 22(b)(10) of Schedule 14A; Items 13(b)(3), 13(b)(5), 13(b)(6), 13(b)(7), 13(b)(8), and 13(b)(9) of Form N-1A; Items 18.6, 18.8, 18.9, 18.10, 18.11, and 18.12 of Form N-2; Items 20(e), 20(g), 20(h), 20(i), 20(j), and 20(k) of Form N-3.*

We continue to believe that shareholders have a significant interest in information concerning circumstances that may affect the directors' allegiance to shareholders. None of the alternatives suggested by commenters would provide this information to shareholders on a regular basis. The first two alternatives would completely exclude shareholders from the process of evaluating the independence of directors. The third alternative, limiting conflicts of interest disclosure to the proxy statement for the election of directors, ignores the fact that the proxy statement has become an ineffective vehicle for communicating information to fund shareholders on a regular basis because funds generally are no longer required to hold annual meetings.[319]

a) Modifications to Persons Covered

*(1) **Interested Directors***

We are modifying our proposal to exclude interested directors from the conflicts of interest disclosure requirements in both the SAI and proxy statement.[320] We are persuaded by the commenters' arguments that if the purpose of the conflicts of interest disclosure is to allow investors and the Commission staff to better evaluate the true independence of independent directors, this goal will not be achieved by requiring disclosure of interested directors' potential conflicts of interest. As previously discussed, however, funds will be required to describe the relationships, events, or transactions that make a director an interested person.[321]

*(2) **Immediate Family Members***

We are narrowing the scope of "immediate family members" covered by the disclosure requirements to a director's spouse, children residing in the director's household, and dependents of the director.[322] As proposed, "immediate family members" also included the director's parents, siblings, children not residing with the director, and in-laws.[323]

We received many comments on this definition, with the overwhelming majority of commenters arguing that the proposed extension of conflicts of interest disclosure to include a director's immediate family members, as defined in the proposal, was overly broad and too burdensome. Commenters noted that the definition, as proposed, would require directors to seek financial information from remote family members with whom they have little or no contact, and that the requirement could impose liabilities on directors without providing the means to

[319]See *Proposing Release*, supra *note 3, at n.149 and accompanying text.*

[320]*Items 22(b)(4), 22(b)(6), 22(b)(7), 22(b)(8), 22(b)(9), and 22(b)(10) of Schedule 14A; Items 13(b)(3), 13(b)(5), 13(b)(6), 13(b)(7), 13(b)(8), and 13(b)(9) of Form N-1A; Items 18.6, 18.8, 18.9, 18.10, 18.11, and 18.12 of Form N-2; Items 20(e), 20(g), 20(h), 20(i), 20(j), and 20(k) of Form N-3.*

[321]See supra *note 73 and accompanying text. In addition, we are retaining the existing requirement that funds disclose positions held by interested directors with affiliated persons or principal underwriters of the fund. Item 22(b)(2) of Schedule 14A; Item 13(a)(2) of Form N-1A; Item 18.2 of Form N-2; Item 20(b) of Form N-3.*

[322]*Item 22(a)(1)(vii) of Schedule 14A; Instruction 1(c) to Item 13 of Form N-1A; Instruction 1.c to Item 18 of Form N-2; Instruction 1.c to Item 20 of Form N-3. The term "children" includes step and adoptive children. We are using the term "dependent" as defined in section 152 of the Internal Revenue Code. I.R.C. 152.*

[323]*Proposed Item 22(a)(vi) of Schedule 14A; Proposed Instruction 1(b) to Item 13 of Form N-1A; Proposed Instruction 1.b. to Item 18 of Form N-2; Proposed Instruction 1.b. to Item 20 of Form N-3.*

enable directors to obtain the required information from reluctant relatives. We are persuaded by the commenters and have addressed their concerns by limiting the definition of "immediate family members" along the lines suggested by many commenters. The narrower definition ensures that disclosure will only be required with respect to family members from whom directors can reasonably be expected to obtain the required information.[324]

(3) ***Related Persons***

The Commission proposed to require disclosure about circumstances involving directors, on the one hand, and the fund and persons related to the fund, on the other. We are modifying the proposal to exclude administrators from the persons related to the fund that are covered by the requirements. Several commenters expressed concern that inclusion of administrators that are not affiliated with the fund's adviser or principal underwriter would produce irrelevant and unnecessary information for shareholders because interactions between directors and unaffiliated administrators would not create conflicts of interest that could affect an independent director's judgment. We are persuaded by these commenters and note that administrators that control, are controlled by, or are under common control with the adviser or principal underwriter will be covered by the conflicts of interest disclosure.[325]

While some commenters also recommended excluding entities "under common control" with the adviser or principal underwriter, we believe that disclosure of interests, positions, and transactions and relationships with entities under common control is important and could highlight circumstances that potentially could affect the judgment of independent directors. We also note that the current proxy rules require disclosure with respect to commonly controlled entities.[326]

Although we are narrowing the scope of immediate family members and related persons in recognition of the overbreadth of our proposal in certain circumstances, we wish to emphasize that a fund's independent directors can vigilantly represent the interests of shareholders only when they are truly independent of those who operate and manage the fund. To that end, we encourage funds to examine any circumstances that could potentially impair the independence of independent directors, whether or not they fall within the scope of our disclosure requirements.

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[324]*A number of commenters recommended that if the Commission adopted the proposed definition of "immediate family members," disclosure of potential conflicts of interest should be limited to those of which the director had actual knowledge. Since we are narrowing the definition of "immediate family member," incorporation of an actual knowledge standard is unnecessary.*

[325]*Items 22(b)(4)(iv), 22(b)(6)(ii), 22(b)(7)(ii), 22(b)(8)(vii), 22(b)(9), and 22(b)(10)(iii) of Schedule 14A; Items 13(b)(3)(iv), 13(b)(5)(ii), 13(b)(6)(ii), 13(b)(7)(vii), 13(b)(8), and 13(b)(9)(iii) of Form N-1A; Items 18.6(d), 18.8(b), 18.9(b), 18.10(g), 18.11, and 18.12(c) of Form N-2; Items 20(e)(iv), 20(g)(ii), 20(h)(ii), 20(i)(vii), 20(j), and 20(k)(iii) of Form N-3.*

[326]See *Item 22(b)(1) of Schedule 14A (requiring independent directors to disclose direct or indirect securities interests in any person under common control with fund's adviser); Item 22(b)(3) (requiring all directors to disclose material transactions to which the adviser, principal underwriter, administrator, any parent or subsidiary of such entities (other than another fund), or any subsidiary of the parent of such entities was or is to be a party).*

There may, for example, be circumstances where an interest of a family member outside the ambit of our rules, or a director's interest in an administrator, impairs the director's ability to represent the interests of shareholders vigilantly.

b) Other Modifications

*(1) **Threshold for Disclosure of Interests, Transactions, and Relationships***

We are adopting a $60,000 threshold for disclosure of interests, transactions, and relationships.[327] Many commenters requested that the Commission establish a specific dollar threshold that would trigger the disclosure requirements to eliminate the need to make subjective "materiality" determinations. We are persuaded by these comments and are adopting the $60,000 threshold, a level recommended by many commenters and contained in the existing proxy rules.[328]

We have replaced a materiality test with the $60,000 threshold in order to facilitate compliance with the disclosure requirements that we adopt today. This change does not, however, reflect a determination that the $60,000 threshold may be equated with "materiality." We note that the antifraud provisions of the federal securities laws may obligate funds to disclose a material conflict of interest between a director and the fund or its shareholders without regard to the $60,000 threshold. For example, a transaction between a director and a fund's adviser may constitute a material conflict of interest with the fund or its shareholders that is required to be disclosed, regardless of the amount involved, if the terms and conditions of the transaction are not comparable to those that would have been negotiated at "arms-length" in similar circumstances.

*(2) **Time Periods***

We are adopting, as proposed, a five-year time period for disclosure of positions and interests of directors and immediate family members in the proxy statement for the election of directors.[329] We are, however, reducing the time period for disclosure of positions and interests in the SAI to two calendar years.[330] We believe that, when a shareholder is asked to vote to elect

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[327]*Items 22(b)(7), 22(b)(8), and 22(b)(9) of Schedule 14A; Items 13(b)(6), 13(b)(7), and 13(b)(8) of Form N-1A; Items 18.9, 18.10, and 18.11 of Form N-2; Items 20(h), 20(i), and 20(j) of Form N-3. In the case of transactions, the $60,000 threshold applies to the size of a transaction, and a materiality standard applies to the director's or immediate family member's interest in the transaction. Item 22(b)(8) of Schedule 14A; Item 13(b)(7) of Form N-1A; Item 18.10 of Form N-2; Item 20(i) of Form N-3. The materiality of the interest is to be determined based on the significance of the information to investors in light of all the circumstances. Instruction 8 to Item 22(b)(8) of Schedule 14A; Instruction 7 to Item 13(b)(7) of Form N- 1A; Instruction 7 to Item 18.10 of Form N-2; Instruction 7 to Item 20(i) of Form N-3. This is similar to a provision of the current proxy rules. Item 404(a) of Regulation S-K.*

[328]Cf. *redesignated Item 22(b)(11) of Schedule 14A; Item 404(a) of Regulation S-K. In determining whether the $60,000 threshold is exceeded for interests and relationships, a director's interest is to be aggregated with those of his immediate family members. Instruction 2 to Item 22(b)(7) and Instruction 6 to Item 22(b)(9) of Schedule 14A; Instruction 2 to Item 13(b)(6) and Instruction 5 to Item 13(b)(8) of Form N-1A; Instruction 2 to Item 18.9 and Instruction 5 to Item 18.11 of Form N-2; Instruction 2 to Item 20(h) and Instruction 5 to Item 20(j) of Form N-3.*

[329]*Items 22(b)(4) and 22(b)(7) of Schedule 14A.*

[330]*Items 13(b)(3) and 13(b)(6) of Form N-1A; Items 18.6 and 18.9 of Form N-2; Items 20(e) and 20(h) of Form N-3.*

directors, he is entitled to information about potential conflicts covering a significant period of time.[331] We recognize, however, that providing five years of information annually in the SAI, would, as suggested by commenters, increase fund compliance burdens without commensurate benefits to shareholders.

We are adopting, as proposed, the requirement to disclose material transactions and relationships since the beginning of the last two completed fiscal years in the proxy statement for the election of directors.[332] In the SAI, however, we have modified the proposal to require disclosure of transactions and relationships during the two most recently completed calendar years, rather than the last two fiscal years as proposed.[333]

Many commenters noted that a director may serve multiple funds with staggered fiscal years and that a requirement to disclose transactions and relationships for fiscal year time periods could require funds to obtain the information from directors as frequently as monthly, which would be overly burdensome. We have revised the proposal to require two calendar years of disclosure, rather than two fiscal years, in order to reduce this burden for funds with staggered fiscal years, while maintaining the requirement to include two years of disclosure.[334]

(3) ***Routine, Retail Transactions and Relationships***

As proposed, the conflicts of interest disclosure provisions would not have required a fund to disclose routine, retail transactions and relationships, such as a credit card or bank or brokerage account, unless the director is accorded special treatment. At the request of commenters, we are clarifying that the exception for routine, retail transactions and relationships extends to residential mortgages and insurance policies.[335] We also note that the exception for routine, retail

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[331] *Several commenters recommended that the Commission limit all conflicts of interest disclosure to a two-year period. These commenters argued that a two-year time period is consistent with the time limit for material business or professional relationships in section 2(a)(19) of the Act. We note, however, that the five-year time period for disclosure of positions and interests is currently required in the proxy rules. In fact, when the amendments to the proxy rules were adopted in 1994, most of the commenters that addressed the issue of time periods recommended limiting the disclosure of past relationships to the preceding five-year period.* See *Investment Company Act Rel. No. 20614 (Oct. 13, 1994) [59 FR 52689 (October 19, 1994)].*

[332] *Items 22(b)(8) and 22(b)(9) of Schedule 14A.*

[333] *Items 13(b)(7) and 13(b)(8) of Form N-1A; Items 18.10 and 18.11 of Form N-2; Items 20(i) and 20(j) of From N-3.*

[334] *We also have modified the proposal to require funds to disclose in the SAI cross-directorships held by independent directors and their immediate family members during the last two most recently completed calendar years, rather than the last two fiscal years as proposed. Item 13(b)(9) of Form N-1A; Item 18.12 of Form N-2; Item 20(k) of Form N-3.*

[335] *Instruction 11 to Item 22(b)(8) and Instruction 9 to Item 22(b)(9) of Schedule 14A; Instruction 10 to Item 13(b)(7) and Instruction 8 to Item 13(b)(8) of Form N-1A; Instruction 10 to Item 18.10 and Instruction 8 to Item 18.11 of Form N-2; Instruction 10 to Item 20(i) and Instruction 8 to Item 20(j) of Form N-3. We also note that sales load waivers granted to fund directors generally would not be required to be disclosed as "material" transactions or relationships, provided that such waivers are disclosed as otherwise required.* See *Instruction 3 to Item 18(c) of Form N-1A; Instruction 3 to Item 5.2 of Form N-2; Instruction to Item 23(b) of Form N-3 (requiring funds to provide explanations for any differences in the price at which securities are offered generally to the public and the prices at which securities are offered to any class of individuals).*

transactions and relationships is not limited to the specific transactions and relationships enumerated (credit cards, bank or brokerage accounts, residential mortgages, and insurance policies), but extends to other routine, retail transactions and relationships where the director is not accorded special treatment.

4. Board's Role in Fund Governance

We are adopting, as proposed, disclosure requirements in the proxy rules and the SAI relating to a fund's committees of the board of directors, which commenters generally supported.[336] We are also adopting, as proposed, the requirement to disclose in the SAI the board's basis for approving an existing investment advisory contract.[337]

A number of commenters argued that information about the board's basis for approving an existing advisory contract is not relevant to an investment decision and disclosure of this information will be "boilerplate" in nature. After careful consideration of these comments, we continue to believe that shareholders should receive information in the SAI to help them evaluate the board's basis for approving the renewal of an existing investment advisory contract. In approving an investment advisory contract, independent directors must review the level of fees charged. Mutual funds fees and expenses, including advisory fees, are extremely important to shareholders. We note that the United States General Accounting Office ("GAO"), in a recent report to Congress on mutual fund fees, stressed the importance of heightening "investors' awareness and understanding of the fees they pay."[338] We believe that the rules we adopt today, which will ensure that shareholders receive specific information on how directors evaluate and approve fees on a regular basis, will help to address the GAO's concerns. In implementing this disclosure requirement, we remind funds that "boilerplate" disclosure is not appropriate. Funds are required to provide appropriate detail regarding the board's basis for approving an existing investment advisory contract, including the particular factors forming the basis of this determination.

5. Separate Disclosure

We are adopting, as proposed, the requirement that funds present all disclosure for independent directors separately from disclosure for interested directors in the SAI, proxy statements for the election of directors, and annual reports to shareholders.[339] While several commenters argued that this requirement would confuse shareholders by overemphasizing the differences between independent and interested directors, we believe that the new disclosure format will assist shareholders in understanding information about directors, particularly in

[336]*Items 7(e) and 22(b)(14) of Schedule 14A; Item 13(b)(2) of Form N-1A; Item 18.5 of Form N-2; Item 20(d) of Form N-3.*

[337]*Item 13(b)(10) of Form N-1A; Item 18.13 of Form N-2; Item 20(l) of Form N-3.*

[338]*United States General Accounting Office, Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition (June 2000) at 97.*

[339]*Instruction 3 to Item 22(b) of Schedule 14A; Instruction 2 to Item 13 of Form N-1A; Instruction 2 to Item 18 of Form N-2; Instruction 2 to Item 20 of Form N-3.*

evaluating whether the independent directors can, in fact, act as an independent, vigorous, and effective force in overseeing fund operations.[340]

6. Technical and Conforming Amendments

The Commission is adopting, as proposed, the technical and conforming amendments to its schedules, forms, and rules.

F. Recordkeeping Regarding Director Independence

We are adopting as proposed the amendments to rule 31a-2, to require funds to preserve for a period of at least six years any record of: (i) the initial determination that a director qualifies as an independent director, (ii) each subsequent determination of whether the director continues to qualify as an independent director, and (iii) the determination that any person who is acting as legal counsel to the independent directors is an independent legal counsel.[341] The rule amendments, which commenters supported, are designed to permit the Commission staff to monitor a fund's assessment of the independence of directors, and to ascertain whether a fund's assessment reflects diligent efforts to evaluate relevant business and personal relationships that might affect each director's independent judgment.[342]

III. EFFECTIVE DATE; COMPLIANCE DATES

A. Effective Date

The new rules and amendments to rules and forms that the Commission is adopting today will become effective February 15, 2001. The rescission of rule 2a19-1 will become effective on May 12, 2001, the effective date of section 213 of the Gramm-Leach-Bliley Act.

B. Compliance Dates for Investment Company Act Rule Amendments

1. *February 15, 2001.* Persons may begin to rely upon new rules 2a19-3, 10e-1 and 32a-4 on February 15, 2001, the effective date of these rules.

2. *July 1, 2002.* After July 1, 2002: (i) persons may rely upon any of the Exemptive Rules (rules 10f-3, 12b-1, 15a-4(b)(2), 17a-7, 17a-8, 17d-1(d)(7), 17e-1, 17g-1(j), 18f-3, and 23c-3) only if they comply with each of the three new conditions for use of each rule; (ii) persons may rely upon rule 17d-1(d)(7) only if any joint insurance policy then in effect does not exclude coverage of litigation between the independent directors and another insured person under the

[340]*We reiterate that funds may present information regarding independent and interested directors in a single table or chart, so long as the information for independent and interested directors is provided in separate sections within the table or chart.* See *Proposing Release,* supra *note 3, at text accompanying and following n.226.*

[341]See *rule 31a-2(a)(4), (5).*

[342]*For a discussion of the Commission staff's views on the types of professional and business relationships that may be considered material for purposes of sections 2(a)(19)(A)(vi) and (B)(vi) of the Act, see Interpretive Matters Concerning Independent Directors of Investment Companies, Investment Company Act Release No. 24083 (Oct. 14, 1999) [64 FR 59877 (Nov. 3, 1999)].*

amended rule;[343] and (iii) funds must begin to comply with the recordkeeping requirements of amended rule 31a-2.

C. Compliance Date for Disclosure Amendments

January 31, 2002. All new registration statements and post-effective amendments that are annual updates to effective registration statements, proxy statements for the election of directors, and reports to shareholders filed on or after January 31, 2002 must comply with the disclosure amendments. Based on the comments, we believe that this will provide funds with sufficient time to make the necessary changes to disclosure documents. We note that a post-effective amendment that is filed for any purpose other than those specifically enumerated in paragraph (b)(1) of rule 485 is required to be filed pursuant to rule 485(a).[344] We would not, however, object if existing funds file their first annual update complying with the amendments pursuant to rule 485(b), unless information is included in response to the new conflicts of interest disclosure requirements, provided that the post-effective amendment otherwise meets the conditions for immediate effectiveness under the rule.[345] Thereafter, funds must make their own determination as to whether their annual updates should be filed pursuant to rule 485(a) or may be filed pursuant to rule 485(b) under the Securities Act.[346]

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[343] See *rule 17d-1(d)(7)(iii).*

[344] *17 CFR 230.485.*

[345] *17 CFR 230.485(b). This also would apply to closed-end interval funds filing post-effective amendments pursuant to rule 486(b) under the Securities Act. 17 CFR 230.486(b).*

[346] *17 CFR 230.485(a) and 230.485(b). Likewise, closed-end interval funds filing future post-effective amendments must determine whether they must file pursuant to rule 486(a) or may file pursuant to rule 486(b) under the Securities Act. 17 CFR 230.486(a) and 230.486(b).*

1983 GUIDELINES FOR FORM N-1A
(Rescinded in 1998 with Adoption of New Form N-1A)

Consistent with the Commission's practice of publishing the views of the staff to assist issuers, their counsel, accountants, and others concerned with complying with applicable provisions of the federal securities laws, this section sets forth guidelines prepared by the Division of Investment Management for use in the preparation and filing of registration statements for open-end management investment companies on Form N-l A.

The guidelines consist of a compilation and adaptation of applicable Commission releases and staff positions and interpretations. It is anticipated that adherence to these guidelines will substantially expedite the examination by the Division's staff of registration statements on Form N-lA. The policies embodied in these guidelines will be changed as experience or altered factual situations require, or should the form itself be changed.

Registrants should be aware that these guidelines are not rules of the Commission and, except as noted herein, represent the views of the staff of the Division of Investment Management rather than an official position of the Commission. The guidelines should be read in conjunction with the Investment Company Act releases cited herein.

Guide 1. Name of Registrant.

The registrant's name, as set forth in Item 1 and Item 10, must be consistent with the provisions of Section 35 of the Investment Company Act of 1940. Section 35(d) provides in effect that a registered investment company may not use a name or title which may be deceptive or misleading. If the registrant's name suggests a certain type of investment policy, its name should be consistent with its statement of investment policy.

If a fund has a name that implies that its distributions will be exempt from federal income taxation it should have a fundamental policy requiring that during periods of normal market conditions either: (1) the fund's assets will be invested so that at least 80 percent of the income will be tax-exempt; or (2) the fund will have at least 80 percent of its net assets invested in tax-exempt securities.[347]

If the registrant's name implies that it will invest primarily in a particular type of security, other than money market instruments or tax-exempt bonds, or in a certain industry or industries, the registrant should have an investment policy that requires that, under normal circumstances, at least 65 percent of the value of its total assets will be invested in the indicated type of security or industry.[348]

Further, the registrant's name may not be so similar to the name of an existing investment company as to cause confusion in identifying the investment company.

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[347] *Investment Company Act Release No. 9785 (May 31, 1977).*

[348] *See Guide 19.*

For guidance in responding to Items 1 and 10, the registrant should refer to Investment Company Act Release No. 5510 (October 8, 1968), which inter alia, concerns the proprietary rights of an investment company and its adviser in the company's name.

Guide 2. Dating the Prospectus and Statement of Additional Information.

The date of the prospectus required by Rules 423 and 482 should be set forth on the cover page of the prospectus in response to Item 1. For the purposes of Form N-l A, the date of the prospectus should be the approximate date of its effectiveness. In response to Item 10, the date of the prospectus to which Part B relates should be included on the cover page of Part B.

Guide 3. Investment Objective and Policies.

In the response to Item 4, the registrant's investment objective and policies (including the types of securities in which it which it will invest) should be clearly and concisely stated in the prospectus so that they may be readily understood by the investor. Because the circumstances of each registrant will vary, it is not possible to define precisely what level of investment would make a particular type of investment one in which the registrant invests "principally," as that term is used in Item 4. As a general matter, however, the level of disclosure as to a particular type of investment should be consistent with the prominence of that type of investment in the registrant's portfolio. The prospectus should emphasize the main types of investments the registrant proposes to make and the basic risks inherent in such investments. Accordingly, discussions of types of investments that will not constitute the registrant's principal portfolio emphasis should be as brief as possible and, in many cases, may be limited to identifying the particular type of investment. (As discussed below, the instructions delineate certain circumstances in which disclosure may be so limited.) Similar treatment should be accorded to other types of practices, such as borrowing money. In order to achieve the objective of clear and concise disclosure, registrants should avoid extensive legal and technical detail and need not discuss every possible contingency, such as remote risks.[349]

Pursuant to Item 4(b) (i), registrant should omit from the prospectus disclosure about so-called negative investment policies, that is, policies that prohibit a particular type of investment or practice. This item may have particular applicability to those types of activities for which Section 8(b) of the 1940 Act specifically requires that there be information in the registration statement. Although Item 4 generally does not attempt to define what or how much disclosure should be made about particular practices, Item 4(b) (ii) calls for minimal disclosure of policies registrant will not follow to a significant extent. Specifically, if not more than five percent of the registrant's net assets will be at risk, the prospectus should merely identify the policy or practice. For example, it a registrant planned to invest no more than five percent of its net assets in speculative growth stocks, it would be sufficient to state that policy in the prospectus without elaboration.

[349] *See individual subject headings of these guidelines concerning disclosure for specific investment techniques or policies.*

The response to Item 13 should include a fuller discussion in the Statement of Additional Information of those investment policies of the registrant with respect to which an abbreviated or no narrative description is included in the prospectus. Fuller descriptions of the registrant's principal types of investments may also be appropriate, depending on the circumstances. The non-use of a policy in the past, as well as the registrant's intention with respect to that policy in the coming year, should also be disclosed in the Statement of Additional Information in responding to Item 13.

Guide 4. Types of Securities.

Item 4 requires the registrant to discuss in the prospectus the types of securities in which it will invest to attain its investment objective. If the name of the registrant implies investment in a particular type of security (e.g., Common Stock Fund), its policy should be consistent with its name (see Guide 1). The relative proportions of the registrant's assets to be invested in debt or equity securities need not be stated in terms of a percentage of total assets. However, a company which purports to be a "balanced" fund should maintain at least 25 percent of the value of its assets in fixed income senior securities. In such case, if convertible senior securities are included in the required 25 percent, only that portion of their value attributable to their fixed income characteristics can be used in calculating the 25 percent figure.

If the registrant intends to invest in foreign securities, real estate or make loans, reference should be made to Guide 21, 12, or 13, respectively.

Generally, the board purpose clauses of corporate charters are not pertinent insofar as a response to Item 4 is concerned; however, if a charter limits the registrant to a particular type of security, such limitation should be set forth.

If an open-end company holds a material percentage of its assets in securities or other assets for which there is no established market, there may be a question concerning the ability of the fund to make payment within seven days of the date its shares are tendered for redemption. The usual limit on aggregate holdings by an open-end investment company of illiquid assets is 15 percent of its net assets. An illiquid asset is any asset which may not be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the mutual fund has valued the investment. See Investment Company Act Release No. 14983 (Mar. 12, 1986).

Guide 5. Portfolio Turnover.

In discussing investment techniques in response to Item 4, the registrant should briefly discuss in the prospectus the probable effect of such techniques on the registrant's rate of total portfolio turnover, if such effects will be significant and if portfolio turnover will have brokerage, tax or other significant consequences. If the registrant has had a portfolio turnover rate of approximately 100 percent or more, or, if the registrant anticipates it will have such a portfolio turnover rate, the brief discussion should include any tax and brokerage consequences which will

result from the higher portfolio turnover rate. Appropriate cross-references to the sections of the prospectus which discuss income taxes and brokerage practices should follow such discussion. In responding to Item 13, the registrant should include in the Statement of Additional Information a discussion of portfolio turnover if no disclosure has been included in the prospectus or to supplement the disclosure in the prospectus. New companies, other than money market funds, should estimate what rate of portfolio turnover will, generally, not be exceeded (e.g., 50 percent, 100 percent, 150 percent etc.). A company already in existence should disclose the rate of portfolio turnover for each of the past two years (but not including the period prior to the date the company's first registration statement under the Securities Act of 1933 became effective).

A "balanced fund," or other fund which invests substantial portions of its assets in both common stock and debt securities or preferred stock, should describe its portfolio turnover policy with respect to the common stock portion of its portfolio separately from the discussion of its portfolio turnover policy with respect to the other portion of its portfolio.[350]

Guide 6. Business History.

The registrant should list in the Statement of Additional Information all prior names for the past five years in response to Item 12. In the case of newly organized companies, the response should state that the registrant has no prior history.

Guide 7. The Borrowing of Money.

If the registrant intends to borrow from a bank or to offer debt securities privately as a part of its investment policy, its intention should be stated in the prospectus in response to Item 4. If such borrowing will be limited to no more than five percent of net assets, a simple statement to that effect will suffice. If registrant will engage in a higher level of borrowing, the purposes and consequences of such borrowing should be concisely discussed. Additional disclosure should be included in the Statement of Additional Information in response to Item 13.

Open-end companies are permitted to borrow from banks pursuant to the provisions of Section 18(f) of the Act. Under Section 18(g) of the Act, certain borrowings for temporary purposes are also permitted. A registrant may not borrow amounts in excess of five percent of the value of its total assets for any reason without first obtaining shareholder approval, unless the registrant has so provided in the prospectus in response to Item 4. Generally, the prospectus need not restate provisions of law limiting borrowing by the registrant.

Because borrowings involve the creation of a senior security, Guide 8 should also be consulted.

Guide 8. Senior Securities, Reverse Repurchase Agreements, Firm Commitment Agreements and Standby Commitment Agreements.

Section 18(f) of the 1940 Act prohibits the issuance of senior securities by open-end companies, except that borrowings from banks are permitted so long as the requisite asset coverage has

[350] *See Guide 4.*

been provided. Policies with respect to such borrowing should be set forth in the prospectus in response to Item 4, or in the Statement of Additional Information in response to Item 13 depending upon the significance of such policies (see Guide 7).

The registration statement should provide concise but clear disclosure of all pertinent information regarding the nature and consequences of the investment company's participation in securities trading practices such as reverse repurchase agreements, firm commitment agreements, and standby commitment agreements.[351] The extent to which such disclosure should be included in the prospectus will depend on the level of registrant's involvement in such practices (see Guide 3). The registration statement should address the potential risk of loss presented to an investment company and its investors by those transactions; the identification of the securities trading practices as separate and distinct from the underlying securities; the differing investment goals inherent in participating in the securities trading practices as compared to those of investing in the underlying securities; (i.e., securities used as collateral for the trading practices); and any other material information relating to such practices and the investment company's participation therein. In addition, in response to Item 1, the registrant should ensure that its name is not misleading in light of its securities trading practices.

Guide 9. Short Sales.

The staff is of the opinion that a short sale involves the creation of a senior security and is, therefore, subject to the limitations of Section 18 of the 1940 Act. The staff has taken the position that in order to comply with the provisions of Section 18, the selling registrant must put in a segregated account (not with the broker) an amount of cash or United States government securities equal to the difference between: (a) the market value of the securities sold short at the time they were sold short, and (b) any cash or United States government securities required to be deposited as collateral with the broker in connection with the short sale (not including the proceeds from the short sale). In addition, until the registrant replaces the borrowed security, it must daily maintain the segregated account at such a level that: (1) the amount deposited in it plus the amount deposited with the broker as collateral will equal the current market value of the securities sold short, and (2) the amount deposited in it plus the amount deposited with the broker as collateral will not be less than the market value of the securities at the time they were sold short.[352]

The practice of effecting a short sale is distinguishable from the practice of selling short "against the box." While a short sale is made by selling a security the company does not own, a short sale is "against the box" to the extent that the company contemporaneously owns or has the right to obtain at no added cost securities identical to those sold short. Accordingly, the procedures described above concerning short sales that are subject to the limitations of Section 18 of the 1940 Act need not be applied to short sales to the extent that they are "against the box."

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[351] *For a more complete discussion of reverse repurchase agreements, firm commitment agreements, and standby commitment agreements, see Investment Company Act Release No. 10666 (April 18, 1979).*

[352] *Investment Company Act Release No 7221 (June 9, 1972).*

If the registrant expects to engage in short sales, and short sales "against the box," its policy and the effect of such policy should be described in the registration statement. The extent to which such description should be included in the prospectus will depend upon the level of the registrant's involvement in short sales (see Guide 3). The registration statement should include: (1) an explanation of the requirement of collateral and a segregated account; (2) the maximum percentage of the value of the registrant's net assets that will be, when added together: (a) deposited as collateral for the obligation to replace securities borrowed to effect short sales, and (b) allocated to segregated accounts in connection with short sales; and (3) the impact that short sales may have on income taxes.[353]

Guide 10. Purchases on Margin.

In view of the prohibition contained in Section 18 of the 1940 Act against the issuance of senior securities by open-end companies, except in connection with a borrowing from a bank, the staff's current interpretation is that open-end companies may not establish or use a margin account with a broker for the purpose of effecting securities transactions on margin.[354]

Guide 11. Underwriting Securities of Other Issuers.

Although the acquisition of restricted securities (securities that must be registered under the Securities Act of 1933 before they may be offered or sold to the public) might not be deemed to be an underwriting commitment within the meaning of Section 12(c) of the 1940 Act, a registrant having a policy permitting the purchase of such securities should describe that policy in the prospectus in response to Item 4 if such restricted securities constitute 10 percent of the registrant's portfolio securities. Otherwise, registrant's policy with respect to restricted securities should be described in response to Item 13.

Note. If an open-end company holds a material percentage of its assets in restricted securities, such holdings may raise questions concerning valuation and the ability of the company to make payment within seven days of the date its shares are tendered for redemption. (See also Guides 13 and 27.)

Guide 12. Purchase and Sale of Real Estate.

It is the staff's position that an interest in real estate includes securities (other than marketable securities) of companies whose assets consist substantially of real property and interests therein, including mortgages and other liens, but does not include securities of companies whose investments in real estate are incidental to another business which is primary, e.g., banks.[355]

Registrant should indicate the type of real estate investments which it proposes to make, if any, in response to Item 4 and Item 13, as appropriate in light of the level of any such investments (see Guide 3). For the limits on aggregate holdings by open-end companies of illiquid assets, see Guide 4.

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[353]*Investment Company Act Release No 7220 (June 9, 1972).*

[354]*Investment Company Act Release No. 7221, supra.*

[355]*However, interests in companies which invest in real estate would not be considered to be interests in real estate for purposes of Section 3(c) (5) (C) of the Act. See Investment Company Act Release No. 3140 (November 18, 1960).*

Guide 13. The Making of Loans to Other Persons.

In response to Item 13, and, if appropriate, in Item 4, the registrant should state its policy with respect to the purchase of non-publicly offered debt securities (including convertible securities) of any issuer. For the purposes of responding to these items, the making of a loan by the registrant will not include the purchase of a portion of an issue of publicly distributed bonds, debentures or other securities, whether or not the purchase was made upon the original issuance of the securities. The registrant should indicate whether it will make loans which are short term (nine months or less), long term, or both. For the limits on aggregate holdings by open-end companies of illiquid assets, see Guide 4.

Guide 14. Other Policies Which Are Changeable Only if Authorized by Shareholder Vote or Which the Registrant Deems a Matter of Fundamental Policy.

Item 4 delineates the appropriate levels of prospectus disclosure with respect to investment policies which are changeable only if authorized by shareholder vote and any other policy (whether or not an investment policy which the registrant elects to treat as "fundamental." Generally, there need be no discussion in the prospectus of policies that prohibit certain practices or of practices that the registrant does not intend to follow. Information concerning negative investment policies or practices is, however, required to be included in the Statement of Additional Information in response to Item 13.[356]

When the requisite vote required by the registrant's charter or by-laws is stricter than that required by the 1940 Act to change a policy (see Sections 2(a) (42) and 13), the response in the Statement of Additional Information to Item 13 should so indicate.

Charter, by-laws or other basic organizational documents submitted as exhibits to the registration statement should be carefully reviewed to make certain a particular policy stated in response to Item 4 is not contrary to the registrant's organizational documents. For example, if a charter provision prohibits the issuance of debt or preferred stock, the registrant should not state as a policy that it intends to issue senior securities. The registrant's corporate documents should not contain any provision which appears to preclude compliance with any provision of the 1940 Act or the rules promulgated thereunder. The organizational documents also should provide the registrant's board of directors with appropriate authority to take whatever corporate action may be necessary in order to comply with any applicable federal statute or rule.

Guide 15. Qualification For Treatment Under Subchapter M of the Internal Revenue Code.

The registrant should be aware that the percentage limitations necessary for qualification under Subchapter M of the Internal Revenue Code are not the same as the percentage limitations in Section 5(b) (i) of the 1940 Act.

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[356] *Investment Company Act, Release No. 7221, supra.*

Guide 16. Investment in Companies For the Purpose of Exercising Control or Management.

If one of the registrant's significant investment policies is to invest in companies for the purpose of exercising control, as defined in Section 2(a)(9) of the 1940 Act, the registrant should explain in the prospectus in response to Item 4 the extent to which, and the circumstances under which, such investments will be made. A statement that the registrant is a diversified company or that it has a policy of not acquiring more than 10 percent of the outstanding voting securities of any one issuer is not an adequate response to this item, since even such registrants could invest for the purpose of exercising control or management.[357]

Guide 17. Investment in Securities of Other Investment Companies.

If the registrant intends to invest to a significant degree in the securities of other investment companies, the registrant should state in the prospectus, in response to Item 4, the percentage of its assets which may be invested in such securities. If the registrant does not intend to follow such a policy to a significant degree, the registrant should state in the Statement of Additional Information in response to Item 13, the percentage of its assets which may be invested in securities of other investment companies. Registrants should be aware that Section 12(d) (1) of the 1940 Act limits the percentage of voting securities which the registrant may acquire of any other investment company. That section also limits the percentage of the value of the registrant's assets which may be invested in securities of all other investment companies, subject to certain exceptions.

Guide 18. Tax-Free Bonds—Issuer Diversification.

The identification of the issuer of a tax-exempt security for purposes of Section 5(b) (1) of the 1940 Act depends on the terms and conditions of the security. When the assets and revenues of an agency, authority, instrumentality or other political subdivision are separate from those of the government creating the subdivision and the security is backed only by the assets and revenues of the subdivision, such subdivision would be deemed to be the sole issuer for purposes of Section 5(b)(1).[358] Similarly, in the case of an industrial development bond, if that bond is backed only by the assets and revenues of the non-governmental user, then such non-governmental user would be deemed to be the sole issuer for purposes of Section 5(b)(1). If, however, in either case, the creating government or some other entity guarantees a security, such a guarantee would be considered a separate security which must be valued and included in the five percent limitation computation of Section 5(b) (1) subject to the limited exclusion allowed under Rule 5b-2 of the Act.[359]

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[357] *Id.*

[358] *Investment Company Act Release No. 9785 (May 31, 1977).*

[359] *Investment Company Act Release No. 9011 (October 30, 1975).*

Guide 19. Concentration of Investments in Particular Industries.

Section 8(b) (1) of the 1940 Act requires every registered investment company to include in its registration statement a recital of its policies with respect to concentration. It is the position of the staff that investment (including holdings of debt securities) of more than 25 percent of the value of the registrant's assets in any one industry represents concentration. If the registrant intends to concentrate in a particular industry or group of industries it should, in responding to Item 4, specify in the prospectus the industry or group of industries in which it will concentrate. If it desires to change a policy of concentration, Section 13(a) (3) of the 1940 Act requires that shareholder approval of a new policy must be obtained.

If the registrant does not intend to concentrate, no further investment may be made in any given industry if, upon making the proposed investment, 25 percent or more of the value of the registrant's assets would be invested in such industry. However, when securities of a given industry come to constitute more than 25 percent of the value of the registrant's assets by reason of changes in value of either the concentrated securities or the other securities, the excess need not be sold.

If the registrant has employed a policy of concentration in the past but does not intend to follow that policy in the future, its intention and its estimate of the time required to implement such intention should be specifically disclosed in the Statement of Additional Information in response to Item 13. Shareholder approval is necessary to change to a policy of not concentrating. (See Section 13(a)(3) of the 1940 Act regarding changes in concentration policy.)

Freedom of action to concentrate pursuant to management's investment discretion, without shareholder approval, has been considered by the staff to be prohibited by Sections 8(b) (1) and 13(a) (3) of the 1940 Act, unless the statement of investment policy clearly indicates when and under what specific conditions any changes between concentration and non-concentration would be made. Statements of concentration policy pursuant to which registrants reserve the right to concentrate in particular industries "without limitation if deemed advisable and in the best interests of the shareholders" are viewed as failing to comply with Section 8(b)(1):[360]

Money market funds may declare an investment policy on industry concentration reserving freedom of action to concentrate their investments in government securities, as defined in the 1940 Act, and certain bank instruments issued by domestic banks[361] provided that, with respect to the latter, in response to Item 13, additional disclosure is made in the Statement of Additional

[360] *Id.*

[361] *United States branches of foreign banks may be considered domestic banks if it can be demonstrated that they are subject to the same regulation as United States banks. Foreign branches of domestic banks, however, are not registered in the United States and are not considered "domestic banks." Nevertheless, if a registrant can disclose that the investment risk associated with investing in instruments issued by the foreign branch of a domestic bank is the same as that of investing in instruments issued by the domestic parent, in that the domestic parent would be unconditionally liable in the event that the foreign branch failed to pay on its instruments for any reason, then the staff believes that the registrant may treat that foreign branch as a domestic bank for purposes of concentration. Otherwise, the staff is of the opinion that the registrant may not reserve freedom of action to concentrate its investments in instruments issued by foreign branches of domestic banks.*

Information concerning the type and nature of the various instruments in which the registrant intends to invest and the criteria used by the registrant in evaluating and selecting such investments. Section 8(b) (1), however, does not permit money market funds to reserve freedom of action in their declaration of investment policy insofar as it relates to concentration of investments in the commercial paper of issuers in any one industry.[362]

Further, the statement of policy required by Section 8(b)(1) as to concentration is not applicable to investments in tax-exempt securities issued by governments or political subdivisions of governments since such issuers are not members of any, industry. However, this exclusion does not eliminate the requirement for each tax-exempt bond fund to disclose its policy with respect to concentration in the Statement of Additional Information. Such a policy would apply to tax-exempt bonds issued by non-governmental users as well as to other securities (i.e., taxable securities) to which such policies normally apply.[363]

When a substantial amount of the assets of a tax-exempt bond fund are invested in securities which are related in such a way that an economic, business, or political development or change affecting one such security would likewise affect the other securities, appropriate disclosure in the fund's prospectus in response to Item 4 is necessary. For example, each investment company investing in tax-exempt bonds should, if 25 percent or more of its assets are or may be invested in securities whose issuers are located in the same state, indicate which states. In addition, if a company invests or may invest 25 percent or more of its assets in securities the interest upon which is paid from revenues of similar type projects, it should disclose this fact, identify the type or types of projects and briefly discuss any economic, business, or political developments or changes which would most likely affect all projects of that type or types. Such disclosure might include, for example, proposed federal or state legislation involving the financing of the projects; pending court decisions relating to the validity of the projects or the means of financing them; predicted or foreseeable shortages or price increases of materials needed for the projects; and declining markets or needs for the projects. Also, if a company invests or may invest 25 percent or more of its assets in industrial development bonds, it should disclose this fact.[364]

Note. In determining industry classifications, the staff will ordinarily use the current *Directory of Companies Filing Annual Reports With the Securities and Exchange Commission*, (the "*Directory*") published by the Commission. A registrant may refer to the Directory, or may select its own industry classifications, but such classifications must be reasonable and should not be so broad that the primary economic characteristics of the companies in a single class are materially different. Registrants selecting their own industry classifications must be reasonable and should disclose them: (a) in the prospectus in the case of policy to concentrate, or (b) in the Statement of Additional Information in the case of a policy not to concentrate.

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[362]*Investment Company Act Release No. 9011, supra.*
[363]*Investment Company Act Release No. 9785, supra.*
[364]*Id.*

Guide 20. Investment Companies Investing in Other Than High-Grade Bonds.

If the registrant seeks high income by investing in other than high-grade bonds,[365] it should concisely but clearly disclose in the prospectus the risks involved in such investments either in response to Item 4 or in response to Item 1 (on the cover page). Where the registrant chooses to use certain rating criteria in its prospectus disclosure, the registrant should also disclose what would be the minimal rating which that fund would find acceptable according to the rating criteria it has chosen.

Guide 21. Disclosure of Risk Factors.

In response to Item 4, principal speculative or risk factors associated with an investment in' the registrant must be disclosed in the prospectus. These factors may be due to such matters as an absence of an operating history of the registrant or the nature of the business in which the registrant engages or proposes to engage.

If the registrant intends to invest as much as 10 percent of its assets in foreign securities which are not publicly traded in the United States, such intention must be stated in the prospectus. For many foreign securities, however, there are dollar-denominated American Depository Receipts ("ADRs"), which are traded in the United States on exchanges or over-the-counter, are issued by domestic banks and do not involve the same currency risk as a foreign security. The staff is of the opinion that ADRS need not be treated as foreign securities for purposes of the risk disclosure suggested by this guide.

In many cases, a substantial portion of the portfolio securities held by tax exempt money market funds is supported by credit and liquidity enhancements from third parties, generally letters of credit from foreign or domestic banks. These securities include variable rate demand notes, tender or "put" bonds and similar securities. Where more than forty percent of a money market fund registrant's portfolio consists, or is likely to consist, of securities subject to these features, the registrant should, in response to Item 4, state that, because the fund invests in securities backed by banks and other financial institutions, changes in the credit quality of these institutions could cause losses to the fund and effect its share price.

Guide 22. Government Securities.

If the registrant is investing in United States Government securities, the prospectus should reflect under what conditions, and to what extent the registrant intends to invest its assets in United States Government securities. If the registrant is investing to a significant extent in United States Government securities on a routine basis, the prospectus should include the following information: (i) the types of Government securities in which the fund will invest; (ii) examples of Government agencies and instrumentalities in whose securities the fund will invest; and (iii) whether the securities of such agency or instrumentality are: (a) supported by full faith and

[365] *Other than high-grade bonds would include, for example, bonds receiving a Standard & Poor's rating of BBB or lower or a Moody's rating of Baa or lower.*

credit of the United States, (b) supported by the ability to borrow from the Treasury, (c) supported only by the credit of the agency or instrumentality, or (d) supported by the United States in some other way.

Guide 23. Foreign Currency Transactions.

If the registrant proposes to invest in securities denominated in foreign currencies and engage in currency conversion transactions, disclosure of these policies should be made in the prospectus in response to Item 4 and, if appropriate; in the Statement of Additional Information in response to Item 13 (see Guide 3). If the registrant plans to use foreign currency forward contracts to cover activities which are essentially speculative, such forward contracts should be deemed "senior securities" as defined in Section 18(f)(1) of the 1940 Act and thus subject to the staff's position limiting the amount of such activities as expressed in Investment Company Act Release No. 10666 (April 18, 1979).

Guide 24. Management of the Fund.

Item 5 calls for a description in the prospectus of how the registrant's business is managed. This item specifies that disclosure in the prospectus regarding the role of the board of directors may be limited to a general statement as to the responsibilities of the board of directors under the applicable laws of registrant's jurisdiction of organization for the management of the registrant.

Item 14 requires the registrant to disclose in the Statement of Additional Information the name and address, position with registrant, and principal occupation during the past five years of each director and officer of the registrant performing a "policy-making function" for the registrant. Any position held with affiliated persons or principal underwriters of the registrant by each of these individuals must be described. To the extent specified, family relationships among these individuals must also be disclosed. Executive, investment and advisory committee members must be identified and their function briefly discussed. In addition, the registrant must indicate which of its directors are "interested persons" as that term is defined by Section 2(a)(19) of the 1940 Act.

The composition of the registrant's board of directors must satisfy Section 10 of the 1940 Act. It is the staff's understanding that the Federal Reserve Board takes the position that, under Section 32 of the Banking Act of 1933, an officer or director of a bank which is a member of the federal reserve system may not serve as an officer, director or employee of an open-end investment company that is currently offering its shares.[366]

An "advisory board," as that term is defined in Section 2(a)(1) of the 1940 Act is a body composed of persons who serve the registrant in no other capacity. The staff interprets this provision to bar not only officers and directors but also the investment adviser for and counsel

[366]*Investment Company Act Release No. 7221, supra.*

to the registrant from serving on any such board.[367] Pursuant to Section 10(g) of the 1940 Act, the composition of the advisory board, if a fund chooses to have one, is also subject to the requirements of Section 10 of that Act.

Registrants should note that, for the purposes of disclosure concerning registrant's officers and directors, the term "family relationship" is broader than the definition of a "member of the immediate family" contained in Section 2(a)(19) of the 1940 Act.[368]

Item 14 requires the registrant to disclose in the Statement of Additional Information the aggregate remuneration received by certain officers, directors, members of the advisory board, and certain categories of such persons from the registrant and its subsidiaries, during the registrant's last fiscal year, and all retirement and pension benefits to be received by those individuals from the registrant pursuant to an existing plan. This requirement applies to any individual who was a director, officer or member of the advisory board of the registrant during the last fiscal year and received aggregate remuneration in excess of $60,000.

It is the Commission's view that the registrant must disclose all forms of remuneration received by specified officers and directors.[369] "Remuneration" is intended to include cash and non-cash items, i.e., not only all salaries, fees and bonuses but also personal benefits, commonly known as "perquisites."[370] It is the Commission's view that management is in the best position to determine whether or not a benefit should be considered remuneration, depending on the facts and circumstances of each situation.

Guide 25. Investment Advisory and Other Services.

Item 5 requires the registrant to identify in the prospectus its investment adviser and to state that the adviser is responsible for portfolio management. If the registrant's adviser has no previous experience in advising a mutual fund, this fact should be disclosed as a risk factor in the prospectus.

Item 16 calls for additional information in the Statement of Additional Information about the background and function of each person providing the registrant with advisory services. Particular emphasis is placed on disclosure of the identities of all controlling persons of each investment adviser and the basis for their control. The registrant must identify any affiliations between such persons and the registrant. If any affiliated person of the registrant is also an affiliated person of an adviser, the identity of that person and all bases of affiliation must be disclosed. Item 16 calls for a detailed discussion in the Statement of Additional Information

[367]*Id.*

[368]*This use of the term "family relationship" is consistent with the staff position enunciated in Investment Company Act Release No. 7220, supra.*

[369]*As stated in Investment Company Act Release No. 9900 (August 18, 1977).*

[370]*For a detailed discussion of those personal benefits which the staff has interpreted to be remuneration requiring disclosure, see Investment Company Act Release Nos. 9900, supra; 10112 (February 6, 1978); 11439 (November 14, 1980); 12070 (December 3, 1981).*

concerning the method used to compute the advisory fee paid by the registrant. In addition, the registrant must describe in Part B all services performed for it, or on its behalf, pursuant to any investment advisory or management-related service contract,[371] and in each case must identify the persons paying for such services. The registrant must also summarize the substantive portions of any management-related service contract, which may be of material interest to a purchaser of the registrant's securities. Any person providing investment advice on a more informal basis must also be identified, and the nature of the arrangement and remuneration should be discussed. Registrants should be aware that all investment advisory services must be provided pursuant to a written contract which complies with the provisions of Section 15 of the 1940 Act.[372]

Item 5 requires the registrant to provide in the prospectus the name and address of the transfer agent and dividend-paying agent for the investment company. Item 16 calls for identifying information concerning the custodian and independent public accountant. Custodial arrangements must be in conformity with Section 17(f) of the 1940 Act and the rules promulgated thereunder. If the registrant's portfolio securities are held by any person other than a commercial bank, trust company or registered depository, the registrant must, in response to Item 16, state in the Statement of Additional Information the nature of the business of each such person. Item 16 also requires the disclosure of any services performed by, and the basis of remuneration received by, any affiliated person of registrant or of any affiliate of such affiliate which acts as custodian, transfer agent, or dividend-paying agent for registrant. If a custodian is affiliated with the investment company, the investment company is considered a self-custodian for purposes of Section 17(f) of the 1940 Act and is, therefore, subject to regulatory requirements different from those applicable to other custodians.

Guide 26. Brokerage Allocation.

If the registrant uses affiliated brokers or takes the sale of its shares into account when allocating brokerage,[373] a statement to that effect must be included in the prospectus in response to Item 5. Responses in the prospectus to Item 5 should be concise and should not include lengthy descriptions of practices that are standard in the investment company industry nor of technical or legal requirements. Item 17 requires registrants to provide in the Statement of Additional Information a fuller explanation of the brokerage allocation practices that they engage in. In addition, Item 17 requires the registrant to describe how transactions in portfolio securities are effected, including a statement about mark-ups on principal transactions and brokerage commissions paid during the most recent fiscal year. Further, Item 17 requires the registrant to describe in the Statement of Additional Information the process it undergoes in selecting brokers and

[371]*See Instructions to Item 16(d) of Form N-l A for the definition of the term "management-related service contract."*

[372]*Registrants should note that the disclosure requirements of both Part A and Part B apply to sub-advisers as well, see Investment Company Act Release 7220, supra.*

[373]*On March 4, 1981, the Commission approved an NASD proposal to amend portions of Article III, Section 26 of the NASD Rules of Fair Practice and related interpretations of the "Anti-Reciprocal Rule," Investment Company Act Release No. 11662 (March 4, 1981). The rule as amended no longer prohibits NASD members from seeking or granting brokerage commissions in connection with the sale of investment company shares, and permits NASD members to sell shares of investment companies that follow a disclosed policy of considering sales of their shares as a factor in the selection of broker-dealers to execute portfolio transactions, subject to specified conditions.*

evaluating the commissions to be paid, including a discussion of the factors used in this determination process, such as the research services provided by that broker. If the research services furnished by brokers used by the registrant to effect transactions for the registrant may be used by the registrant's investment adviser in servicing all of its managed accounts, and if all such services may not be used by the investment adviser exclusively in connection with the registrant, such practices must be described and explained. If the registrant is not required to respond to Item 17 of the form, then no disclosure suggested by this guide concerning brokerage allocation practices would be considered necessary.

Guide 27. Redemption or Repurchase.

Section 22(e) of the 1940 Act prohibits the suspension of the right of redemption or the postponement of payment upon redemption of any mutual fund share for more than seven days after the proper tender of the security for redemption, except under certain specified conditions. The staff has taken the position that, under certain circumstances, redemption payments can be withheld beyond the period specified in Section 22(e) to prevent the financial losses or dilution of net asset value that can occur when purchase payment checks are returned dishonored after the redemption payments have been made.[374]

The procedures for implementing payment for redemption soon after purchase must be disclosed in the prospectus, as should any procedures an investor can follow to avoid any delay in payment upon redemption, such as submission of a certified check along with the purchase order.

Item 8 requires the registrant to include in the prospectus a brief description of the procedures for redeeming shares or having shares repurchased by the registrant. Any charges or restrictions applying to such procedures imposed by the distributor or principal underwriter must be disclosed in the prospectus. In addition, the prospectus should disclose the fact that if a shareholder uses the services of a broker-dealer for the repurchase of registrant's shares there may be a charge to the shareholder for such services. The specific fees charged by the broker-dealer for such services, however, do not need to be disclosed.

Item 19 permits the registrant to provided a fuller description in the Statement of Additional Information of matters relating to these redemption or repurchase procedures. Item 8 requires brief discussions in either the prospectus or Statement of Additional Information, at the discretion of the registrant, of any provisions for involuntary redemptions, delays in redemptions, reinvestment privileges for those who redeem, and in kind redemptions. If the registrant has made an election for redemption pursuant to Rule 18f-l under the 1940 Act, such policy must be described in the Statement of Additional Information in response to Item 19 to the extent such information has not been provided by the registrant, at its discretion, in the prospectus.

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[374]*For a discussion of the conditions under which an investment company can delay redemption or repurchase for more than seven days pending clearance of share purchase checks, see Investment Company Institute (Pub. avail. May 3, 1975).*

If the registrant includes a synopsis in the prospectus, the synopsis should indicate where in the prospectus investors can find a description of the redemption and repurchase procedures available.[375]

In the staff's experience, redemption procedures are a frequent source of confusion for investors. Therefore, the following areas of disclosure deserve special attention: (a) differences, if any, in methods for redeeming certificated fund shares that are in the shareholder's possession, as opposed to uncertificated shares held by the fund for the shareholder, and (b) when signature guarantees are necessary, and who is an appropriate person to make such a guarantee.[376]

Guide 28. Valuation of Securities Being Offered.

Item 7 requires a registrant to identify in the prospectus the method used to value the assets. In some circumstances, value can be determined fairly in more than one way. For any asset traded on a national exchange, valuation normally should be based on market value when readily available.[377] If a security was traded on the valuation date, the last quoted sale price generally is used. In the case of securities listed on more than one national securities exchange, the last quoted sale, up to the time of valuation, on the exchange on which the security is principally traded should be used or, if there were no sales on that exchange on the valuation date, the last quoted sale, up to the time of valuation, on the other exchanges should be used.

If there was no sale on the valuation date but published closing bid and asked prices are available, the valuation in such circumstances should be within the range of these quoted prices. Some companies as a matter of general policy use the bid price, others use the mean of the bid and asked prices, and still others use a valuation within the range of bid and asked prices considered best to represent value in that circumstance; each of these policies is acceptable if consistently applied. Normally, the use of the asked price alone is not appropriate. Where, on the valuation date, only a bid price or an asked price is quoted or the spread between bid and asked prices is substantial, quotations for several days should be reviewed. If sales have been infrequent, or there is a thin market in the security, or the size of the reported trades is considered not representative of the fund's holding (as in the case of certain debt securities) , further consideration should be given as to whether "market quotations are readily available." If it is decided that they are not readily available, the alternative method of valuation prescribed by Section 2(a)(41)—"fair value as determined in good faith by the board of directors"—should be used.

For debt or equity securities traded over-the-counter where closing prices are not readily available, quotations for a security should be obtained from more than one broker-dealer,

[375] *See Guide 33.*

[376] *See Investment Company Act Release No. 7220, supra.*

[377] *Investment Company Act Release No. 7221, supra. For debt securities, the staff is aware that registrants often value portfolio securities by reference to other securities which are considered comparable in rating, interest rate, due date, etc. (often called "matrix pricing") or rely on pricing services which use matrix pricing for valuation of these instruments. (Of course, a pricing service does not need to rely on a matrix to develop the prices it supplies to registrants.) Although the staff does not object to the use of matrix pricing or a pricing service by funds, registrants should be aware that it is their responsibility to ascertain that these methods are relying on the proper criteria in their valuation process.*

particularly if quotations are available only from broker-dealers not known to be established market-makers for that security. A company may adopt a policy of using a mean of the bid prices, or of the bid and asked prices, or of the prices of a representative selection of broker-dealers quoted on a particular security; or it may use a valuation within the range of bid and asked prices considered best to represent value in that circumstance. The staff will consider any of these policies appropriate if consistently applied.

If the validity of the quotations appears to be questionable, or if the number of quotations is such as to indicate that there is a thin market in the security, further consideration should be given to whether "market quotations are readily available." If it is decided that they are not readily available, the security should be considered one required to be valued at "fair value as determined in good faith by the board of directors."

To comply with Section 2(a) (41). of the Act and Rule 2a-4 under the Act, the directors must satisfy themselves that all appropriate factors relevant to the value of securities for which market quotations are not readily available have been considered and determine the method of arriving at the fair value of each such security. No single standard for determining "fair value in good faith" can be established, since fair value depends upon the circumstances of each individual case. As a general principle, the current "fair value" of an issue of securities being valued by the board of directors would be the amount which the owner might reasonably expect to receive for them upon their current sale.[378]

Securities held under circumstances where the sale of such securities to the public would not be permissible without an effective registration statement under the Securities Act are considered securities for which market quotations are not readily available. They must, therefore, be valued in good faith by the board of directors.[379] It would be improper for the board of directors to value these securities at the market quotation for unrestricted securities of the same class without considering other relevant factors, although this may be a factor considered in structuring the final valuation.[380] The existence of a shelf registration for the restricted securities may be properly considered by the board of directors as another factor in the determination of the value of such securities, but there may not be an automatic valuation at market price based on this factor alone.[381]

The valuation of short sales of securities, which are not traded on a national exchange, can be at the asked price, that being the most conservative value, or the mean average of bid and asked prices. The use of bid price alone to value short positions is not appropriate.

Certain securities trading practices such as reverse repurchase agreements, firm commitment agreements and standby commitment agreements required the consideration of special factors in connection with valuation. For example, changes in the value of a firm commitment agreement

[378]*For a general discussion of the factors to be considered in this determination, see Investment Company Act Release No. 6295 (December 23, 1970).*

[379]*Investment Company Act Release No. 7221, supra.*

[380]*Investment Company Act Release No. 5847 (October 21, 1969).*

[381]*Investment Company Act Release No. 6121 (July 20, 1970).*

will affect the price at which shares of an investment company may be sold, redeemed or repurchased. Accordingly, directors, in determining fair value, must take care that no inaccuracies exist with regard to the valuation of such trading practices.[382] In valuing standby commitments (puts), registrants using the amortized cost method of valuation should indicate that the acquisition of a standby commitment will not affect the valuation of the underlying security which will continue to be valued in accordance with the amortized cost method. The actual standby commitment will be valued at zero in determining net asset value. In such event, where the fund pays directly or indirectly for a standby commitment, its cost will be reflected as an unrealized loss for the period during which the commitment is held by the fund and will be reflected in realized gain or loss when the commitment is exercised or expires.[383]

The maturity of a municipal obligation purchased by the fund will not be considered shortened by any standby commitment to which such obligation is subject. Therefore, standby commitments will not affect the dollar weighted average maturity of the fund's portfolio. (However, where a money market fund acquires a variable rate or floating rate municipal obligation having a demand feature which allows the fund unconditionally to obtain the amount due from the issuer upon notice of seven days or less, the maturity of the instrument will normally be the longer of the notice period for the commitment or the time remaining to the next rate adjustment.)

Money market funds with portfolio securities that mature in one year or less may use the amortized cost or penny rounding method to value their securities pursuant to the conditions of Rule 2a-7.[384] If the portfolio of a money market fund is to be valued at amortized cost, there must be disclosure in the Statement of Additional Information in response to Item 19 concerning the effect of this method of valuation on the fund's net asset value and yield as interest rates change and the corresponding dilution of shareholders' interest.

Item 7 requires a statement in the prospectus as to when calculations of net asset value are generally made. The current net asset value of redeemable securities should be computed at least once each day whenever there is enough trading in the investment company's portfolio securities to materially affect the current net asset value of the investment company's redeemable securities and on which an order for purchase, redemption, or repurchase of its securities is received. Calculations of net asset values should be made at such specific time or times during the day as set by the directors of the investment company, at least once a year. An investment company need not compute net asset value on: (i) a day when no order to purchase or sell such security was received or was on hand, having been received since the last previous computation of net asset value; or (ii) customary national business holidays described or listed in the prospectus and local and regional business holidays listed in the prospectus.[385]

Under Item 7, a fund must identify in a general manner or list the customary national business holidays on which it will (or will not) price. For this purpose, a fund could indicate, for

[382]*Investment Company Act Release No. 10666, supra.*

[383]*There may be alternative methods of valuation of standby commitments, but in any event the value of the standby commitment together with the underlying security should not exceed the amount received by the fund upon disposal of the underlying security.*

[384]*Investment Company Act Release No. 13380 (July 11, 1983).*

[385]*Investment Company Act Release No. 10827 (August 13, 1979); and No. 14559 (June 6, 1985).*

example, that pricing will take place "every day the New York Stock Exchange is open for trading" or "Monday through Friday exclusive of federal holidays" or the fund may use soma other general description which conveys the necessary meaning about the customary national business holidays on which orders will (or will not) be priced. A fund which will be closed on local or regional holidays must specifically list these holidays under Item 7 of the prospectus. Where national holidays on which the fund will be closed are only generally described in the prospectus, they must be specifically listed in the Statement of Additional Information. If all holiday closings are specifically listed in the prospectus, the list need not be repeated in the Statement of Additional Information.

Where a fund's closing policy may have a significant impact on investor access to the fund, this should be explained in the Statement of Additional Information under Item 19. The necessity for and appropriate level of disclosure under Item 19 depends on the nature of the fund. For example, funds with portfolio securities primarily listed on foreign exchanges which trade on Saturdays or other customary United States national business holidays would be expected to disclose to their investors, if the fund does not price on these days, that the portfolio will trade and the net asset value of the fund's redeemable securities may be significantly affected on days when the investor has no access to the fund. On the -other hand, a fund need not discuss the consequences of its pricing policies if the fund's portfolio securities trade only on the New York Stock Exchange and the fund is closed only on days when that exchange is closed.

The prospectus disclosure regarding sales charges should make clear that the term "offering price" as used throughout the prospectus includes the sales charge, if any.

Guide 29. Distribution Expenses.

Item 7 requires a registrant that bears distribution or other expenses in accordance with Rule 12b-l to briefly describe the plan in the prospectus. To comply with this item, the brief description of the Rule 12b-l plan should include: a discussion of the relationships between amounts paid to an underwriter and expenses actually incurred by the underwriter (e.g., whether the plan reimburses the distributor only for actual expenses incurred or whether the distributor's compensation is based on the fund's average daily net assets or some other factor, regardless of the amount of expenses incurred). If the fund is or can be charged for interest, carrying, or any other financing charges on any unreimbursed distribution or other expense incurred in a prior plan year, or considers itself under a legal obligation to pay all or part of the amount carried over, the registrant should so disclose in the prospectus.

If the registrant imposes a sales load payable in installments on the securities being offered, the registrant must describe briefly in response to Item 6 any related material tax consequences for investors.

When special arrangements will be made to sell shares of the fund to customers of depository institutions, possible applicability of the Glass-Steagall Act should be discussed in the prospectus. The legal issues raised by payments to depository institutions for their services in this connection should be identified, and the consequences for the fund, if these issues are resolved adversely, should also be discussed.

Guide 30. Tax Consequences.

Item 6 requires the registrant to describe briefly in the prospectus the tax consequences to investors of an investment in the securities offered. Thus, a series company having more than one portfolio, which is treated as a single entity in computing net profits, must disclose the possibility of an advantage accruing to the shareholders of one series by offsetting the gains in that series against the losses in another, or in a concomitant disadvantage, if the gains realized by one series must be distributed as taxable long-term gains, because earlier losses of that series which might have offset those gains had been used already to offset gains in another series.[386] A series fund having only a single portfolio need not disclose the tax consequences appurtenant to being organized as a series fund, if the fund has no current intention of adding another portfolio to the series.

It is the position of the Division that it is misleading for tax-exempt bond funds to discuss the federal income tax-exempt status of their distributions in their prospectuses, advertisements and supplemental sales literature unless, to the extent applicable, such a discussion is accompanied by disclosure indicating that some or all of the distributions may be subject to federal, state, and local income taxation; that distributions which are exempt from federal taxes may be subject to state and local taxation; and that capital gains realized by the fund generally will be subject to taxation at each level.

Investment companies that intend to qualify under Section 852(b)(5) of the Internal Revenue Code, which allows tax-exempt status for certain interest distributions, should .disclose in the Statement of Additional Information in response to Item 20 the basis that will be used for determining the designated percentage of each distribution to be exempt and the approximate time at which such designation will be made. If the "actual earned" method is used, the disclosure should indicate that the percentage of the distribution that is tax-exempt may vary from distribution to distribution. If the "average annual" method is used, the disclosure should make clear that the percentage of income designated as tax-exempt for any particular distribution may be substantially different from the percentage of the company's income that was tax-exempt during the period covered by the distribution.

Registrant must disclose in the prospectus in response to Item 6 that there is a possibility that shareholders may lose the tax-exempt status on the accrued income of a municipal bond if they redeem their shares before a dividend has been declared. Thus, the dates on which dividends will be declared should be disclosed in the prospectus so shareholders know when a redemption can be effected with the least possible adverse tax consequences. The Division believes that Section 36 of the 1940 Act may require that directors and management of such funds consider the dates of redemptions under any automatic withdrawal programs which the fund may have when setting dividend declaration dates in order to maximize, consistent with the tax-exempt income objective of the fund, the amount of income or gain which is tax-exempt for shareholders under these programs.[387]

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[386] *Investment Company Act Release No. 9786, supra.*

[387] *Id.*

In determining mutual funds dividends which qualify for the dividend exclusion, registrant should note Revenue Ruling 80-345 (December 29, 1980).

In regard to the Subchapter M disclosure required in the prospectus by Item 6, if more than 50 percent of registrant's stock is owned by five or fewer persons, the registrant may be a "personal holding company" under the Internal Revenue Code and unable to meet the requirements of Subchapter M so long as that ownership continues. Appropriate disclosure of any adverse tax consequences to the investors as a result of this status is required in the prospectus. The response should summarize registrant's tax status at the time of filing as well as its future intention with respect to qualification under the Code.[388]

If there are any special or unusual tax aspects of the registrant that exist, the registrant must describe these fully in response to Item 20.

Guide 31. Financial Statements.

The form, content and presentation of financial statements is discussed in Regulation S-X.

Guide 32. Performance Data.

Item 3(c) requires a brief explanation of how the registrant calculates its historical performance for purposes of advertising this data. Algebraic equations and detailed, intricate explanations should be avoided in favor of a more general, concise description of the essential features of the data and how it is computed. For example, a no-load money market fund advertising both its yield and effective yield might describe these two yields in the following manner:

From time to time the Fund advertises its "yield" and "effective yield." *Both yield figures are based on historical earnings and are not intended to indicate future performance.* The "yield" of the Fund refers to the income generated by an investment in the Fund over a seven-day period (which period will be stated in the advertisement). This income is then "annualized." That is, the amount of income generated by the investment during that week is assumed to be generated each week over a 52-week period and is shown as a percentage of the investment. The "effective yield" is calculated similarly but, when annualized, the income earned by an investment in the Fund is assumed to be reinvested. The "effective yield" will be slightly higher than the "yield" because of the compounding effect of this assumed reinvestment.

For guidance in responding to Item 22, the registrant should refer to Investment Company Act Release No. 13049 (February 28, 1983); Investment Company Act Release No. 11028 (January 28, 1980); and Investment Company Act Release No. 11379 (September 30, 1980).

[388]*Investment Company Act Release No. 7221, supra.*

Guide 33. The Synopsis.

If the registrant determines that inclusion of a synopsis is appropriate because of the length or complexity of the prospectus, that synopsis should be a clear and concise description of the key features of the offering and the registrant.[389] The information provided in the synopsis need not be set forth in the order or the manner described in this guide. Further, the information may be presented in a question-and-answer format.

A synopsis provided pursuant to Item 2 of Form N-l A should, in the staff's opinion, include: (i) a brief description of how the registrant proposes to achieve its investment objectives, including identification of the types of securities in which the registrant proposes to invest primarily and a statement as to whether the registrant proposes to operate as a diversified or non-diversified investment company; (ii) a summary of the principal speculative or risk factors associated with investment in the registrant, including factors peculiar to the registrant as well as those generally attendant to investment in an investment company with objectives and policies similar to registrant's; and (iii) the nature of the securities being offered.

The synopsis should also: (i) provide the name of the investment adviser, and, if any other person provides services of the type customarily provided by an investment adviser, the identity of such person and the services so provided; (ii) provide a cross-reference to the description in the prospectus of how to purchase the securities being offered; and (iii) provide a cross-reference to the description in the prospectus of how a shareholder may effect redemption and, if applicable, a repurchase transaction.

Finally, the synopsis may include other information, but care should be taken that such additional information does not, either by its nature, quantity, or manner or presentation, impede understanding of the information required to be presented in the prospectus.

Guide 34. Multiple Class and Master-Feeder Structures.

In response to Item 6, if a single prospectus is used to offer more than one class of a multiple class fund or more than one feeder fund that invests in the same master fund, the prospectus should provide a separate response to Item 2(a)(i) (the fee table requirement) for each class or feeder fund and should clearly explain the differences between the expenses and/or sales load arrangements of the classes or feeder funds. The fee table information should be arranged to facilitate a comparison by shareholders of the different fee structures.

Guide 35. Money Market Fund Investments in Other Money Market Funds.

Money market funds are permitted to invest in the securities of other money market funds in accordance with the provisions of Rule 2a-7 and Section 12(d)(1) of the 1940 Act. Except when a fund has invested substantially all of its assets in the other money market fund, the investing fund does not need to "look through" the shares of the fund(s) in which it is investing in order to determine compliance with the diversification or Second Tier Security limitations of

[389] *The table required by Item 2(a) should, in all cases, be included in the prospectus.*

Rule 2a-7. (See Investment Company Act Rel. No. 21837 (March 21,1996) at Section II.G.2.) However, the investment objectives and policies of the money market fund making the investment and the money market fund(s) in which it is investing should not be inconsistent. Paragraph (c)(4)(iv)(A)(5) of Rule 2a-7 describes the obligations of a fund that invests substantially all of its asset in another money market fund.

APPENDIX II

Release on new Rule 35d-1—Investment Company Names
[Release No. IC-24828]
January 17, 2001

SUMMARY: The Securities and Exchange Commission is adopting a new rule under the Investment Company Act of 1940 to address certain broad categories of investment company names that are likely to mislead investors about an investment company's investments and risks. The rule requires a registered investment company with a name suggesting that the company focuses on a particular type of investment (*e.g.,* an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80% of its assets in the type of investment suggested by its name. The rule also would address names suggesting that an investment company focuses its investments in a particular country or geographic region, names indicating that a company's distributions are exempt from income tax, and names suggesting that a company or its shares are guaranteed or approved by the United States government.

DATES: *Effective Date:* March 31, 2001. *Compliance Date:* Registered investment companies must comply with § 270.35d-1 by July 31, 2002.

FOR FURTHER INFORMATION CONTACT: Paul G. Cellupica, Senior Special Counsel, or John L. Sullivan, Senior Counsel, Office of Disclosure Regulation, at (202) 942-0721, or, regarding accounting issues, Kenneth B. Robins, Office of the Chief Accountant, at (202) 942-0590, in the Division of Investment Management, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549-0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting new rule 35d-1 [17 CFR 270.35d-1] under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq.*] ("Investment Company Act").[1]

[1]*Unless otherwise noted, all references to "rule 35d-1" or any paragraph of the rule will be to 17 CFR 270.35d-1, as adopted by this release*

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I. Introduction

Section 35(d) of the Investment Company Act, as amended by the National Securities Markets Improvement Act of 1996, prohibits a registered investment company from using a name that the Commission finds by rule to be materially deceptive or misleading.[2] Before section 35(d) was amended, the Commission was required to declare by order that a particular name was misleading and, if necessary, obtain a federal court order prohibiting further use of the name. In amending section 35(d), Congress reaffirmed its concern that investors may focus on an investment company's name to determine the company's investments and risks, and recognized that investor protection would be improved by giving the Commission rulemaking authority to address potentially misleading investment company names.[3]

Today the Commission is adopting new rule 35d-1 to address certain investment company names that are likely to mislead an investor about a company's investment emphasis. The Commission believes that investors should not rely on an investment company's name as the sole source of information about a company's investments and risks.[4] An investment company's name, like any other single piece of information about an investment, cannot tell the whole story about the investment company.[5] As Congress has recognized, however, the name of an investment company may communicate a great deal to an investor.

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[2] *15 U.S.C. 80a-34(d); Pub. L. No. 104-290, § 208, 110 Stat. 3416, 3432 (1996).*

[3] See *S. Rep. No. 293, 104th Cong., 2d Sess. 8-9 (1996).*

[4] See *generally "Investor Protection: Tips from an SEC Insider," Remarks by Arthur Levitt, Chairman, SEC, before the Investors' Town Meeting at the Houstonian Hotel, Washington, D.C. (Apr. 12, 1995) ("An informed investor looks beyond the packaging of a fund, and also sees what's inside."); "The SEC and the Mutual Fund Industry: An Enlightened Partnership," Remarks by Arthur Levitt, Chairman, SEC, before the General Membership Meeting of the Investment Company Institute ("ICI") at the Washington Hilton Hotel, Washington, D.C. (May 19, 1995) ("some fund names can leave investors with the wrong impression about [the fund's] safety.").*

[5] See *Herman,* The Confusion is Mutual: Buyers Beware When Funds Drift From Original Intent, *New York Daily News, Oct. 24, 1999, at 5; Millman,* First Pop The Hood: A Fund's Name May Tell You Nothing About How It Acts, *U.S. News & World Rep., Feb. 3, 1997, at 70.*

The rule applies to all registered investment companies, including mutual funds, closed-end investment companies, and unit investment trusts ("UITs"), and requires an investment company with a name that suggests a particular investment emphasis to invest in a manner consistent with its name. The rule, for example, would require an investment company with a name that suggests that the company focuses on a particular type of security (*e.g.*, an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80% of its assets in the type of security indicated by its name. An investment company seeking maximum flexibility with respect to its investments would be free to select a name that does not connote a particular investment emphasis.

Under current positions of the Division of Investment Management ("Division"), an investment company with a name suggesting that the company focuses on a particular type of investment generally is required to invest only 65% of its assets in the type of investment suggested by its name.[6] In 1997, we proposed rule 35d-1 to replace the staff's positions with a rule codifying the Commission's views and to increase the 65% threshold to 80%.[7]

Today we are adopting rule 35d-1 and the 80% investment requirement to guard against the use of misleading investment company names and to implement Congress's intent in amending section 35(d). Requiring an investment company to invest at least 80% of its assets in the type of investment suggested by its name will provide an investor greater assurance that the company's investments will be consistent with its name. The need for investment companies to invest in a manner consistent with their names is particularly important to retirement plan and other investors who place great emphasis on allocating their investment company holdings in well-defined types of investments, such as stocks, bonds, and money market instruments.[8] As of the end of 1999, an estimated 82.8 million individuals in 48.4 million U.S. households held $5.5 trillion in mutual fund assets.[9] These investors face an increasingly diverse universe of investment companies when choosing a company suitable for their investment needs.[10] The 80% investment requirement will help reduce confusion when an investor selects an investment company for specific investment needs and asset allocation goals.

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[6]*The Division continues to take this position in reviewing investment company disclosure, although the Division's formal guidance in this area was rescinded as part of the general overhaul of Form N-1A in 1998. See Former Guide 1 to Form N-1A, Investment Company Act Release No. 13436 (Aug. 12, 1983) [48 FR 37928 (Aug. 22, 1983)] ("N-1A Guidelines Release") (rescinded by Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916 (March 23, 1998) at 13940 n.214] ("N-1A Amendments")).*

[7]*Investment Company Act Release No. 22530 (Feb. 27, 1997) [62 FR 10955 (Mar. 10, 1997), correction 62 FR 24161 (May 2, 1997)] ("Proposing Release").*

[8]See, e.g., *Vickers,* A Price of Success: An Unbalanced Portfolio, *N.Y. Times, Jan. 12, 1997, at F6; Glassman,* With New Year, Stock Up a 401(k) for the Long Term, *Wash. Post, Jan. 1, 1997, at C13. The amount of retirement assets invested in mutual funds totaled $2.5 trillion at the end of 1999, representing an increase of $553 billion, or 29%, over the 1998 year-end total of $1.9 trillion. ICI, Mutual Fund Fact Book 49-50 (2000). This $2.5 trillion in mutual fund retirement plan assets represented 36% of all mutual fund assets at year-end 1999.* Id. *at 49. The ICI estimates that, in 1998, 77% of fund shareholders invested primarily for retirement purposes. ICI, 1998 Profile of Mutual Fund Shareholders (1999).*

[9]Id. *at 41.*

[10]*According to Division estimates based on data from the ICI and Lipper Analytical Services, between September 1985 and July 2000, investment company assets increased from $591 billion to $7.4 trillion, and the number of investment companies (including the individual series of registered mutual funds) increased from 9,200 to 32,403.*

II. Discussion

The Commission received 28 letters commenting on proposed rule 35d-1.[11] Most of the commenters supported the proposal, asserting that an investment company with a name indicating that it will invest in a particular security or industry should follow an overall investment strategy consistent with its name. Many commenters recommended revisions to the proposed rule. In addition, the Commission has received five rulemaking petitions urging adoption of the proposed rule.[12] The Commission is adopting rule 35d-1 with the modifications described below that address commenters' concerns.

A. General

1. Names Indicating an Investment Emphasis in Certain Investments or Industries

We are adopting, substantially as proposed, the requirement that an investment company with a name that suggests that the company focuses its investments in a particular type of investment (*e.g.*, the ABC Stock Fund or XYZ Bond Fund) or in investments in a particular industry (*e.g.*, the ABC Utilities Fund or the XYZ Health Care Fund) invest at least 80% of its assets in the type of investment suggested by the name.[13] The 80% requirement will allow an investment company to maintain up to 20% of its assets in other investments. In the case of mutual funds, these assets, for example, could include cash and cash equivalents that could be used to meet redemption requests. While many commenters supported setting the investment requirement at 80%, some commenters opposed the level of the investment requirement, arguing that it would unduly restrict legitimate portfolio strategies and result in decreased diversification and increased risk and deter investment companies from using descriptive names.

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[11]A summary of the comments prepared by the staff of the Division of Investment Management is available in the public comment file for S7-11-97.

[12]Rulemaking Petition by the Financial Planning Association (June 28, 2000); Rulemaking Petition by Fund Democracy, LLC (June 28, 2000); Rulemaking Petition by Consumer Federation of America, et al. (Aug. 8, 2000); Rulemaking Petition by National Association of Investors Corporation (Oct. 9, 2000); Rulemaking Petition by the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") (Dec. 20, 2000). The rulemaking petitions are available for inspection and copying in File No. 4-439 in the Commission's Public Reference Room.

[13]Rule 35d-1(a)(2). A mutual fund that uses a name suggesting that it is a money market fund would continue to be subject to the maturity, quality, and diversification requirements of rule 2a-7 under the Investment Company Act, and its name would be deemed misleading under section 35(d) of the Investment Company Act if it did not comply with these requirements. [17 CFR 270.2a-7(b) & (c)]. The language of the proposal would have required an investment company with a name that suggests that the company focuses its investments in a particular type of security to invest at least 80% of its assets in the indicated securities. Proposed rule 35d-1(a)(2). We have modified this language to require that an investment company with a name that suggests that the company focuses its investments in a particular type of investment invest at least 80% of its assets in the indicated investments. Rule 35d-1(a)(2). In appropriate circumstances, this would permit an investment company to include a synthetic instrument in the 80% basket if it has economic characteristics similar to the securities included in that basket. We note that, for purposes of applying the 80% investment requirement, an investment company may "look through" a repurchase agreement to the collateral underlying the agreement (typically, government securities), and apply the repurchase agreement toward the 80% investment requirement based on the type of securities comprising its collateral. Cf. Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities, Investment Company Act Release No. 24050 (Sept. 23, 1999) [(64 FR 52476 (Sept. 29, 1999)] (proposing rule that would codify prior staff positions permitting investment companies to "look through" counterparties to certain repurchase agreements and treat securities comprising the collateral as investments for certain purposes under the Act).

The Commission disagrees with these commenters. Investment companies are not required to adopt names that describe their investment policies. Those investment companies that do not adopt such a name are not subject to the 80% requirement. We believe that if an investment company elects to use a name that suggests its investment policy, it is important that the level of required investment be high enough that the name will accurately reflect the company's investment policy. Moreover, we believe that certain modifications to the proposed rule (*e.g.,* allowing an investment company to have a policy that it will notify its shareholders 60 days prior to a change in its investment policy, rather than requiring that the investment policy be fundamental) will maintain the rule's flexibility and prevent the percentage investment requirement from being too restrictive.[14] One commenter recommended that the Commission adopt an additional requirement that the remaining 20% of an investment company's assets be invested in securities that are substantially equivalent to its primary investments. We are not adopting the commenter's recommendations because we do not believe that an investment company's name, standing alone, can be expected to fully inform investors about all of the investments of the company.[15] Further, we are concerned that restricting the investment of the remaining 20% of an investment company's assets would unnecessarily reduce the manager's flexibility without providing significant additional benefit to shareholders.

We note, however, that the 80% investment requirement is not intended to create a safe harbor for investment company names. A name may be materially deceptive and misleading even if the investment company meets the 80% requirement. Index funds, for example, generally would be expected to invest more than 80% of their assets in investments connoted by the applicable index. Similarly, a UIT with a name indicating that its distributions are tax-exempt may have a misleading name even if it invests 80% of its assets in tax-exempt investments.[16]

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[14]See infra *note 18 and accompanying text (discussing notice alternative).*

[15]See, e.g., *Item 2(b) of Form N-1A (requiring a mutual fund's prospectus to identify its principal investment strategies, including the types of securities in which the fund invests principally). We note that an investment company that is covered by the rule should disclose its policy to invest its assets in accordance with the 80% investment requirement suggested by its name as one of its principal investment strategies in the prospectus. We would not object if mutual funds that change an existing investment policy from 65% to 80% to comply with rule 35d-1 file an amendment to a registration statement disclosing the 80% investment policy pursuant to rule 485(b) under the Securities Act of 1933, provided that the post-effective amendment otherwise meets the conditions for immediate effectiveness under the rule. 17 CFR 230.485(b). This also would apply to closed-end interval funds filing post-effective amendments pursuant to rule 486(b) under the Securities Act. 17 CFR 230.486(b). In other circumstances, mutual funds must determine whether an amendment to a registration statement that discloses changes in investment policy should be filed pursuant to rule 485(a) or may be filed pursuant to rule 485(b) under the Securities Act. 17 CFR 230.485(a) and 230.485(b). Likewise, closed-end interval funds filing post-effective amendments in other circumstances must determine whether they must file pursuant to rule 486(a) or may file pursuant to rule 486(b) of the Securities Act. 17 CFR 230.486(a) and 230.486(b).*

[16]*The Division currently applies a 95% investment requirement to tax-exempt UITs.* Cf. *Guide 1 of Proposed Form N-7, Investment Company Act Release No. 15612 (Mar. 9, 1987) [52 FR 8268 (Mar. 17, 1987) at 8295] (proposing release for Form N-7, proposed form for registration of UITs) ("The staff takes the position that a [tax-exempt] trust must have at least 95% of its net assets invested in tax-exempt securities in order to have substantially all of its net assets so invested.").*

We are modifying the requirement in the proposal that the 80% investment requirement be a fundamental policy of the investment company, *i.e.*, a policy that may not be changed without shareholder approval.[17] Most commenters opposed the fundamental policy requirement, arguing that it would be too burdensome for investment companies, constraining their ability to respond efficiently to market events or to new regulatory requirements, and discouraging them from using descriptive names.

The Commission is persuaded by the commenters' arguments, and the rule, as adopted, generally will provide investment companies with an alternative to the fundamental policy requirement. In lieu of adopting the 80% investment requirement as a fundamental policy, an investment company may adopt a policy that it will provide notice to shareholders at least 60 days prior to any change to its 80% investment policy.[18] This notice alternative will ensure that when shareholders purchase shares in an investment company based on its name, and with the expectation that it will follow the investment policy suggested by that name, they will have sufficient time to decide whether to redeem their shares in the event that the investment company decides to pursue a different investment policy.[19] Any investment company that changes its 80% investment policy would, of course, also be required to change its name, as necessary to comply with the requirements of rule 35d-1 in light of its new investment policy.

We are, however, adopting, as proposed, the provision that the 80% investment requirement be adopted as a fundamental policy for tax-exempt investment companies. This requirement is consistent with the long-standing Division position that a tax-exempt fund may not change its tax-exempt status without shareholder approval.[20] The Commission believes that the 80% investment requirement should continue to be a fundamental policy for a tax-exempt investment company because of the critical importance of the tax-exempt status to its investors.

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[17]See *section 8(b)(3) of the Investment Company Act, 15 U.S.C. 80a-8(b)(3) (regarding policies deemed fundamental by an investment company), and section 13(a)(3) of the Investment Company Act, 15 U.S.C. 80a-13(a)(3) (requiring shareholder approval to change a policy deemed fundamental under section 8(b)(3)).*

[18]*Rule 35d-1(a)(2)(ii) and (a)(3)(iii). The notice must be in plain English in a separate written document.* See *rule 35d-1(c)(1). Securities Act rule 421(d)(2) [17 CFR 230.421(d)(2)] lists the following plain English principles: (i) Short sentences; (ii) definite, concrete, everyday words; (iii) active voice; (iv) tabular presentation or bullet lists for complex material, whenever possible; (v) no legal jargon or highly technical terms; and (vi) no multiple negatives. The notice, as well as the envelope containing the notice, also must contain a prominent statement such as "Important Notice Regarding Change in Investment Policy." As an alternative to this requirement, if the notice is sent in a separate mailing, the prominent statement may appear either on the envelope or on the notice itself.* See *rule 35d-1(c)(2) & (3).*

[19]*We believe that an investment company should update its prospectus to reflect an upcoming change in its 80% investment policy by means of an amendment to its registration statement or a prospectus supplement or "sticker" no later than the time that it provides notice to its current shareholders of the change in policy. In addition, after an investment company and/or its investment adviser have taken steps that will result in a change in the company's 80% investment policy but before the time when notice to current shareholders is required by rule 35d-1, it may be materially misleading for an investment company to sell its shares to investors without prospectus disclosure of the upcoming change. The time at which prospectus disclosure is required depends on all the facts and circumstances, including the degree of certainty that the change will occur and the steps that have been taken to effect the change.*

[20]See *Certain Matters Concerning Investment Companies Investing in Tax-Exempt Securities, Investment Company Act Release No. 9785 (May 31, 1977) [42 FR 29130 (June 7, 1977)]; Letter to Matthew P. Fink, Senior Vice President and General Counsel, ICI, from Mary Joan Hoene, Deputy Director, Division of Investment Management, SEC (pub. avail. Dec. 3, 1987) ("Fink Letter").*

2. Names Indicating an Investment Emphasis in Certain Countries or Geographic Regions

We are modifying our proposal to require investment companies with names that suggest that they focus their investments in a particular country (*e.g.*, The ABC Japan Fund) or in a particular geographic region (*e.g.*, The XYZ Latin America Fund) to meet a two-part 80% investment requirement.[21] Rule 35d-1, as adopted, requires that an investment company with a name that suggests that it focuses its investments in a particular country or geographic region adopt a policy to invest at least 80% of its assets in investments that are tied economically to the particular country or geographic region suggested by its name.[22] The investment company also must disclose in its prospectus the specific criteria that are used to select investments that meet this standard.[23] As proposed, rule 35d-1 would have required these investment companies to invest in securities that met one of three criteria specified in the rule.[24] Most commenters addressing this aspect of the proposed rule opposed the two-part test, arguing that the specific criteria would be too restrictive because there may be additional securities that would not meet any of the criteria but would expose an investment company to the economic fortunes and risks of the country or geographic region indicated in the company's name. We are persuaded by these comments, which are consistent with the historical position of the Division of Investment Management.[25] The disclosure approach that we are adopting will allow an investment company the flexibility to invest in additional types of investments that are not addressed by the three proposed criteria

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[21]*The language of the proposal would have required an investment company with a name that suggests that the company focuses its investments in a particular country or geographic region to invest at least 80% of its assets in securities of issuers that are tied economically to that country or region. Proposed rule 35d-1(a)(3). We have modified this language to require that such an investment company invest at least 80% of its assets in investments that are tied economically to the particular country or geographic region suggested by its name. Rule 35d-1(a)(3)(i).* See supra *note 13.*

[22]*Rule 35d-1(a)(3)(i). The term "geographic region" includes one or more states of the United States or a geographic region within the United States. One commenter expressed concern that the rule, by its terms, would apply to an investment company with a long-standing trade name that includes a geographic location, such as the city where the company is headquartered, but which is not intended to refer to the geographic region in which the company invests. We do not intend that rule 35d-1 would require an investment company to change its name in these circumstances, where the connotation of the name is clear through long-standing usage and there is no risk of investor confusion.*

[23]*Rule 35d-1(a)(3)(ii).*

[24]*Proposed rule 35d-1(a)(3). Specifically, the investment would have to have been in: (i) securities of issuers that are organized under the laws of the country or of a country within the geographic region suggested by the company's name or that maintain their principal place of business in that country or region; (ii) securities that are traded principally in the country or region suggested by the company's name; or (iii) securities of issuers that, during the issuer's most recent fiscal year, derived at least 50% of their revenues or profits from goods produced or sold, investments made, or services performed in the country or region suggested by the company's name or that have at least 50% of their assets in that country or region.*

[25]Cf. *Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 22, 1993) at II.A. (rescinded by N-1A Amendments,* supra *note 6, at 13940 n.214) (using substantially the same three proposed criteria, but indicating that the Division would consider other criteria).*

but expose the company's assets to the economic fortunes and risks of the country or geographic region indicated by its name.[26]

3. Tax-Exempt Investment Companies

We are adopting substantially as proposed the requirement that an investment company that uses a name suggesting that its distributions are exempt from federal income tax or from both federal and state income taxes adopt a fundamental policy: (i) to invest at least 80% of its assets in investments the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax;[27] or (ii) to invest its assets so that at least 80% of the income that it distributes will be exempt, as applicable, from federal income tax or from both federal and state income tax. Consistent with current Division positions, the requirements would apply to a company's investments or distributions that are exempt from federal income tax under both the regular tax rules and the alternative minimum tax rules.[28]

One commenter recommended that single state tax-exempt money market funds be exempt from the requirements of rule 35d-1, arguing that in several states, the supply of tax-free instruments that are eligible for purchase by money market funds is severely limited and, as a result, some of these funds may not be able to meet the 80% investment requirement. The Commission has determined not to provide this exemption. We note that a single state tax-exempt money market fund, like other tax-exempt investment companies, will be subject to the 80% investment requirement "under normal circumstances."[29] Thus, a single state tax-exempt fund could deviate from the 80% requirement in limited circumstances, such as a temporary shortage of securities of appropriate quality that distribute income that is tax-exempt in that particular state.[30] If, however, the supply of such securities is so limited that the fund cannot meet the 80% requirement

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[26]*For example, an investment company may invest in a foreign stock index futures contract traded on a U.S. commodities exchange, which may not meet any of the three proposed criteria but could expose the investment company to the economic fortunes and risks of the geographic region covered by the index. We note, however, that if an investment company uses a criterion that requires qualifying investments to be in issuers that derive a specified proportion of their revenues or profits from goods produced or sold, investments made, or services performed in the applicable country or region, or that have a specified proportion of their assets in that country or region, the Division, consistent with its current position, would expect the proportion used to be at least 50%, in order for the investments to be deemed to be tied economically to the country or region.*

[27]*Rule 35d-1(a)(4)(i). The language of the proposal would have required an investment company with a name that suggests that the company's distributions are exempt from federal income tax or from both federal and state income tax to invest at least 80% of its assets in securities the income from which is exempt from the applicable taxes. Proposed rule 35d-1(a)(4). We have modified this language to require that such an investment company invest at least 80% of its assets in investments the income from which is exempt from the applicable taxes.* See supra *note 13.*

[28]See *Fink Letter,* supra *note 20.*

[29]*Rule 35d-1(a)(4)(i) and (ii).* See infra *notes 37-38 and accompanying text (discussing "under normal circumstances" requirement).*

[30]*Under rule 35d-1, a single state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state. Investors are generally more interested in the tax-exempt nature of an issuer's distributions than the issuer's location.* Cf. *Rule 2a-7(a)(23) (defining a single state fund by reference to the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state, rather than the location of the issuers in which it invests).*

under normal circumstances, we believe that the investment company should not use a name suggesting that it is a single state tax-exempt fund.[31]

4. Applying the 80% Investment Requirement

Time of application

The 80% investment requirement generally applies, as proposed, at the time when an investment company invests its assets.[32] We are, however, including a grandfather provision so that a UIT that has made an initial deposit of securities prior to the rule's compliance date will not be required to comply with the 80% investment requirement.[33] Because of the fixed nature of UIT portfolios, such UITs would not be able to adjust their portfolios to comply with the rule.

Assets to which requirement applies

As adopted, the 80% investment requirement will be based on an investment company's net assets plus any borrowings for investment purposes.[34] This is a modification from the proposed requirement that would have based the 80% investment requirement on a company's net assets plus any borrowings that are senior securities under section 18 of the Investment Company Act.[35]

The use of net assets rather than total assets was intended to reflect more closely an investment company's portfolio investments. Commenters were generally supportive of the proposed use of net assets. Several commenters, however, recommended that the 80% investment requirement be applied to net assets plus borrowings used for investment purposes, arguing that this modification would more closely track the Commission's stated objective of preventing an investment company from circumventing the 80% investment requirement by investing borrowed funds in investments that are not consistent with its name. The Commission agrees with these commenters, and has modified the proposal accordingly.[36]

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[31]*Rule 2a-7(a)(23), by contrast, defines a single state fund as a tax-exempt fund "that holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state." (emphasis added) Rule 2a-7 provides relief from its diversification requirements to single state funds in recognition of the fact that such a fund may have difficulty in meeting these standards without sacrificing credit quality, and this relief is appropriate when a fund is seeking to maximize its distributions that are tax-exempt in a particular state. We do not, however, believe that it is appropriate for a fund to suggest, through its name, that it is a single state tax-exempt money market fund unless it complies with the 80% investment requirement.*

[32]*The rule would require an investment company that no longer meets the 80% investment requirement (e.g., as a result of changes in the value of its portfolio holdings or other circumstances beyond its control) to make future investments in a manner that would bring the company into compliance with the 80% requirement. However, an investment company subject to the requirement would not have to sell portfolio holdings that have increased in value.* See *Proposing Release,* supra *note 7, at 10958 n.28 and accompanying text.*

[33]*Rule 35d-1(b).*

[34]*Rule 35d-1(d)(2).*

[35]*15 U.S.C. 80a-18.* See *proposed rule 35d-1(b)(2)(ii).*

[36]*Whether a particular transaction is considered borrowing for investment purposes would depend on all of the facts and circumstances. For purposes of this provision, however, a typical securities lending transaction (in which an investment company lends its portfolio securities and enters an agreement with a lending agent to reinvest cash collateral in highly liquid fixed-income securities, such as U.S. government securities) would not be considered borrowing for investment purposes.*

Temporary Departure from 80% Requirement

Consistent with current Division positions, the rule, as adopted, will require investment companies to comply with the 80% investment requirement "under normal circumstances."[37] This is a modification of the proposed rule, which contemplated that an investment company may depart from the 80% requirement in order to take a "temporary defensive position" to avoid losses in response to adverse market, economic, political, or other conditions.[38] We are persuaded by the commenters who argued that the "temporary defensive position" exception was too narrow and did not give investment companies sufficient flexibility to manage their portfolios, particularly in the case of large cash inflows or anticipated large redemptions.

The "under normal circumstances" standard will provide funds with flexibility to manage their portfolios, while requiring that they would normally have to comply with the 80% investment requirement. This standard will permit investment companies to take "temporary defensive positions" to avoid losses in response to adverse market, economic, political, or other conditions. In addition, it will permit investment companies to depart from the 80% investment requirement in other limited, appropriate circumstances, particularly in the case of unusually large cash inflows or redemptions. For example, a new investment company will be permitted to comply with the 80% investment requirement within a reasonable time after commencing operations. We remind investment companies, however, that in the Division's view, an investment company generally must not take in excess of six months to invest net proceeds in order to operate in accordance with its investment objectives and policies.[39] In addition, we would generally expect new mutual funds, which typically invest in relatively liquid assets and which receive cash from share purchases on an ongoing basis, to be fully invested within a much shorter time.[40] We emphasize that an investment company should not use a name subject to the rule unless it intends to, and does, comply with the 80% investment requirement absent unusual circumstances.

B. Names Suggesting Guarantee or Approval by the U.S. Government

Consistent with the requirements of section 35(a) of the Investment Company Act, rule 35d-1, as adopted, prohibits an investment company from using a name that suggests that the company or its shares are guaranteed or approved by the United States government or any United States government agency or instrumentality.[41] The prohibited types of names include names that use the words "guaranteed" or "insured" or similar terms in conjunction with the words "United States" or "U.S. government."

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[37]See *former Guide 1 in the N-1A Guidelines Release,* supra *note 6 (applying 65% investment requirement "under normal circumstances").*

[38]*Proposed rule 35d-1(b)(3).*

[39]See *Guide 1 to Form N-2, Registration Statement of Closed-End Management Investment Companies.*

[40]*In very limited circumstances, it may be appropriate for a closed-end fund that invests in securities whose supply is limited to take longer than six months to invest offering proceeds.* See *Guide 1 to Form N-2, Registration Statement of Closed-End Management Investment Companies (may be appropriate for a closed-end fund investing in a single foreign country or small businesses to take up to two years to invest offering proceeds).*

[41]*Rule 35(d)-1(a)(1).*

C. Other Investment Company Names

1. General

Rule 35d-1, as adopted, does not codify positions of the Division of Investment Management with respect to investment company names including the terms "balanced," "index," "small, mid, or large capitalization," "international," and "global."[42] In addition, the rule does not apply to fund names that incorporate terms such as "growth" and "value" that connote types of investment strategies as opposed to types of investments. The Division will continue to scrutinize investment company names not covered by the proposed rule.[43] In determining whether a particular name is misleading, the Division will consider whether the name would lead a reasonable investor to conclude that the company invests in a manner that is inconsistent with the company's intended investments or the risks of those investments.[44]

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[42]See *Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 25, 1994) at II.D. (rescinded by N-1A Amendments,* supra *note 6, at 13940 n.214) ("small, medium, and large capitalization"); Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Jan. 17, 1992) at II.A. (rescinded by N-1A Amendments,* supra *note 6, at 13940 n.214) ("index"); Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Jan. 3, 1991) at II.A. (rescinded by N-1A Amendments,* supra *note 6, at 13940 n.214) ("international" and "global"). The terms "small, mid, or large capitalization" and "index" suggest a focus on a particular type of investment, and investment companies that use these terms will be subject to the 80% investment requirement of the rule. The term "balanced," however, does not suggest a particular investment focus, but rather a particular type of diversification among different investments, and "balanced" funds will not be subject to the rule. The Division takes the position that an investment company that holds itself out as "balanced" should invest at least 25% of its assets in fixed income senior securities and should invest at least 25% of its assets in equities.* Cf. *Former Guide 4 in the N-1A Guidelines Release,* supra *note 6 (rescinded by N-1A Amendments,* supra *note 6, at 13940 n.214) (requiring an investment company that purports to be "balanced" to maintain at least 25 percent of the value of its assets in fixed income senior securities). The term "foreign" indicates investments that are tied economically to countries outside the United States, and an investment company that uses this term would be subject to the 80% requirement. The terms "international" and "global," however, connote diversification among investments in a number of different countries throughout the world, and "international" and "global" funds will not be subject to the rule. We would expect, however, that investment companies using these terms in their names will invest their assets in investments that are tied economically to a number of countries throughout the world.* See *Proposing Release,* supra *note 7, at 10960 n.38 and accompanying text ("The Division no longer distinguishes the terms 'global' and 'international.'").*

[43]*As a general matter, an investment company may use any reasonable definition of the terms used in its name and should define the terms used in its name in discussing its investment objectives and strategies in the prospectus.* See *Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 25, 1994) at II.D (rescinded by N-1A Amendments,* supra *note 6, at 13940 n.214) (using this approach for investment companies that include the words "small, mid, or large capitalization" in their names).*

[44]See *In re Alliance North Am. Gov't Income Trust, Inc. Securities Litigation, No. 95 Civ. 0330 (LMM), 1996 U.S. Dist. LEXIS 14209, at *8 (S.D.N.Y. Sept. 27, 1996); The Private Investment Fund for Governmental Personnel, Inc., 37 S.E.C. 484, 487-88 (1957).*

2. Names and Average Weighted Portfolio Maturity and Duration

Investment companies investing in debt obligations often seek to distinguish themselves by limiting the maturity of the instruments they hold. These investment companies may call themselves, for example, "short-term," "intermediate-term," or "long-term" bond or debt funds. Historically, the Division of Investment Management has required investment companies with these types of names to have average weighted portfolio maturities of specified lengths. In particular, the Division has required an investment company that included the words "short-term," "intermediate-term," or "long-term" in its name to have a dollar-weighted average maturity of, respectively, no more than 3 years, more than 3 years but less than 10 years, or more than 10 years.[45] Although the Proposing Release stated that the Division did not intend to continue to use these criteria, the Division has re-evaluated this position in light of its subsequent experience and the comments received on the Proposing Release. The Division has concluded that it will continue to apply these maturity criteria to investment companies that call themselves "short-term," "intermediate-term," or "long-term" because they provide reasonable constraints on the use of those terms.

We note, however, that there may be instances where the average weighted maturity of an investment company's portfolio securities may not accurately reflect the sensitivity of the company's share prices to changes in interest rates.[46] The Commission and the Division, therefore, do not intend compliance with the Division's maturity guidelines to act as a safe harbor in determining whether a name is misleading. In a case, for example, where an investment company's name was consistent with the Division's maturity guidelines, but the "duration" of the company's portfolio was inconsistent with the sensitivity to interest rates suggested by the company's name, the name may be misleading.[47]

D. Compliance Date

Rule 35d-1 will become effective March 31, 2001. The Commission proposed to allow an investment company up to one year from the effective date of the proposed rule to comply with the rule's requirements. The Commission is persuaded by commenters that additional time may be required to make portfolio adjustments; internal compliance system changes; and, for those companies that do not wish to be subject to the rule, to adopt name changes. Therefore the Commission will permit an investment company until July 31, 2002, to comply with the rule's requirements.

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[45]See *Investment Company Act Release No. 15612 (Mar. 9, 1987) [52 FR 8268 (Mar. 17, 1987) at 8301] (proposing to codify these positions in a guideline).*

[46]*In 1994, some investors did not anticipate how certain investment companies would perform when interest rates declined over a relatively short period of time.* See, e.g., *Antilla,* A New Concept in Fund Ads: Truth, *N.Y. Times, July 10, 1994, at C13 (regarding the performance of certain short-term bond funds).*

[47]*In view of the shortcomings associated with analyzing interest rate volatility based on average weighted maturity, investment companies and investment professionals increasingly evaluate bond portfolios based on "duration," which reflects the sensitivity of an investment company's return to changes in interest rates.* See, e.g., *Wright,* Duration: The Second Step, *Morningstar Mutual Funds 1-2 (Sept. 12, 1997); Rekenthaler,* Duration Arrives, *Morningstar Mutual Funds 1-2 (Jan. 21, 1994). Whether a name was misleading in the circumstances outlined above would depend on all the facts and circumstances, including other disclosures to investors.*

Frequently Asked Questions about Rule 35d-1 (Investment Company Names)

December 4, 2001

The staff of the Division of Investment Management has prepared these responses to frequently asked questions about new rule 35d-1, which addresses certain broad categories of investment company names that are likely to mislead investors about an investment company's investments and risks. The adopting release for rule 35d-1 can be found at www.sec.gov/rules/final/ic-24828.htm.

These responses represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved this information.

Adoption of 80% Investment Policy

Question 1

Q If a fund wishes to adopt a fundamental 80% investment policy to comply with rule 35d-1, does the fund need to obtain shareholder approval?

A The Investment Company Act does not require shareholder approval to adopt a new fundamental policy unless the new fundamental policy deviates from an existing fundamental policy.[48] Therefore, if a fund currently has a non-fundamental 65% investment policy and wishes to change the policy to a fundamental 80% investment policy, the Investment Company Act would not require shareholder approval unless the new fundamental policy deviates from some other existing fundamental policy.

Similarly, under the Investment Company Act, shareholder approval would not be required by a fund that has a fundamental 65% investment policy that wishes to adopt a fundamental 80% investment policy, unless adoption of the new policy constitutes deviation from the existing policy or some other existing fundamental policy. A fund would therefore need to determine, based on its individual circumstances, whether it would be necessary to seek shareholder approval to change a fundamental investment policy to increase the investment threshold from 65% to 80%.

For example, a fund that has a fundamental policy to invest at least 65% of its assets in equity securities generally would not be deviating from that policy if it adopted a new fundamental policy to invest at least 80% of its assets in equity securities and would not be required to obtain shareholder approval. By contrast, a fund that has a fundamental policy to invest at least 65%, but not more than 75%, of its assets in equity securities would not be able to adopt a new

[48] See *Section 13(a)(3) of the Investment Company Act (requiring shareholder approval to deviate from a fundamental policy); Investment Company Names, Investment Company Act Release No. 22530, at n. 49 (Feb. 27, 1997) [62 FR 10955, 10960-10961 n. 49 (Mar. 10, 1997), correction 62 FR 24161 (May 2, 1997)] (Investment Company Names Proposing Release) (discussing whether funds need shareholder approval to adopt a fundamental 80% investment policy).*

fundamental policy to invest at least 80% of its assets in equity securities without deviating from the existing fundamental policy. In this case, shareholder approval of the new fundamental policy would be required under the Investment Company Act.

A fund should also consider whether factors outside the Investment Company Act, such as state law or the fund's charter or by-laws, would require shareholder approval in order to adopt a fundamental 80% investment policy.

Question 2

Q May a fund that changes its investment policy from 65% to 80% in order to come into compliance with rule 35d-1 disclose that change in a post-effective amendment filed pursuant to rule 485(b) under the Securities Act?

A Yes. A fund that changes its investment policy from 65% to 80% in order to come into compliance with the rule may disclose the change in a post-effective amendment filed pursuant to rule 485(b) under the Securities Act of 1933, provided that the post-effective amendment otherwise meets the conditions for immediate effectiveness under rule 485(b). If a fund makes other material changes to its investment policy together with a change from 65% to 80%, it must disclose the other changes in a rule 485(a) amendment. A fund should disclose its policy to invest its assets in accordance with the 80% investment requirement suggested by its name in Item 2(b) of Form N-1A, which requires a fund to identify its principal investment strategies, including the types of securities in which it invests principally.[49]

Tax-Exempt Funds

Question 3

Q How does rule 35d-1 apply to single-state tax-exempt funds? Are single-state tax-exempt funds required to satisfy the 80% investment requirement only with securities of issuers located in the named state?

A A fund with a name that suggests that its distributions are exempt from both federal and state income tax, *e.g.*, the Maryland Tax-Exempt Fund, must have a fundamental policy to invest, under normal circumstances, either: (i) at least 80% of the value of its assets in investments the income from which is exempt from both federal income tax and the income tax of the named state, or (ii) its assets so that at least 80% of the income that it distributes will be exempt from both federal income tax and the income tax of the named state.[50] A single-state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named

[49]See *Investment Company Names, Investment Company Act Release No. 24828 (Jan. 17, 2001) [66 FR 8509, 8511 n. 15 (Feb. 1, 2001), correction 66 FR 14828 (Mar. 14, 2001)] (Investment Company Names Adopting Release).*

[50]*Rule 35d-1(a)(4).*

state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state.[51]

Single state tax-exempt funds are not subject to section (a)(3) of the rule (relating to funds with names that suggest investment in a specific country or geographic region).

Question 4

Q Are funds with the term "municipal" in their names treated like tax-exempt funds under rule 35d-1(a)(4)?

A Yes. The terms "municipal" and "municipal bond" in a fund's name suggest that the fund's distributions are exempt from income tax. Therefore, funds that use these terms in their names would be expected to comply with rule 35d-1(a)(4). However, funds that use the term "municipal" rather than "tax-exempt" may count securities that generate income subject to the alternative minimum tax toward the 80% investment requirement, while funds that use the term "tax-exempt" may not.

Question 5

Q The SEC recently adopted rules that require a mutual fund to include standardized after-tax returns in advertisements and sales literature that include any quotation of performance and that represent or imply that the fund is managed to limit or control the effect of taxes on fund performance.[52] Advertisements and sales literature for a fund that is eligible to use a name suggesting that its distributions are exempt from federal income tax or both federal and state income tax under rule 35d-1 are not, however, required to include standardized after-tax returns, unless they voluntarily choose to include after-tax performance information.[53] All fund advertisements and sales literature are required to comply with the new after-tax return rules no later than December 1, 2001,[54] but compliance with rule 35d-1 is not required until July 31, 2002. Prior to July 31, 2002, must a fund that relies on the exception for tax-exempt funds from the requirement to report standardized after-tax returns in advertising and sales literature meet the requirements of rule 35d-1(a)(4)?

A Generally, yes. Rule 35d-1 was effective on March 31, 2001. Although funds are not required to comply with rule 35d-1 until July 31, 2002, any fund that relies on the exception for tax-exempt funds from the after-tax return advertising rule at any time must comply with the eligibility requirements under rule 35d-1(a)(4) for using a name suggesting that the fund's distributions are exempt from federal income tax or from both federal and state income tax. As a

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[51]See *Investment Company Names Adopting Release*, supra *note 2, 66 FR at 8512 n. 30.*

[52]See *Disclosure of Mutual Fund After-Tax returns, Investment Company Act Release No. 24832 (Jan. 18, 2001) [66 FR 9001 (Feb. 5, 2001)].*

[53]*Securities Act rule 482(f); Investment Company Act rule 34b-1(b)(iii)(C).*

[54]*The compliance date for this requirement was recently extended from October 1, 2001, to December 1, 2001.* See *Disclosure of Mutual Fund After-Tax Returns; Extension of Compliance Date, Investment Company Act Release No. 25175 (Sept. 26, 2001) [66 FR 50102 (Oct. 2, 2001)].*

practical matter, this means that, prior to July 31, 2002, in order to rely on the exception for tax-exempt funds from the after-tax return advertising rule, a tax-exempt fund, including a single state tax-exempt fund, need only comply with the eligibility requirements under rule 35d-1(a)(4) for using a name suggesting that the fund's distributions are exempt from federal income tax. The requirements set forth in rule 35d-1(a)(4) for a fund that has a name suggesting that its distributions are exempt from federal income tax are generally the same as those currently applied by the Division of Investment Management.

Specific Terms Commonly Used in Fund Names

Question 6

Q Does rule 35d-1 apply to funds that use the terms "small-cap," "mid-cap," and "large-cap?"

A Yes. Terms such as "small-, mid-, or large-capitalization" suggest a focus on a particular type of investment, and investment companies that use these terms will be subject to the 80% investment requirement of the rule. As a general matter, an investment company may use any reasonable definition of these terms and should define these terms in its discussion of its investment objectives and strategies in its prospectus.[55] In developing a definition of the terms "small-, mid-, or large-capitalization," registrants should consider all pertinent references, including, for example, industry indices, classifications used by mutual fund rating organizations, and definitions used in financial publications. Definitions and disclosure inconsistent with common usage, including definitions relying solely on average capitalization, are considered inappropriate by the staff.

Question 7

Q How does rule 35d-1 apply to a fund that uses the term "high-yield" in its name?

A The term "high-yield" is generally understood in the financial and investment community to describe corporate bonds that are below investment grade, commonly defined as bonds receiving a Standard & Poor's rating below BBB or a Moody's rating below Baa.[56] Therefore, a fund using the term "high-yield" in its name generally must have a policy to invest at least 80% of its assets in bonds that are below investment grade.

However, a fund that uses the term "high-yield" in conjunction with a term such as "municipal" or "tax-exempt" that suggests that the fund invests in tax-exempt bonds would not

[55]See *Investment Company Names Adopting Release,* supra *note 2, 66 FR at 8513-8514 nn. 42-43 and accompanying text.*

[56]See, e.g., *Morningstar, Principia Pro Plus (May 2001) (including funds "with at least 65% or more of bond assets in bonds rated below BBB" in high-yield bond category of taxable bond funds); William F. Sharpe, Gordon J. Alexander, & Jeffery V. Bailey, Investments 437 (5th ed. 1995) (defining "junk bonds" as "bonds that have been assigned to one of the lower ratings (BB and below by Standard & Poor's; Ba and below by Moody's)"); Richard J. Teweles, Edward S. Bradley, & Ted M. Teweles, The Stock Market 539 (6th ed. 1992) (defining "junk" or "high-yield" securities as debt securities with ratings below BBB from Standard & Poor's or below Baa from Moody's).*

be required to invest at least 80% of its assets in bonds that meet these rating criteria. Because the market for below investment grade municipal bonds is smaller and relatively less liquid than its taxable counterpart, tax-free high-yield bond funds have historically invested to a greater degree in higher grade bonds than taxable high-yield funds. As a result, the use of the term "high-yield" together with a term suggesting that the fund invests in tax-exempt bonds suggests that the fund has an investment strategy of pursuing a higher yield than other municipal or tax-exempt bond funds.

Question 8

Q Does rule 35d-1 apply to a fund that uses the term "tax-sensitive" in its name?

A No. The term "tax-sensitive" connotes a type of investment strategy rather than a focus on a particular type of investment. Therefore, use of the term "tax-sensitive" in a fund's name will not require the fund to comply with the 80% investment requirement of rule 35d-1.

We remind funds, however, that a particular fund name may be misleading under the anti-fraud provisions of the federal securities laws, even if it is not covered by rule 35d-1. In determining whether a particular name is misleading, the Division considers whether the name would lead a reasonable investor to conclude that the fund invests in a manner that is inconsistent with the fund's intended investments or the risks of those investments.[57]

Question 9

Q How does rule 35d-1 apply to a fund that uses the term "income" in its name?

A Rule 35d-1 would not apply to the use of the term "income" where that term suggests an investment objective or strategy rather than a type of investment. When used by itself, the term "income" in a fund's name generally suggests that the fund emphasizes the achievement of current income and does not suggest a type of investment. For example, fund companies offering a group of "life cycle" funds, each of which invests in stocks, bonds, and cash in a ratio considered appropriate for investors with a particular age and risk tolerance, sometimes use the term "income" to describe the fund that places the greatest emphasis on achieving current income. Similarly, the term "growth and income" does not suggest that a fund focuses its investments in a particular type of investment, but rather suggests that a fund invests its assets in order to achieve both growth of capital and current income. Likewise, the term "equity income" suggests that a fund focuses its investments in equities and has an investment objective or strategy of achieving current income. By contrast, a term such as "fixed income" suggests investment in a particular type of investment and would be covered by rule 35d-1.

[57] See *Investment Company Names Adopting Release,* supra *note 2, 66 FR at 8514 nn. 43-44 and accompanying text.*

Question 10

Q How does rule 35d-1 apply to a fund with a name that includes the term "global" or "international," followed by a term that suggests a particular type of investment, such as "fixed income?"

A The terms "international" and "global" connote diversification among investments in a number of different countries throughout the world, and therefore the use of these terms in a fund name is not subject to the rule.[58] However, a fund that has a name containing both the term "global" or "international," and a term that suggests that the fund focuses its investments in a particular type of investment, *e.g.,* "fixed income," will be expected to comply with the 80% investment requirement with respect to the latter term.

Question 11

Q Would rule 35d-1 require a fund that uses a term such as "intermediate term bond" in its name to invest at least 80% of its assets in intermediate term bonds?

A No. The Division takes the position that a "short-term," "intermediate-term," or "long-term" bond fund should have a dollar-weighted average maturity of, respectively, no more than 3 years, more than 3 years but less than 10 years, or more than 10 years. Such a fund should, however, invest at least 80% of its assets in bonds in order to comply with rule 35d-1. Compliance with the Division's maturity guidelines is not intended to act as a safe harbor in determining whether a name is misleading. There may be instances where the dollar-weighted average maturity of a fund's portfolio securities may not accurately reflect the sensitivity of the fund's share price to changes in interest rates.[59]

Question 12

Q Are there any guidelines for a bond fund's use of a name that suggests that its portfolio has a specified duration, *e.g.,* "short-duration bond fund?"

A The Division has not developed specific guidelines regarding a fund's use of a name, *e.g.,* "short-duration bond fund," suggesting that its bond portfolio has a particular duration. A fund that uses a name suggesting that its bond portfolio has a particular duration, *e.g.,* short, intermediate, or long, may use any reasonable definition of the terms used, and should explain its definition in its discussion of its investment objectives and strategies in the fund's prospectus. In developing a definition of a term that suggests a particular portfolio duration, registrants should consider all pertinent references, including, for example, classifications used by mutual fund rating organizations, definitions used in financial publications, and industry indices. Definitions and disclosure inconsistent with common usage are considered inappropriate by the staff. A fund that uses a name suggesting that its bond portfolio has a particular duration is not required to invest at least 80% of its assets in bonds of that duration.

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[58]See *Investment Company Names Adopting Release,* supra *note 2, 66 FR at 8513-8514 n. 42.*

[59]See *Investment Company Names Adopting Release,* supra *note 2, 66 FR at 8514 nn. 45-47 and accompanying text.*

Question 13

Q A fund that uses the term "money market" in its name must invest solely in eligible securities and meet other investment requirements under rule 2a-7, in order for its name not to be deemed materially deceptive or misleading within the meaning of Section 35(d) of the Investment Company Act.[60] Is a fund that uses the term "money market" in its name also required to comply with rule 35d-1?

A Rule 35d-1 would require a fund using the term "money market" in its name to adopt a policy to invest at least 80% of its assets in the type of money market instruments suggested by its name. For example, a fund calling itself "The XYZ U.S. Treasury Money Market Fund" would be required to adopt a policy to invest at least 80% of its assets in U.S. Treasury securities. However, a generic money market fund, *i.e.*, a money market fund that has a name suggesting that it invests in money market instruments generally (*e.g.,* "The XYZ Money Market Fund"), would not be required to specifically adopt a policy to invest at least 80% of its assets in eligible securities since rule 2a-7, in any event, requires the fund to invest solely in eligible securities.

Notice to Shareholders of Change in Investment Policy

Question 14

Q For a fund that has adopted a policy to provide its shareholders with at least 60 days' notice prior to changing its 80% investment policy, what should the notice include?

A Rule 35d-1 does not prescribe the contents of a notice of a change in a fund's investment policy. We believe, however, that the notice should, at a minimum, describe the 80% investment policy, the nature of the change to the investment policy, the fund's new name, and the effective date of the investment policy and name changes. In order to comply with rule 35d-1(c), a fund's notice policy must provide that the notice will:

be provided in plain English;

be a separate written document (although the notice may be delivered to shareholders together with other communications to investors, such as an annual or semi-annual report); and

contain the statement "Important Notice Regarding Change in Investment Policy," or a similar clear and understandable statement, prominently and in bold-face type. This prominent statement also must appear on the envelope in which the notice is delivered, if the notice is not delivered separately from other communications to investors. If the notice is delivered separately, the statement must appear either on the notice or on the envelope in which the notice is delivered.[61]

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[60]*Rule 2a-7(b)(2) and (c)(3)(i).*

[61]Cf. *Delivery of Proxy Statements and Information Statements to Households, Securities Act Rel. No. 7912, Exchange Act Rel. No. 43487, Investment Company Act Rel. No. 24715 (Oct. 27, 2000) [65 FR 65736, 65738 (Nov. 2, 2000)] (describing notice to investors of intent to "household" proxy statements and information statements); Delivery of Disclosure Documents to Households, Securities Act Rel. No. 7766, Exchange Act Rel. No. 42101, Investment Company Act Rel. No. 24123 (Nov. 4, 1999) [64 FR 62540, 62541 (Nov. 16, 1999)] (describing notice to investors of intent to "household" prospectuses, annual reports, and investment company semi-annual reports).*

Compliance Date

Question 15

Q When do new registrants have to comply with the requirements of rule 35d-1?

A All registered investment companies must be in compliance with the rule by July 31, 2002, regardless of when they initially register. Newly registered investment companies may, however, wish to comply with rule 35d-1 from the time of registration in order to avoid the need to make portfolio adjustments, internal compliance system changes, and/or name changes, as a result of the need to come into compliance with the rule.

Disclosure of Mutual Fund After-Tax Returns

[Release Nos. 33-7941; 34-43857; IC-24832)]

ACTION: Final rule

SUMMARY: The Securities and Exchange Commission is adopting rule and form amendments under the Securities Act of 1933 and the Investment Company Act of 1940 to improve disclosure to investors of the effect of taxes on the performance of open-end management investment companies ("mutual funds" or "funds"). These amendments require mutual funds to disclose in their prospectuses after-tax returns based on standardized formulas comparable to the formula currently used to calculate before-tax average annual total returns. The amendments also require certain funds to include standardized after-tax returns in advertisements and other sales materials. Disclosure of standardized mutual fund after-tax returns will help investors to understand the magnitude of tax costs and compare the impact of taxes on the performance of different funds.

EFFECTIVE DATE: April 16, 2001. Section II. J. of this release contains information on compliance dates.

FOR FURTHER INFORMATION CONTACT: Vincent J. Di Stefano, Senior Counsel, Peter M. Hong, Special Counsel, Martha B. Peterson, Special Counsel, or Kimberly Dopkin Rasevic, Assistant Director, (202) 942-0721, Office of Disclosure Regulation, Division of Investment Management, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549-0506.

Table of Contents

I. Introduction

We are adopting rule and form amendments that require a mutual fund to disclose after-tax returns.[62] Taxes are one of the most significant costs of investing in mutual funds through taxable accounts. In 1999, mutual funds distributed approximately $238 billion in capital gains and $159 billion in taxable dividends.[63] Shareholders investing in stock and bond funds paid an estimated $39 billion in taxes in 1998 on distributions by their funds.[64] Recent estimates suggest that more than two and one-half percentage points of the average stock fund's total return is lost each year to taxes.[65] Moreover, it is estimated that, between 1994 and 1999, investors in diversified U.S. stock funds surrendered an average of 15 percent of their annual gains to taxes.[66]

Despite the tax dollars at stake, many investors lack a clear understanding of the impact of taxes on their mutual fund investments.[67] Generally, a mutual fund shareholder is taxed when he or she receives income or capital gains distributions from the fund and when the shareholder redeems fund shares at a gain.[68]

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[62]See *Disclosure of Mutual Fund After-Tax Returns, Investment Company Act Release No. 24339 (Mar. 15, 2000) [65 FR 15500 (Mar. 22, 2000)] ("Proposing Release").*

[63]*Investment Company Institute ("ICI"), Mutual Fund Fact Book 56 (2000) ("2000 Mutual Fund Fact Book") (distributions of taxable dividends included $95.6 billion on equity, hybrid, and bond funds and $63.1 billion on money market funds).*

[64]*Liberty Funds Distributor News Release, Liberty Announces Annual Mutual Fund Tax Pain Index (Apr. 12, 2000) http://www.libertyfunds.com (estimate of the tax burden based on net capital gains realized on mutual funds other than money market funds, and net investment income on equity, bond, and income funds).*

[65]*KPMG Peat Marwick LLP, An Educational Analysis of Tax-Managed Mutual Funds and the Taxable Investor ("KPMG Study"), at 14.*

[66]*Jonathan Clements, Fund Distributions are a Taxing Problem; How the Tax Man Dines on Your Funds, The Wall Street Journal, Aug. 31, 1999, at C1.*

[67]*In a recent telephone survey, 1,000 mutual fund investors were asked about their tax knowledge. Eighty-five percent of respondents claimed taxes play an important role in investment decisions, but only thirty-three percent felt that they were very knowledgeable about the tax implications of investing. Eighty-two percent were unable to identify the maximum rate for long-term capital gains. The Dreyfus Corporation, Dreyfus' 1999 Tax Informed Investing Study (visited Jan. 2, 2001) <http://www.dreyfus.com/>.*

[68]*I.R.C. 61(a)(3) and (7) (providing that an individual's gross income includes dividends and gains derived from dealings in property); I.R.C. 852(b)(3)(8) (capital gain dividend from a mutual fund treated as gain from sale or exchange of capital asset held for more than one year); I.R.C. 1001 (gain from sale or other disposition of property is excess of amount realized over adjusted basis, and loss is excess of the adjusted basis over amount realized).* See *IRS Publication 564, Mutual Fund Distributions (2000), at 2-4 (explaining tax treatment of distributions of income and capital gains by mutual funds to their shareholders).*

The tax consequences of distributions are a particular source of surprise to many investors when they discover that they can owe substantial taxes on their mutual fund investments that appear to be unrelated to the performance of the fund. Even if the value of a fund has declined during the year, a shareholder can owe taxes on capital gains distributions if the portfolio manager sold some of the fund's underlying portfolio securities at a gain.[69]

The tax impact of mutual funds on investors can vary significantly from fund to fund. For example, the amount and character of a fund's taxable distributions are affected by its investment strategies, including the extent of a fund's investments in securities that generate dividend and other current income, the rate of portfolio turnover and the extent to which portfolio trading results in realized gains, and the degree to which portfolio losses are used to offset realized gains. One recent study reported that the annual impact of taxes on the performance of stock funds varied from zero, for the most tax-efficient funds, to 5.6 percentage points, for the least tax-efficient.[70] While the tax-efficiency of a mutual fund is of little consequence to investors in 401(k) plans or other tax-deferred vehicles, it can be very important to an investor in a taxable account, particularly a long-term investor whose tax position may be significantly enhanced by minimizing current distributions of income and capital gains.

Recently, there have been increasing calls for improvement in the disclosure of the tax consequences of mutual fund investments. Mutual funds, as well as third party providers that furnish information to mutual fund shareholders, are responding to this growing investor demand by providing after-tax returns, calculators that investors can use to compute after-tax returns,

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[69] *This is attributable, in part, to the fact that a mutual fund generally must distribute substantially all of its net investment income and realized capital gains to its shareholders in order to qualify for favorable tax treatment as a "regulated investment company" ("RIC"). I.R.C. 852 and 4982(b). As a RIC, a mutual fund is generally entitled to deduct dividends paid to shareholders, resulting in its shareholders being subject to only one level of taxation on the income and gains distributed to them. I.R.C. 851 (circumstances under which an investment company may be treated as a RIC) and 852(b)(2) (calculation of taxable income of a RIC).* See, e.g., Year-End Tax Tips, *Bob Edwards (National Public Radio, Morning Edition radio broadcast, Dec. 28, 1999) (describing tax consequences of mutual fund distributions as a "shock" to investors).*

[70] *KPMG study,* supra *note 3, at 14 (reporting the impact of taxes on performance of 496 stock funds for the ten-year period ending December 31, 1997).*

and other tax information.[71] In addition, several fund groups have created new funds promoting the use of more tax-efficient portfolio management strategies.[72] Moreover, in April 2000, a bill that would require the Commission to revise its regulations to require improved disclosure of mutual fund after-tax returns was passed by the U.S. House of Representatives and referred to the Senate.[73] Many press commenters also have highlighted the need for improvements in mutual fund tax disclosure.[74]

Currently, the Commission requires mutual funds to disclose significant information about taxes to investors.[75] While we believe that this disclosure is useful, we are persuaded that funds

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[71]*For example, Eaton Vance Management reports after-tax returns and tax-efficiency ratios for certain of its tax-managed funds on its website. Eaton Vance, Eaton Vance Mutual Funds (visited December 19, 2000) http:// www.eatonvance.com/mutual_funds/mutualfunds_A.asp. Online tax calculators are also available. The Vanguard Group, After-Tax Returns Calculator (visited December 19, 2000) http:// majestic5. vanguard.com/FP/DA/ 0.1.vgi_FundAfterTaxSim/07919034801913465O?AFTER_TAX_CALC=SIMPLE (calculator that can be used to calculate after-tax returns for Vanguard funds); Andrew Tobias' Mutual Fund Cost Calculator (visited Dec. 22, 2000) http:// www.personalfund.com/cgi-bin/cost.cgi? ticker=TWLBX (cost calculator includes a feature that calculates after-tax returns). Fidelity Investments and Charles Schwab & Co. offer Internet tools that feature after-tax returns of funds offered in their fund supermarkets. E.g., Fidelity Investments, Fidelity Funds (visited December 19, 2000) http:// personal100. fidelity.com/gen/mflfid/0/316145200.html; About Schwab, Schwab Introduces New On-line Mutual Fund Selection and Screener Tools, Dec. 22, 1999 (visited Dec. 19, 2000) http://www.prnewswire.com/cgi-bin/ micro_stories.pl? ACCT=154881&TICK=SCH&STORY=/www/story/ 12-22-1999/0001102424&E DATE=Dec+22, +1999. Further, Morningstar, Inc., and Forbes report mutual fund after-tax returns. Morningstar, Mutual Fund 500 (2000 ed.); Fund Survey, Forbes, Feb. 7, 2000, at 166.*

[72]*he fund groups offering funds labeled as "tax-managed," "tax-efficient," "tax-sensitive," or "tax-aware" include 59 Wall Street, American Century, Bernstein, Delaware Investments, DFA Investment Dimensions, Dresdner RCM Global Investors, Dreyfus, Eaton Vance, Evergreen, Fidelity, GMO, Golden Oak, ING, J.P. Morgan, Liberty Financial Funds, PaineWebber, PIMCO, Prudential, Putnam, Russell, Standish Ayer & Wood, STI Classic, SunAmerica, T. Rowe Price, USAA, and Vanguard. Morningstar, Inc., currently tracks 59 tax-managed funds, as compared to 12 such funds only four years ago. Morningstar, Principia Pro Plus (Dec. 2000) (reporting as of Nov. 30, 2000).*

[73]*The Mutual Fund Tax Awareness Act of 2000, H. R. 1089, 106th Cong., 2nd Sess. (2000) (introduced by Congressman Paul Gillmor, passed by the House, as amended, on Apr. 3, 2000, by a vote of 358 to 2, and referred to the Senate on Apr. 4, 2000.).* See also *H.R. 1089: The Mutual Fund Tax-awareness Act of 1999: Hearings Before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce, 106th Cong., 1st Sess. (Oct. 29, 1999) (Statement of the U.S. Securities and Exchange Commission Concerning Disclosure of the Tax Consequences of Mutual Fund Investments and Charitable Contributions).*

[74]See, e.g., *Fred Barbash*, Facts Might Confuse Us? Excuse Me?, *The Washington Post, Nov. 19, 2000, at H1; Karen Damato*, Funds' Tally of IRS Bite Can Be Tricky, *The Wall Street Journal, Nov. 3, 1999, at C1; Paul J. Lim*, Your Money; Funds and 401(k)s; As Stock Market Returns Shrink, After-Tax Results Gain Importance, *Los Angeles Times, Oct. 17, 1999, at C3; Charles A. Jaffe*, Mutual Fund Gains Create Interesting Tax Issues Later, *The Kansas City Star, Mar. 23, 1999, at D19.*

[75]*In its prospectus, a mutual fund is required to disclose (i) the tax consequences of buying, holding, exchanging, and selling fund shares, including the tax consequences of fund distributions; and (ii) whether the fund may engage in active and frequent portfolio trading to achieve its principal investment strategies, and, if so, the tax consequences of increased portfolio turnover and how this may affect fund performance. Item 7(e) of Form N-1A; Instruction 7 to Item 4 of Form N-1A. A fund also must disclose in its prospectus and annual report the portfolio turnover rate and dividends and capital gains distributions per share for each of the last five fiscal years. Items 9(a) and 22(b)(2) of Form N-1A. These items also require funds to show net realized and unrealized gain or loss on investments on a per share basis for each of the fund's last five fiscal years.*

can more effectively communicate to investors the tax consequences of investing. As a result, last March we proposed for public comment amendments to our rules and to Form N-1A, the registration form for mutual funds, that would require disclosure of standardized mutual fund after-tax returns.[76]

Today we adopt rule and form amendments that require a fund to disclose its standardized after-tax returns for 1-, 5-, and 10-year periods. After-tax returns, which will accompany before-tax returns in fund prospectuses, will be presented in two ways: (i) after taxes on fund distributions only; and (ii) after taxes on fund distributions and a redemption of fund shares. Although after-tax returns will not generally be required in fund advertisements and sales literature, any fund that either includes after-tax returns in these materials or includes other performance information together with representations that the fund is managed to limit taxes will be required to include after-tax returns computed according to our standardized formulas.

While the Commission recognizes that a significant amount of mutual fund assets are held through tax-deferred arrangements, such as 401(k) plans or individual retirement accounts ("IRAs"), almost forty percent of non-money market fund assets held by individuals are held in taxable accounts.[77] We are concerned that the millions of mutual fund investors who are subject to current taxation may not fully appreciate the impact of taxes on their fund investments because mutual funds are required to report their performance on a before-tax basis only.[78] Although performance is only one of many factors that an investor should consider in deciding whether to invest in a particular fund, many investors consider performance one of the most significant factors when selecting or evaluating a fund.[79] As a result, we believe it would be beneficial for funds to provide their after-tax performance in order to allow investors to make better-informed decisions.

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[76]*Proposing Release,* supra *note 1.*

[77]*As of year end 1999, eighty-one percent of mutual fund assets ($5.5 trillion) were held by individuals. 2000 Mutual Fund Fact Book,* supra *note 2, at 41. At the end of 1999, mutual fund assets held in retirement accounts stood at $2.5 trillion. 2000 Mutual Fund Fact Book, at 49. Mutual fund assets held by individuals in money market funds stood at $885 billion. 2000 Mutual Fund Fact Book, at 103. Thus, almost 40 percent of non-money market fund assets held by individuals ($2.1 trillion) were held in taxable accounts. An investor is not taxed on his or her investments in IRAs, 401(k) plans, and other qualified retirement plans until the investor receives a distribution from the plan.*

I.R.C. 401 et seq. See *IRS Publication 564, Mutual Fund Distributions (1999), at 2 (explaining tax treatment of mutual funds held in retirement vehicles).*

[78]*An investor is not taxed on his or her investments in IRAs, 401(k) plans, and other qualified retirement plans until the investor receives a distribution from the plan.*

I.R.C. 401 et seq. See *IRS Publication 564, Mutual Fund Distributions (1999), at 2 (explaining tax treatment of mutual funds held in retirement vehicles).*

See *Items 2, 5, 9, and 22(b)(2) of Form N-1A.*

[79]*Last year, we posted a bulletin for mutual fund investors on our website, in which we cautioned investors to look beyond performance when evaluating mutual funds and to consider the costs relating to a mutual fund investment, including fees, expenses, and the impact of taxes on their investment. Securities and Exchange Commission, Mutual Fund Investing: Look at More Than a Fund's Past Performance (last modified Jan. 24, 2000) http://www.sec.gov/consumer/mperf.htm.*

See *ICI, Understanding Shareholders' Use of Information and Advisers (Spring 1997), at 21 and 24 (Total return information was frequently considered by investors before a purchase, second only to the level of risk of the fund. Eighty-eight percent of fund investors surveyed said that they considered total return before their most recent purchase of a mutual fund. Eighty percent of fund owners surveyed reported that they followed a fund's rate of return at least four times per year.).*

This is the latest Commission action in our continuing effort to improve fund disclosure of costs. Since 1988, we have required mutual funds to include a uniform fee table in the prospectus.[80] More recently, we have increased our efforts to educate investors about mutual fund costs and how those costs affect performance.[81] In 1999, we introduced a "Mutual Fund Cost Calculator" to assist investors in determining how fund fees and charges affect their mutual fund returns.[82] Moreover, we are currently considering recommendations made in separate reports by the United States General Accounting Office and the Commission's Division of Investment Management on ways to improve fund disclosure of fees and costs.[83]

The amendments we adopt today represent another significant step in these efforts. Taxes are one of the largest costs associated with a mutual fund investment, having a dramatic impact on the return an investor realizes from a fund. Disclosure of standardized mutual fund after-tax returns will help investors to understand the magnitude of tax costs and compare the impact of taxes on the performance of different funds.

II. Discussion

The Commission received 235 letters commenting on the Proposing Release.[84] One hundred ninety-five of the letters were from individual investors or investor advocacy groups. The individual investors and investor advocacy groups overwhelmingly supported the Commission's proposal to require disclosure of after-tax returns. The remaining 40 letters were from industry participants, who were divided in their views. Many generally supported the proposal, while expressing concerns regarding specific disclosure requirements. Others opposed the proposal. Many commenters offered recommendations for improving portions of the proposal. The Commission is adopting the proposed rule and form amendments with the modifications described below that address commenters' concerns.

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[80]*Item 3 of Form N-1A; Consolidated Disclosure of Mutual Fund Expenses, Investment Company Act Release No. 16244 (Feb. 1, 1988) [53 FR 3192 (Feb. 4, 1988)].*

[81]See, e.g., *Securities and Exchange Commission, Mutual Fund Investing: Look at More Than a Fund's Past Performance (last updated Jan. 24, 2000) http://www.sec.gov/ consumer/mperf.htm; Securities and Exchange Commission, Invest Wisely: An Introduction To Mutual Funds (last modified Oct. 21, 1996) http://www.sec.gov /consumer/ inwsmf.htm; "Common Sense Investing in the 21st Century Marketplace," Remarks by Arthur Levitt, Chairman, SEC, Investors Town Meeting, Albuquerque, NM (Nov. 20, 1999); "Financial Self-Defense: Tips From an SEC Insider," Remarks by Arthur Levitt, Boston Globe "Moneymatters" Personal Finance Conference, Boston, MA (Oct. 16, 1999); Transparency in the United States Debt Market and Mutual Fund Fees and Expenses: Hearings Before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce, 105th Cong., 2nd Sess. (Sept. 29, 1998) (Statement of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission).*

[82]*Securities and Exchange Commission, The SEC Mutual Fund Cost Calculator (last modified Jul. 24, 2000) http:// www.sec.gov/mfcc/get-started.html.*

[83]*United States General Accounting Office, Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition (June 2000) (recommending that the Commission require fund quarterly account statements to include the dollar amount of each investor's share of fund operating expenses); Division of Investment Management, Securities and Exchange Commission, Report on Mutual Fund Fees and Expenses (Dec. 2000) (recommending that the Commission consider requiring fund shareholder reports to include a table showing the cost in dollars incurred by a shareholder who invested a standardized amount in the fund, paid the fund's actual expenses, and earned the fund's actual return for the period).*

[84]*The comment letters and a summary of the comments prepared by the Commission staff are available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. (File No. S7-09-00).*

A. Required Disclosure of After-Tax Returns

The Commission is adopting, with modifications, the requirement that mutual funds disclose after-tax return, a measure of a fund's performance adjusted to reflect taxes that would be paid by an investor in the fund. As discussed more fully below, funds will be required to include after-tax return information in the risk/return summary of the prospectus.[85] Funds will not generally be required to include after-tax returns in advertisements or other sales materials. Funds will, however, be required to include after-tax returns computed according to a standardized formula in sales materials that either include after-tax returns or include any other performance information together with representations that the fund is managed to limit taxes.[86]

Individual commenters overwhelmingly supported the required disclosure of after-tax returns. Many of these individuals stated that after-tax returns would help them compare funds and make better-informed investment decisions. Industry comments, however, were mixed regarding whether funds should be required to disclose this information. Industry commenters supporting after-tax return disclosure noted that the disclosure would give investors a clearer understanding of fund performance and assist them in evaluating the impact of taxes on the performance of various funds. Industry commenters opposing after-tax return disclosure argued, among other things, that the disclosure would overwhelm investors, be irrelevant to investors in tax-deferred accounts such as 401(k) plans, be inaccurate because the returns are not tailored to individual investors' specific tax situation, place funds at a competitive disadvantage, and be unduly burdensome to compute. A few of these commenters suggested that, instead of requiring the disclosure of after-tax returns, the Commission should encourage the development of web-based personalized after-tax return calculators.

After careful consideration of these comments, we continue to believe that requiring funds to provide standardized after-tax returns will be beneficial to investors, allowing them to make better-informed investment decisions. We believe that after-tax return disclosure is useful to, and understandable by, investors, as evidenced by the overwhelming support of individual commenters. Moreover, in recognition of the fact that after-tax returns would not be relevant for investors who hold fund shares through tax-deferred arrangements, we are requiring that after-tax returns be accompanied by narrative disclosure to that effect, and we are exempting prospectuses used exclusively to offer fund shares as investment options for tax-deferred arrangements from the after-tax return disclosure requirement.[87]

We recognize that the computation of after-tax return depends on assumed tax rates, which vary from investor to investor. Standardized after-tax returns will, however, serve as useful guides to understanding the effect of taxes on a fund's performance and allow investors to compare funds' after-tax returns. The presentation of standardized after-tax returns, coupled with the presentation of before-tax returns, will provide investors with a more complete and accurate picture of a fund's performance than before-tax returns standing alone.

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[85]*Items 2(c)(2)(i) and (iii) of Form N-1A.*

[86]*Rule 482(e)(4) and (5)(iii); rule 482(f); rule 34b-1(b)(1)(iii)(B) and (C).*

[87]*General Instruction C.3(d)(iii) and Item 2(c)(2)(iv)(B) of Form N-1A.*

We strongly encourage funds to develop web-based calculators and other tools that investors may use to compute their individualized after-tax return for a fund. This information will be very useful to investors in assessing how a particular fund has performed for them. We believe, however, that after-tax returns should be made available to all investors, not only to those who have the ability to access and use these web-based programs. In addition, personalized after-tax calculators often do not facilitate ready comparisons of different funds' after-tax performance.

We do not believe that requiring funds to disclose after-tax returns will place them at a competitive disadvantage vis-à-vis other investments. Investors choose funds over other investment products because they offer advantages unavailable with most other investment products, *e.g.,* access to professional portfolio management and diversification with a relatively small investment. In addition, we are exempting money market funds from the after-tax return disclosure requirement, in part because of our concern that they would be disadvantaged vis-à-vis very similar, competing products.

Finally, we believe that the burden to funds of computing and disclosing after-tax returns is justified by the benefits to investors from receiving this information. While we acknowledge that funds will incur a one-time cost to modify their systems to compute after-tax returns, the computation thereafter should be straightforward to perform using readily available data.

B. Types of Return to Be Disclosed

As proposed, funds will be required to calculate after-tax returns using a standardized formula similar to the formula presently used to calculate before-tax average annual total return.[88] We proposed to require funds to disclose after-tax return for 1-, 5-, and 10-year periods on both a "pre-liquidation" and "post-liquidation" basis, and we are adopting that requirement. Pre-liquidation after-tax return assumes that the investor continued to hold fund shares at the end of the measurement period, and, as a result, reflects the effect of taxable distributions by a fund to its shareholders but not any taxable gain or loss that would have been realized by a shareholder upon the sale of fund shares.[89] Post-liquidation after-tax return assumes that the investor sold his or her fund shares at the end of the measurement period, and, as a result, reflects the effect of both taxable distributions by a fund to its shareholders and any taxable gain or loss realized by the shareholder upon the sale of fund shares.[90] Pre-liquidation after-tax return reflects the tax effects on shareholders of the portfolio manager's purchases and sales of portfolio securities, while post-liquidation after-tax return also reflects the tax effects of a shareholder's individual decision to sell fund shares.

Most commenters addressing the issue of whether we should require pre- and post-liquidation after-tax returns supported disclosure of both types of after-tax returns. A few commenters argued that pre-liquidation after-tax return should be eliminated because the addition of

[88]See *Item 21(b)(1) of Form N-1A.*
[89]*Proposed Item 21(b)(3) of Form N-1A*
[90]*Proposed Item 21(b)(4) of Form N-1A.*

another performance figure could overwhelm and confuse investors and, if provided without post-liquidation after-tax return, would tend to suggest to shareholders that taxation could be deferred indefinitely. A few commenters recommended that only pre-liquidation after-tax returns be required because post-liquidation returns reflect the action of a specific shareholder (*i.e.*, the decision to sell fund shares), rather than the tax-efficiency of the fund's portfolio management.

The Commission is adopting, as proposed, the requirement that funds present both pre- and post-liquidation after-tax returns in order to provide investors with a more complete understanding of the impact of taxes on a fund's performance.[91] We believe that pre-liquidation after-tax return is important because it provides information about the tax-efficiency of portfolio management decisions. We also believe, however, that it is important for shareholders, many of whom hold shares for a relatively brief period, to understand the full impact that taxes have on a mutual fund investment that has been sold.[92]

In response to commenters' concerns about investor confusion, we are streamlining the returns required to be disclosed. Most commenters recommended that we revise the proposed pre-liquidation after-tax return figure to deduct fees and charges payable upon a redemption of fund shares, such as sales charges or redemption fees. This would make the pre-liquidation after-tax return figure comparable to currently required standardized before-tax returns, which also deduct fees and charges payable upon sale, and would result in comparable disclosure by funds that impose sales charges upon purchase and those that impose sales charges upon redemption.[93] Commenters also argued that this modification would eliminate the need for the proposed pre-liquidation before-tax return figure with no deduction of fees and charges payable upon sale, thereby simplifying the presentation of before- and after-tax returns.

We agree and have eliminated pre-liquidation before-tax returns. This will result in three, rather than four, types of return, all of which are net of all fees and charges: before-tax return; return after taxes on distributions (pre-liquidation); and return after taxes on distributions and redemption (post-liquidation).[94] To address concerns that investors could be confused by a pre-liquidation after-tax return measure that assumes no sale of fund shares for purposes of computing tax consequences but nonetheless reflects fees and charges payable upon a sale of fund shares, we have modified the captions in the performance table to focus investor attention on the taxes that are deducted, rather than whether or not the shareholder held or sold his shares.[95]

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[91]*Items 21(b)(2) and (3) of Form N-1A.*

[92]*A recent report estimates that over the past decade the average holding period of mutual funds has decreased from over 10 years to about 3 years. Steve Galbraith, Mary Medley, Sean Yu, The Apotheosis of Stuart-Lighting the Candle in U.S. Equities, Bernstein Research Call, Sanford C. Bernstein & Co., Jan. 10, 2000.*

[93]*Instruction 4 to Item 21(b)(1) of Form N-1A.*

[94]*Items 2(c)(2)(i) and (iii) and 21(b)(1)-(3) of Form N-1A.*

[95]See *Section D,* infra, *regarding modifications to the format of disclosure.*

C. Location of Required Disclosure

We are requiring, as proposed, that funds disclose after-tax returns in the performance table contained in the risk/return summary of the prospectus.[96] The amendments also will have the effect of requiring that after-tax returns be included in any fund profile because a profile must include the prospectus risk/return summary.[97] We proposed, but are not adopting, a requirement that after-tax returns be included in Management's Discussion of Fund Performance ("MDFP"), which is typically contained in the annual report.[98] Funds will, however, be required to state in the MDFP that the performance table and graph do not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares.[99]

We are requiring that after-tax returns be included in the prospectus and profile because, for the overwhelming majority of prospective investors who base their investment decision, in part, on past performance, after-tax returns can be useful in understanding past performance.[100] Most commenters that addressed the issue of the appropriate location for after-tax return disclosure supported requiring disclosure of after-tax returns in fund prospectuses.

Several commenters recommended that after-tax returns not be included in fund profiles. Commenters were concerned that the length and complexity of the disclosure could overwhelm the remaining information in the profile, defeating the purpose of the summary disclosure document. We continue to believe, however, that after-tax returns should be included in the fund profile because of the importance of past performance in many investors' investment decisions. We have, however, addressed the concerns expressed by commenters by simplifying the presentation of required after-tax returns.[101]

Some commenters supported inclusion of after-tax returns in the risk/return summary, but others recommended that after-tax returns be disclosed in the section of the prospectus describing the tax consequences to investors of buying, holding, exchanging, and selling fund shares.[102] These commenters argued that the required disclosure is too lengthy and technical for inclusion in the risk/return summary. We believe that it is critical that after-tax returns be disclosed in the same location as before-tax returns, so that after-tax returns will be easy for investors to find and compare with before-tax returns. Therefore, we are adopting, as proposed, the requirement that after-tax returns be presented in the risk/return summary. In addition, in response to

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[96]*Item 2(c)(2)(iii) of Form N-1A.*

[97]*Rule 498(c)(2)(iii) under the Securities Act [17 CFR 230.498(c)(2)(iii)]. In addition, after-tax returns would be required in registration statements filed on Form N-14 [17 CFR 239.23], the registration form used by mutual funds to register securities to be issued in mergers and other business combinations under the Securities Act.* See *Item 5(a) of Form N-14 (cross-referencing Item 2 of Form N-1A).*

[98]See *Proposing Release,* supra *note 1, at nn. 36-41, and accompanying text.*

[99]*Item 5(b)(2) of Form N-1A.*

[100]*An estimated 88 percent of mutual fund shareholders considered the total return of the fund before their most recent fund purchase. Seventy-five percent of mutual fund shareholders considered the fund's performance relative to similar funds. ICI, Understanding Shareholders' Use of Information and Advisers,* supra *note 18, at 21.*

[101]See *Section II.A.,* supra, *regarding modifications to the types of returns required; Section II.D.,* infra, *regarding modifications to the format of disclosure, including simplification of presentation for funds offering more than one class of shares in the prospectus; Section II.H.,* infra, *regarding the narrative accompanying the performance table.*

[102]*Item 7(e) of Form N-1A.*

commenters' concerns that the proposed disclosure would be too lengthy or complex for inclusion in the risk/return summary, we have simplified the presentation of returns in the table, as well as the accompanying narrative.[103]

We have decided not to require funds to include after-tax returns in the MDFP, which is typically contained in the annual report. Many commenters who addressed the issue of the appropriate location for disclosing after-tax returns recommended that after-tax returns not be included in the MDFP. As commenters observed, existing shareholders already receive detailed information that allows them to determine the tax impact of their investment in the fund.[104] They also typically receive on an annual basis an updated prospectus that will contain after-tax performance information.[105] Moreover, commenters pointed out that, because after-tax returns in the MDFP would have been calculated on a fiscal year basis, they would not be comparable from fund to fund, and use of fiscal year results could enable funds to time distributions in order to artificially enhance after-tax returns. We have therefore decided not to require disclosure of after-tax returns in the MDFP.

We are concerned, however, that investors may be confused about whether the returns included in the performance table and graph in the MDFP have been calculated on a before- or after-tax basis. Therefore, funds will be required to include a statement in the MDFP that accompanies the performance table and graph to the effect that the returns shown do not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares.[106]

D. Format of Disclosure

We are requiring, as proposed, that before and after-tax returns be presented in a standardized tabular format. Consistent with the modifications to the types of returns required, funds must present before- and after-tax returns as follows:[107]

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[103]See *discussion in note 40,* supra.

[104]*Annually, funds are required to send Form 1099-DIV or a similar statement to any shareholder receiving $10 or more in taxable income. I.R.C. 6042. Form 1099-DIV reports the amount and character of fund distributions* (e.g., *ordinary dividends, capital gain distributions, and non-taxable distributions) received by shareholders during the year. Funds also are required to send Form 1099-B or a similar statement to any shareholder who sells, exchanges, or redeems fund shares during the year. I.R.C. 6045. Form 1099-B reports the proceeds from the sale of fund shares.*

[105]*The Securities Act requires mutual funds to send updated prospectuses only to those existing shareholders who make additional purchases. In practice, many mutual funds send an updated prospectus annually to all of their shareholders.*

[106]*Item 5(b)(2) of Form N-1A.*

[107]*Item 2(c)(2)(iii) of Form N-1A.*

AVERAGE ANNUAL TOTAL RETURNS

(For the period ended December 31,)

	1 year	5 years [or Life of Fund]	10 years [or Life of Fund]
Return Before Taxes	____%	____%	____%
Return After Taxes on Distributions	____%	____%	____%
Return After Taxes on Distributions and Sale of Fund Shares	____%	____%	____%
Index (reflects no deduction for [fees, expenses, or taxes])	____%	____%	____%

Before- and after-tax returns must be presented in the order specified, using the captions provided by Form N-1A. When more than one fund or series is offered in a prospectus, the before- and after-tax returns of each fund or series must be adjacent to one another. A prospectus may not, for example, present the before-tax returns for all funds, followed by the after-tax returns for all funds.[108] We believe that this presentation will help investors to compare funds and to understand the differences among the different measures of return for any particular fund.

We have modified the captions in the performance table to focus investor attention on the taxes that are deducted, rather than whether or not the shareholder held or sold his shares. We have also modified the captions to clarify that returns are shown for the life of the fund, if shorter than the 5- or 10-year measurement periods, and that the language following the caption for the index may be modified, as appropriate, to be consistent with the index selected by the fund.

We have also simplified the presentation for funds that offer multiple classes of a fund in a single prospectus. We were persuaded by several commenters who argued that requiring after-tax returns for all classes of a fund, as proposed, could result in overwhelming or confusing disclosure to investors, and that, with the exception of expense ratio differences, which affect the level of dividend distributions, the tax burden of the various share classes will be similar. We have modified the amendments to require that a fund offering multiple classes in a single prospectus present the after-tax returns of only one class.[109] The class selected must be offered to investors who hold their shares through taxable accounts and have returns for at least 10 years, or, if no such class has 10 years of return, be the class with the returns for the longest period.

A fund that offers multiple classes in a single prospectus must explain in the narrative that accompanies the performance table that the after-tax returns are for only one class offered by the prospectus and that the after-tax returns for other classes will vary.[110] In addition, in order to facilitate comparisons among the returns shown, after-tax returns for the one class presented must be adjacent to the before-tax returns for that class and not interspersed with the before-tax

[108]*Item 2(c)(2)(iii) of Form N-1A; Instruction 2(e) to Item 2 of Form N-1A.*

[109]*Instruction 3(c)(ii) to Item 2 of Form N-1A.*

[110]*Item 2(c)(2)(iv)(C) of Form N-1A.*

returns of the other classes, returns of other funds, or with the return of the broad-based securities market index.[111] The return of the broad-based securities index may either precede or follow the returns for the fund.[112]

E. Exemptions from the Disclosure Requirement

We are exempting money market funds from the requirement to disclose after-tax returns, as proposed.[113] We are also adopting, with modifications, our proposal to permit a fund to omit the after-tax return information in a prospectus used exclusively to offer fund shares as investment options for defined contribution plans and similar arrangements.[114]

Specifically, we are permitting a fund to omit the after-tax return information in a prospectus used exclusively to offer fund shares as investment options to one or more of the following:

a defined contribution plan that meets the requirements for qualification under section 401(k) of the Internal Revenue Code ("Code");

a tax-deferred arrangement under section 403(b) or 457 of the Code;

a variable contract as defined in section 817(d) of the Code;

a similar plan or arrangement pursuant to which an investor is not taxed on his or her investment in the fund until the investment is sold;[115] or

entities that are not subject to the individual federal income tax.

The proposed after-tax return information would largely be irrelevant in these circumstances because the affected investors either are not subject to current taxation on fund distributions or are not subject to current taxation at the individual federal income tax rates, and their tax consequences on a sale of fund shares are different from those experienced by individual investors in taxable accounts.[116]

In response to the recommendations of several commenters, we have expanded the exemption to include prospectuses used to offer fund shares to entities that are not subject to individual

[111] *Instructions 2(e) and 3(c)(iii) to Item 2 of Form N-1A.*

[112] *Instruction 2(e) to Item 2 of Form N-1A.*

[113] *Item 2(c)(2)(iii) of Form N-1A.*

[114] *General Instruction C.3(d)(iii) of Form N-1A.*

[115] *These similar plans or arrangements may include those existing under current tax law or new types of plans or arrangements permitted by future changes in the tax law.*

[116] See *IRS Publication 575, Pension and Annuity Income (2000), at 4 (explaining tax treatment of earnings under a variable annuity contract) and 7-19 (explaining tax treatment of distributions from retirement plans); IRS Publication 525, Taxable and Non-Taxable Income (2000), at 6 (explaining tax treatment of contributions to a retirement plan) and 15 (explaining tax treatment of proceeds of a life insurance contract); IRS Publication 575, Pension and Annuity Income (2000), at 5 (tax treatment of Section 457 Deferred Compensation Plan); IRS Publication 571, Tax Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations (1999), at 2 (explaining tax treatment of Section 403(b) tax sheltered annuities).*

taxation (*e.g.,* tax-exempt foundations, colleges, and corporations). We agree that the after-tax return information is not relevant to these investors. A fund may not, however, rely on this exemption if the prospectus is used indirectly to offer shares to persons that are subject to individual taxation, such as an offer to a partnership whose individual partners are taxed on a pass-through basis.[117]

The Commission carefully considered whether to exclude bond funds, generally, or tax-exempt funds, specifically, from the requirement to disclose after-tax returns. A number of commenters argued that bond funds should be exempt from disclosing after-tax returns because investors in bond funds are generally aware of the tax consequences of investing in these funds, the funds do not usually make unexpected distributions of capital gains, and the funds are bought for their yield and not their growth potential. Other commenters argued that bond funds should not be exempt because such funds may have significant capital gains or losses in volatile markets, certain types of bond funds commonly realize significant capital gains, and some managers of bond funds seek to avoid making capital gains distributions by using various tax management strategies.

Having considered the views expressed by commenters, we have decided not to exempt bond funds from disclosing after-tax returns. While investors may more readily understand the tax impact of owning a bond fund that makes few, if any, capital gains distributions, than the tax impact of owning other funds, bond funds may have significant capital gains or losses, and we believe that it is important for after-tax return information to be available to their shareholders.

Similarly, while most, if not all, income distributed by a tax-exempt mutual fund generally will be tax-exempt, a tax-exempt mutual fund may also make capital gains distributions that are taxable and an investor is taxed on gains from the sale of fund shares.[118] As a result, the performance of a tax-exempt fund may be affected by taxes, and taxes may have a greater or lesser impact on different tax-exempt funds. Therefore, we have decided not to exempt tax-exempt funds from the required disclosure.[119]

F. Advertisements and Other Sales Literature

We are adopting, with modifications, amendments that require certain fund advertisements and sales literature to include after-tax performance that is calculated according to the standardized formulas prescribed in Form N-1A for computation of after-tax returns in the risk/return

[117]*I.R.C. 702 (regarding taxation of partners).*

[118]*Interest on any state or local bond is excluded from gross income. However, there is no exclusion for capital gains resulting from the sale of such bonds.* See *I.R.C. 103(a); IRS Publication 564, Mutual Fund Distributions (2000), at 2 (describing tax treatment of tax-exempt mutual funds).*

[119]*A tax-exempt fund, like any other fund, may assume, when calculating after-tax returns, that no taxes are due on the portions of any distribution that would not result in federal income tax on an individual. Instruction 3(a) to Item 21(b)(2) and Instruction 3(a) to Item 21(b)(3) of Form N-1A.*

summary. As proposed, all fund advertisements and sales literature that include after-tax performance information will be required to include after-tax returns computed according to the standardized formulas.[120] Any quotation of non-standardized after-tax return also will be subject to the same conditions currently applicable to quotations of non-standardized performance that are included in fund advertisements and sales literature.[121] Requiring advertisements and sales literature that include after-tax performance information to include standardized after-tax returns will help to prevent misleading advertisements and sales literature and permit shareholders to compare claims about after-tax performance.

Commenters generally supported the proposal to require fund advertisements and sales literature that include after-tax performance information to include standardized after-tax returns, but several commenters recommended that we extend the requirement to advertisements and sales literature that claim that a fund is "tax-managed" or "tax-efficient" and that include any performance information. As noted by one commenter, a fund advertising 20 percent before-tax return and claiming 100 percent tax-efficiency could have significant unrealized gains that would result in tax liabilities when a shareholder redeems his or her shares. We are persuaded that, to help prevent such tax-efficiency claims from being misleading, such advertisements should include standardized after-tax returns, which will help an investor to assess the tax-efficiency of the fund more accurately. Therefore, we have modified the proposal to require the inclusion of standardized after-tax returns in any advertisement or sales literature that includes a quotation of performance and that represents or implies that the fund is managed to limit or control the effect of taxes on performance.[122]

This requirement does not apply to advertisements or sales literature for a fund that is eligible to use a name suggesting that the fund's distributions are exempt from federal income tax or

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[120]*Rule 482(e)(4) permits the standardized after-tax returns for 1-, 5-, and 10-year periods to be contained in an advertisement, provided that the standardized after-tax returns (i) are current to the most recent calendar quarter ended prior to the submission of the advertisement for publication; (ii) are accompanied by quotations of standardized before-tax return; (iii) include both measures of standardized after-tax return; (iv) are set out with equal prominence to one another and in no greater prominence than the required quotations of standardized before-tax return; and (v) identify the length of and the last day of the 1-, 5-, and 10-year periods.*

Any other measure of after-tax return could be included in advertisements if accompanied by the standardized measures of after-tax return. Rule 482(e)(5)(iii). Similarly, measures of after-tax return may be included in other sales materials if accompanied by the standardized measures of after-tax return. Rule 34b-1(b)(1)(iii)(B).

A quotation of standardized tax equivalent yield in an advertisement or other sales literature need not be accompanied by standardized after-tax returns. Rules 482(e)(2) and 34b-1(b)(iii)(B).

[121]*Specifically, any measure of after-tax return in a rule 482 advertisement will be required to reflect all elements of return and be set out in no greater prominence than the required quotations of standardized before-tax and after-tax returns. The advertisement will be required to identify the length of and the last day of the period for which performance is measured. Rule 482(e)(5)(i), (iv), and (v).*

Likewise, any sales literature that contains a quotation of performance that has been adjusted to reflect the effect of taxes remains subject to the other requirements of rule 34b-1.

[122]*We believe that any fund that uses terms such as tax-managed, tax-efficient, tax-sensitive, or tax-aware in its name is representing or implying that the fund is managed to limit or control the effect of taxes on performance. Therefore, a fund using these terms in its name will be required to include standardized after-tax returns in any advertisement or sales literature that includes a quotation of performance.*

from both federal and state income tax under our recently-adopted fund names rule.[123] Because these funds meet the strict standards of the names rule, we have concluded that the additional requirement for including standardized after-tax returns in advertisements or sales literature should not apply to them unless they voluntarily choose to include after-tax performance information.

One commenter recommended that we prohibit funds from publishing after-tax returns for periods of less than one year. The commenter argued that this would prevent funds from reporting year-to-date after-tax returns just before a large taxable distribution, wrongly suggesting to shareholders that the fund had been tax-efficient. While we have decided not to prohibit funds from publishing after-tax returns for periods of less than one year in all cases, we remind funds that sales materials are subject to the antifraud provisions of the federal securities laws and that compliance with the terms of rule 482 under the Securities Act or rule 34b-1 under the Investment Company Act is not a safe harbor from liability for fraud.[124] Therefore, any fund that publishes after-tax returns for periods shorter than one year should be extremely careful to ensure that the returns are not materially misleading, *e.g.,* because the returns incorrectly suggest that a fund has been more tax-efficient than has, in fact, been the case.

G. Formulas for Computing After-Tax Return

We are adopting, with the modifications discussed below, the requirement that funds compute after-tax returns using standardized formulas that are based largely on the current standardized formula for computing before-tax average annual total return.[125] After-tax returns will be computed assuming a hypothetical $1,000 one-time initial investment and the deduction of the maximum sales load and other charges from the initial $1,000 payment.[126] Also, after-tax returns will be calculated for 1-, 5-, and 10-year periods.[127]

1. Tax Bracket

We are requiring, as proposed, that standardized after-tax returns be calculated assuming that distributions by the fund and gains on a sale of fund shares are taxed at the highest applicable individual federal income tax rate.[128] Comment was divided on this issue. Some commenters

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[123]*Rules 482(e)(6) and 34b-1(b)(1)(iii)(C). The fund names rule, rule 35d-1(a)(4), requires a fund that uses a name suggesting that a fund's distributions are exempt from federal income tax or from both federal and state income tax to adopt a fundamental policy under section 8(b)(3) of the Investment Company Act: (i) to invest at least 80 percent of its assets in investments the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; or (ii) to invest its assets so at least 80 percent of the income that it distributes will be exempt, as applicable, from federal income tax or from both federal and state income tax.* See *Investment Company Names, Investment Company Act Release No. 24828 (Jan. 17, 2001).*

[124]See, e.g., *Advertising by Investment Companies, Investment Company Act Release No. 16245 (Feb. 2, 1988) [53 FR 3868 (Feb. 10, 1988)], at n.51.* See also *section 17(a) of the Securities Act [15 U.S.C. 77q]; section 10(b) of the Exchange Act [15 U.S.C. 78j(b); section 34(b) of the Investment Company Act [15 U.S.C. 80a-33]; section 206 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-6].*

[125]*Items 21(b)(2) and (3) of Form N-1A.*

[126]*Items 21(b)(2) and (3) of Form N-1A; Instruction 1 to Item 21(b)(2) and Instruction 1 to Item 21(b)(3) of Form N-1A.*

[127]*Items 21(b)(2) and (3) of Form N-1A.*

[128]*Instruction 4 to Item 21(b)(2) of Form N-1A; Instruction 4 to Item 21(b)(3) of Form N-1A.*

Currently, the highest individual marginal income tax rate imposed on ordinary income is 39.6%, and the highest rate imposed on long-term capital gains is 20%. I.R.C. 1(a)-(d), (h).

supported the highest tax rate as providing investors with the full range of historical after-tax returns, as well as being the simplest rate to use to compute after-tax returns. Other commenters, however, recommended that we require funds to calculate after-tax returns using an intermediate tax rate in addition to, or in lieu of, the highest tax rate. These commenters observed that the typical mutual fund investor is not in the highest tax bracket, and argued that after-tax returns calculated using tax rates to which the typical mutual fund investor is subject would be more useful.

After careful consideration of these comments, we continue to believe that it is most appropriate to use the highest tax rate, rather than an intermediate rate. Computing after-tax returns with maximum tax rates will provide investors with the "worst-case" federal income tax scenario. Coupled with before-tax return, which reflects the imposition of taxes at a 0 percent rate, this "worst-case" scenario will effectively provide investors with the full range of historical after-tax returns. We believe that providing the full range of federal income tax outcomes provides investors the most complete information.

In addition, we concluded that any benefits of using an intermediate tax rate would be outweighed by the complexity of determining the appropriate intermediate rate from one year to the next as tax rates and the income of a typical mutual fund investor change. Most of the commenters who recommended that after-tax returns be calculated using an intermediate rate suggested that we either use a specific rate (*e.g.,* 28 percent) or select a specific income level (*e.g.,* $55,000) that would be used to identify the appropriate tax rate. If we were to adopt either of these approaches, we would be required to make ongoing modifications to respond to changes in tax rates and income levels. One commenter suggested that we determine the intermediate rate by reference to the median United States household income reported by the U.S. Census Bureau. This approach would be predicated on assumptions about the "typical" mutual fund investor and the past, present, and future income of that investor.

In any case, a requirement that funds calculate after-tax returns using an intermediate rate would effectively require that we continually monitor the changing demographics of mutual fund investors, as well as changing tax laws, and update our rules accordingly. The use of an intermediate rate also would require that funds include complex narrative disclosure in the risk/return summary about how the intermediate rate had been selected or what intermediate rate had been used from year to year.[129]

While we are not adopting a requirement that funds calculate after-tax returns using an intermediate rate, we encourage funds to provide their investors with additional information that is tailored to a particular fund's typical investor, or to make available to investors after-tax returns calculated using multiple tax rate assumptions. Funds can supply this information in a variety of ways (*e.g.,* calculators on their websites or disclosure elsewhere in the prospectus of returns calculated based on different tax rate assumptions).

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[129] *The concerns expressed by the commenters are, in any event, mitigated by the fact that after-tax returns will not reflect state and local taxes, which are often quite significant. State income tax rates can be as high as 12%; and a rate of 6%-7%, or higher, is common on taxable income of $55,000, the income level suggested by commenters as representative of a typical mutual fund investor.* See *The World Almanac and Book of Facts 161 (2000) (state income tax rates).*

2. *Capital Gains and Losses Upon a Sale of Fund Shares*

We are adopting, substantially as proposed, amendments requiring that return, after taxes on distributions and redemption, be computed assuming a complete sale of fund shares at the end of the 1-, 5-, or 10-year measurement period, resulting in capital gains taxes or a tax benefit from any resulting capital losses.[130] As proposed, a fund will be required to track the actual holding periods of reinvested distributions and may not assume that they have the same holding period as the initial $1,000 investment.[131] We have made technical changes to clarify that applicable federal tax law should be used to determine whether and how gains and losses from the sale of shares with different holding periods should be netted, as well as the tax character (*e.g.*, short-term or long-term) of any resulting gains or losses.[132]

Several commenters suggested that we permit funds to calculate taxes on gains realized upon a sale of shares at the end of the one-year period (*i.e.*, short-term capital gains) as if the shares had been held for one year and one day (*i.e.*, long-term capital gains).[133] These commenters argued that a reasonable shareholder would hold the shares for the extra day in order to qualify for the more advantageous tax treatment, and that it is inappropriate to assume that shares would be sold at the end of the one-year period. We are not modifying the proposal to reflect this comment. A shareholder who redeems his or her shares at any time during the one-year period is subject to taxation of gains at short-term rates. We believe that it is important for the after-tax return calculation to accurately reflect the fact that redeeming shares within the one-year period may have significant adverse tax consequences. In addition, we are providing that the tax consequences of a sale of fund shares should be determined in accordance with applicable federal tax law on the redemption date. If we were, instead, to prescribe a special rule for one-year returns, we would have to reevaluate this special rule in light of subsequent changes in tax law, such as increases to the holding period required for long-term gain treatment.

A number of commenters suggested other modifications to the proposal regarding the tracking of holding periods, such as treating the holding period of all reinvested distributions as beginning on the date of the original investment, and treating all gains on redemption as qualifying for long-term capital gains treatment. We are not adopting these recommended modifications, each of which would have the effect of reclassifying short-term gains as long-term gains, as they would minimize the impact of short-term gains on fund returns, in a manner

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[130] *Instructions 6 and 7 to Item 21(b)(3) of Form N-1A. In order to simplify the computation of returns after taxes on distributions and sale of fund shares, funds may assume that a taxpayer has sufficient capital gains of the same character to offset any capital losses on a sale of fund shares and therefore that the taxpayer may deduct the entire capital loss. Instruction 7(d) to Item 21(b)(3) of Form N-1A.*

[131] *Instruction 7(c) to Item 21(b)(3) of Form N-1A.*

A fund would also be required to separately track the basis of shares acquired though the $1,000 initial investment and each subsequent purchase through reinvested distributions. We wish to clarify that a distribution representing a return of capital will reduce the basis of an existing lot of shares and be included in the basis of the shares acquired upon reinvestment, which may have the effect of shifting the amount of basis allocated to shares with various holding periods.

[132] *Instruction 7(d) to Item 21(b)(3) of Form N-1A.*

[133] *I.R.C. 1222(1) provides that the term "short-term capital gain" means "gain from the sale or exchange of a capital asset held for not more than 1 year, if and to the extent such gain is taken into account in computing gross income."*

inconsistent with federal tax law. One of our purposes in requiring the disclosure of after-tax returns is to provide investors with information about the differential impact that taxes have on the before-tax returns of various funds, and we believe that ignoring the effect of short-term gains would tend to minimize these differences inappropriately.

3. Other Assumptions

Commenters generally supported the other assumptions that the Commission proposed to require in the computation of after-tax returns, and we are adopting those requirements as proposed. Specifically, after-tax returns:

Will be calculated using historical tax rates;[134]

Will be based on calendar-year periods, consistent with the before-tax return disclosure that currently appears in the risk/return summary;[135]

Will exclude state and local tax liability;[136]

Will not take into account the effect of either the alternative minimum tax or phaseouts of certain tax credits, exemptions, and deductions for taxpayers whose adjusted gross income is above a specified amount;[137]

Will assume that any taxes due on a distribution are paid out of that distribution at the time the distribution is reinvested and reduce the amount reinvested;[138] and

Will be calculated assuming that the taxable amount and tax character (*e.g.*, ordinary income, short-term capital gain, long-term capital gain) of each distribution are as specified by the fund on the dividend declaration date, adjusted to reflect subsequent recharacterizations.[139]

4. Tax Treatment of Distributions

As proposed, we are not specifying in detail the tax consequences of fund distributions. Funds generally should determine the tax consequences of distributions by applying the tax law in effect on the date the distribution is reinvested. However, because a number of commenters expressed concern about whether a fund that has elected to pass through foreign tax credits to its shareholders may reflect the foreign tax credit in after-tax returns, we are providing that the

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[134]*Instruction 4 to Item 21(b)(2) of Form N-1A; Instruction 4 to Item 21(b)(3) of Form N-1A. The Proposing Release sets forth the maximum federal income tax rates for the years 1990-2000. Proposing Release,* supra *note 1, at n.66, and accompanying text.*

[135]*Item 2(c)(iii) of Form N-1A.*

[136]*Instruction 4 to Item 21(b)(2) of Form N-1A; Instruction 4 to Item 21(b)(3) of Form N-1A.*

[137]Id.

[138]*Instruction 3 to Item 21(b)(2) of Form N-1A; Instruction 3 to Item 21(b)(3) of Form N-1A.*

[139]Id.

effect of applicable tax credits, such as the foreign tax credit, should be taken into account in accordance with federal tax law.[140]

H. Narrative Disclosure

We are adopting, with modifications, the requirement that funds include a short, explanatory narrative adjacent to the performance table in the risk/return summary.[141] This is intended to facilitate investor understanding of the table. We are not mandating specific language for the narrative, but it must be in plain English.[142]

Commenters generally agreed that the proposed narrative disclosure would help investors understand information in the performance table. Several commenters, however, recommended streamlining the narrative by combining some of the proposed items with the narrative currently required for before-tax returns and by eliminating technical items unnecessary for investor understanding of performance information. We agree and have modified the narrative disclosure to require the following information:[143]

After-tax returns are calculated using the historical highest individual federal marginal income tax rates, and do not reflect the impact of state and local taxes; and

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[140]*Instruction 3 to Item 21(b)(2) of Form N-1A; Instruction 3 to Item 21(b)(3) of Form N-1A. A fund may elect to pass through to shareholders foreign tax credits if more than 50 percent of the value of the fund's total assets at the close of the taxable year consists of stock or securities in foreign corporations and the fund otherwise qualifies for favorable tax treatment as a regulated investment company for the taxable year. I.R.C. 853. In computing after-tax returns, a fund that elects to pass foreign tax credits through to shareholders may assume that the shareholders use those credits. We would not object if a fund adjusts after-tax returns to reflect the impact of distributions of up to $600 of foreign tax credits, the amount of credit that may be taken by a married couple filing jointly without regard to limits on the foreign tax credit. I.R.C. 904(a) and (j)(2). If a fund makes distributions of foreign tax credits in excess of $600, the fund must take into account the limits in the federal tax law on the ability of shareholders to use foreign tax credits.*

[141]*Item 2(c)(2)(iv) of Form N-1A.*

[142]See *rule 421(b) and (d) under the Securities Act [17 CFR 230.421(b) and (d)] (requiring that all information in the prospectus be presented in clear, concise, and understandable fashion and that registrants use plain English principles in the organization, language, and design of the summary and risk factors sections of their prospectuses); General Instruction C.1 to Form N-1A (fund prospectus should be easy to understand and promote effective communication); Item 2 of Form N-1A (requiring that the response to Item 2 be stated in plain English).*

[143]*We eliminated the proposed requirement that funds explain the differences between the types of returns presented, which is unnecessary in light of our reduction of the returns from four to three and our revision of the table captions. We also eliminated the proposed requirement that funds disclose that before-tax returns assume all distributions are reinvested. As commenters noted, funds are not currently required to include this technical information with before-tax returns. We also eliminated the similar proposed requirement that funds disclose that after-tax returns assume that taxes are paid out of fund distributions and that distributions, less taxes, are reinvested. Finally, we eliminated the proposed requirement that funds, whose after-tax returns exceed before-tax returns, explain the reason for this result. Funds, however, will have the option of including this explanatory material. Item 2(c)(2)(iv)(D) of Form N-1A.*

Actual after-tax returns depend on the investor's tax situation and may differ from those shown, and the after-tax returns shown are not relevant to investors who hold their fund shares through tax-deferred arrangements such as 401(k) plans or individual retirement accounts.[144]

In addition, a fund will be required to provide a statement to the effect that the fund's past performance, before and after taxes, is not necessarily an indication of how the fund will perform in the future.[145]

[144]*As discussed above, we have simplified the proposal to require a fund offering more than one class of shares in its prospectus to show after-tax returns for one class only.* See *Section II.C.*, supra *notes 48-50 and accompanying text. Consistent with this modification, such funds will be required to include disclosure that after-tax returns are shown for only one class and that after-tax returns for other classes will vary. Item 2(c)(2)(iv)(C) of Form N-1A.*

[145]*Item 2(c)(2)(i) of Form N-1A.*

Frequently Asked Questions About Mutual Fund After-Tax Return Requirements
(12/4/2001 as supplemented January 14, 2002)

The staff of the Division of Investment Management has prepared these responses to frequently asked questions about the new mutual fund after-tax return rule and form amendments. These amendments require mutual funds to disclose in their prospectuses after-tax returns based on standardized formulas comparable to the formula currently used to calculate before-tax average annual total returns. The amendments also require certain funds to include standardized after-tax returns in advertisements and other sales materials. The adopting release for the after-tax return requirements can be found at www.sec.gov/rules/final/33-7941.htm.

Many of the questions that the Division has received involve the tax treatment of distributions, redemptions, and other events that must be considered in calculating after-tax returns. The responses to these questions generally follow the applicable federal tax law. In addressing similar questions that arise in calculation of after-tax returns, funds and third-party providers should consult and apply the tax law in effect for each period for which after-tax returns are calculated.

These responses represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved this information.

Tax Rates

Question 1

Q What are the applicable federal individual income tax rates for calculating after-tax returns?

A The following chart lists the applicable federal individual income tax rates for the years 1985 through 2001.

Beginning of Period for which Effective	Ordinary Income/Short-Term Capital Gain Rate	Long-Term Capital Gain Rate	Mid-Term Capital Gain Rate (effective for July 29, 1997, through Dec. 31, 1997, for investments held for more than 1 year but not more than 18 months)	Section 1250 Gain Rate
Jan. 1, 1985	50.0%	20.0%	Not applicable	Not applicable
Jan. 1, 1987	38.5%	28.0%		
Jan. 1, 1988	28.0%			
Jan. 1, 1991	31.0%			
Jan. 1, 1993	39.6%			
May 7, 1997		20.0%		25.0%
July 29, 1997			28.0%	
Jan. 1, 1998			Not applicable[146]	
Jan. 1, 2001	39.1%			

Question 2

Q What are the applicable federal corporate tax rates for calculating the impact of undistributed capital gains on after-tax returns?

A The following chart lists the applicable corporate tax rates for the years 1985 through 2001. See Question 9, below, for the treatment of undistributed capital gains.

Beginning of Period for which Effective	Corporate Tax Rate
Jan. 1, 1985	46.0%
July 1, 1987	34.0%
Jan. 1, 1993	35.0%

[146] *The mid-term capital gain rate does not apply to capital gain dividend reported to shareholders on IRS Form 1099-DIV for 1998 that is attributable to assets sold by a fund after July 28, 1997, and before January 1, 1998 (after being held for more than one year but not more than 18 months).* See *Omnibus Consolidated And Emergency Supplemental Appropriations Act, 1999, sec. 4002(i)(2), Pub. L. No. 105-277, 112 Stat. 2681-907 (1998).*

Question 3

Q Should after-tax returns always be calculated using the highest rate applicable to any federal income tax bracket?

A Generally, yes. Instruction 4 to Item 21(b)(2) of Form N-1A and Instruction 4 to Item 21(b)(3) of Form N-1A provide that taxes due on distributions are to be calculated using the "highest individual marginal federal income tax rates." Instruction 7(d) to Item 21(b)(3) of Form N-1A provides that capital gains taxes upon redemption are to be calculated using the "highest federal individual capital gains tax rate for gains of the appropriate character."

However, Instruction 4 to Item 21(b)(2) of Form N-1A and Instruction 4 to Item 21(b)(3) of Form N-1A also provide that the effect of phaseouts of certain exemptions, deductions, and credits at various income levels should be disregarded. As a result, there may be circumstances where the highest rate applicable to any federal income tax bracket is not used because that rate reflects the phaseout of certain exemptions, deductions, and/or credits. For example, the Tax Reform Act of 1986 created two tax brackets, 15% and 28%, with a 5% surcharge designed to phase out the effect of the 15% rate and personal exemptions for upper income households. The 5% surcharge created a "bubble" rate of 33% on income at certain levels, with the rate dropping back to 28% on income above the level where the phaseout was complete. As reflected in the chart in Question 1, a 28% rate rather than a 33% rate should be used for the affected years (1988-1990).

Question 4

Q When should the lower capital gains rate for qualified five-year gains enacted by the Taxpayer Relief Act of 1997 be incorporated into the after-tax return calculation?

A For taxpayers in the 20% bracket for long-term capital gains, the qualified five-year gain rate (18%) applies to assets purchased on or after January 1, 2001 (or assets held on January 1, 2001, and subject to a special election to recognize gain on the assets ("mark to market election")) and held for more than five years.[147] Therefore, the 18% rate will not apply until such assets are sold beginning in January 2006. The 18% rate would apply to any distributions designated by the fund as qualified five-year gains on Form 1099-DIV beginning in January 2006, as well as to redemptions of shares purchased on or after January 1, 2001, (or subject to the mark to market election) and held for more than 5 years prior to redemption starting in January 2006. For purposes of the after-tax return calculation, a fund should assume that a shareholder did not elect to mark to market (and recognize gain upon) any shares held on January 1, 2001. Thus, in computing after-tax returns, the 18% rate should not be applied to gains from the redemption of shares purchased prior to January 1, 2001.

[147] *I.R.C. 1(h)(2).*

Capital Gains And Losses; Reinvested Dividends; Cost Basis

Question 5

Q How should the capital gain and loss netting rules be applied in computing return after taxes on distributions and redemption of fund shares?

A Instruction 7(d) to Item 21(b)(3) of Form N-1A provides in part that "applicable federal tax law should be used to determine whether and how gains and losses from the sale of shares with different holding periods should be netted, as well as the tax character (*e.g.*, short-term or long-term) of any resulting gains or losses. Assume that a shareholder has sufficient capital gains of the same character from other investments to offset any capital losses from the redemption so that the taxpayer may deduct the capital losses in full."

In calculating the capital gains taxes (or the benefit resulting from tax losses) on a redemption of fund shares, the federal tax law netting rules should first be applied to losses and gains from the sale of fund shares. A fund should only assume that a shareholder has sufficient gains of the same character from other investments to offset any capital losses from the redemption after the fund has netted all gains and losses from the sale of fund shares. Thus, the netting rules should be applied as follows:

1. Calculate the gain or loss for each lot sold, identifying lots by their appropriate holding periods (*e.g.*, short-term, long-term, or 5-year gain under current tax law)

2. Compute net long-term capital gain or loss by combining long-term gains and long-term losses from the sale of all lots held for more than one year.[148]

3. Compute net short-term capital gain or loss by combining short-term gains and short-term losses from the sale of all lots held one year or less.[149]

4. Determine appropriate tax treatment as follows:

a. If netting results in net long-term capital gain and net short-term capital gain, tax net long-term capital gain at long-term capital gain rate; tax net short-term capital gain at short-term capital gain (ordinary income) rate.[150]

b. Combine net short-term capital gain and net long-term capital loss. If result is greater than zero, tax amount at short-term capital gain (ordinary income) rate. If amount is less than zero, determine benefit resulting from tax loss using long-term capital gain rate.[151]

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[148]See *I.R.C. 1222(7) (defining "net long-term capital gain"); I.R.C. 1222(8) (defining "net long-term capital loss").*

[149]See *I.R.C. 1222(5) (defining "net short-term capital gain"); I.R.C. 1222(6) (defining "net short-term capital loss").*

[150]*I.R.C. 1(a)-(d) (tax rates applicable to ordinary income); I.R.C. 1(h) (tax rates applicable to net capital gain); I.R.C. 1222(11) (defining "net capital gain" as excess of net long-term capital gain over net short-term capital loss).*

[151]*I.R.C. 1(a)-(d) (tax rates applicable to ordinary income); I.R.C. 1211(b) (allowing losses from the sale of capital assets to the extent of gains from sales of capital assets). Because the after-tax return rules require a fund to assume that a shareholder has sufficient capital gains of the same character to offset any capital losses from the redemption, the benefit from any long-term capital loss resulting upon netting of capital gains and losses is determined at the long-term capital gain rate.*

c. Combine net short-term capital loss and net long-term capital gain. If result is greater than zero, tax amount at long-term capital gain rate.[152] If amount is less than zero, determine benefit resulting from tax loss using short-term capital gain (ordinary income) rate.[153]

d. If netting results in net long-term capital loss and net short-term capital loss, determine benefit resulting from net long-term capital loss using long-term capital gain rate and determine benefit resulting from net short-term capital loss using short-term capital gain (ordinary income) rate.[154]

5. In order to simplify the after-tax return calculation, capital gain dividends to shareholders should be excluded from the determination of net gains and losses on redemption.

Example 1. Assume that a fund distributes a $100 long-term capital gain dividend which is reinvested on June 30 and a shareholder realizes a $50 net long-term capital loss (but no short-term capital gain or loss) on redemption on December 31. Under 5, above, the June 30 $100 long-term capital gain dividend would not be netted with the December 31 $50 net long-term capital loss. Therefore, on June 30, the shareholder is deemed to have reinvested $80 in new shares ($100 capital gain dividend less $20 capital gains taxes assuming a 20% tax rate). In addition, under 4(d), above, the fund would determine the benefit resulting from the $50 net long-term capital loss on December 31 using the long-term capital gain rate.

Example 2. Assume that a fund distributes a $100 long-term capital gain dividend which is reinvested on June 30 and a shareholder realizes a $50 net long-term capital gain and a $100 net short-term capital loss on redemption on December 31. As in Example 1, above, on June 30 the shareholder is deemed to have reinvested $80 in new shares ($100 capital gain dividend less $20 capital gains taxes, assuming a 20% tax rate). Under 4(c), above, the fund would offset $50 of the $100 net short-term capital loss on redemption against the $50 net long-term capital gain on redemption. The benefit resulting from the remaining $50 net short-term capital loss would be determined using the short-term capital gain (ordinary income) rate and taken into account on December 31.

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[152]*I.R.C. 1222(11) (defining "net capital gain"); I.R.C. 1(h) (tax rates applicable to net capital gain).*

[153]*I.R.C. 1211(b) (allowing losses from the sale of capital assets to the extent of gains from sales of capital assets). Because the after-tax return rules require a fund to assume that a shareholder has sufficient capital gains of the same character to offset any capital losses from the redemption, the benefit from any short-term capital loss resulting upon netting of capital gains and losses is determined at the short-term capital gain (ordinary income) rate.*

[154]*I.R.C. 1211(b) (allowing losses from the sale of capital assets to the extent of gains from sales of capital assets). Because the after-tax return rules require a fund to assume that a shareholder has sufficient capital gains of the same character to offset any capital losses from the redemption, the benefit from the net long-term capital loss is determined using the long-term capital gain rate and the benefit from the net short-term capital loss is determined using the short-term capital gain (ordinary income) rate.*

Question 6

Q What method should be used to adjust the tax status of prior distributions and reduce the cost basis of shares where a fund distributes a non-taxable return of capital?

A For purposes of the after-tax return calculation, a fund must allocate a return of capital distribution to prior distributions made by the fund in the same manner that the return of capital is reported to shareholders on IRS Form 1099-DIV. Returns of capital are non-taxable distributions, and a fund should assume that no taxes are paid by a shareholder on returns of capital.[155] In addition, a shareholder must reduce the basis in fund shares to the extent that the shareholder receives distributions treated as tax-free returns of capital.[156] The allocated return of capital should ratably reduce the basis of all shares to which it relates. Where a portion of a distribution is treated as a return of capital, the reinvested amount of the distribution should reflect the fact that no tax is due on the return of capital.

Question 7

Q When should the effect of taxes be taken into account for dividends declared to shareholders of record on a specified date that are not immediately reinvested in additional fund shares? This situation may arise, for example, where a fund declares dividends daily but reinvests (and pays) them only monthly.

A Where a dividend has been both declared and reinvested in additional fund shares prior to the end of the measurement period, the effect of taxes on the dividend should be taken into account on the date that the dividend is reinvested.[157] Where a dividend has been declared to shareholders of record but not reinvested in additional fund shares prior to the end of the measurement period, the effect of taxes on the dividend should be taken into account on the final day of the measurement period.

Question 8

Q Are shares acquired with reinvested dividends given cost basis equal to the reinvested amount (*i.e.*, specific identification) or are those shares deemed to have average cost basis (particularly if the fund complex provides average cost information to its shareholders)?

A The instructions for computing after-tax return provide that a fund should separately track the basis of shares acquired through the initial investment and each subsequent purchase through reinvested distributions. In determining the basis for a reinvested distribution, a fund should include the distribution net of taxes assumed paid from the distribution.[158] Thus, all shares have a cost basis equal to the amount invested (on the date of initial investment or the

[155]*Instruction 3 to Item 21(b)(2) of Form N-1A; Instruction 3 to Item 21(b)(3) of Form N-1A.*

[156]*Instruction 7(b) to Item 21(b)(3) of Form N-1A.*

[157]*Instruction 2 to Item 21(b)(2) of Form N-1A and Instruction 2 to Item 21(b)(3) of Form N-1A (requiring funds to assume that distributions, less taxes, are reinvested on reinvestment date).*

[158]*Instruction 7(b) to Item 21(b)(3) of Form N-1A.*

date of reinvestment), as if the shareholder uses the specific identification method of determining cost basis. For example, if a dividend of $80 (net of taxes) is reinvested, the cost basis of the shares acquired is $80.

Question 9

Q How should the after-tax impact of capital gains be calculated if the fund decides to retain them (rather than distribute them as a capital gain dividend)?

A Federal tax law provides that every shareholder of a fund at the close of the fund's taxable year must include long-term capital gains retained by the fund and designated as undistributed capital gains in the shareholder's income tax return for the taxable year in which the last day of the fund's taxable year falls.[159] In addition, the shareholder is deemed to have paid the tax imposed on the fund with respect to the undistributed gains and is allowed a credit or refund for this tax.[160] Finally, the shareholder's basis in his or her shares is increased by the difference between the amount of the includible gains and the tax deemed paid by the shareholder.[161]

Thus, under federal tax law, if a fund has a June 30 taxable year and retains long-term capital gains of $10.00 per share, every shareholder in the fund on June 30 is treated as having long-term capital gains of $10.00 per share resulting in a tax payable of $2.00 per share (assuming the maximum long-term capital gains rate of 20%), as having paid tax of $3.50 per share (assuming the fund paid tax at a rate of 35%), and as having $6.50 of additional basis in each share (the difference between $10.00 in gains and the $3.50 tax deemed paid by the shareholder).

For purposes of the after-tax return calculation, the fund shareholder should be treated as reinvesting an additional $1.50 per share on June 30. Specifically, since the tax payable by the shareholder is $2.00, $8.00 per share is the portion of the $10.00 per share amount that should be treated as remaining in the fund ($10.00-$2.00). Moreover, since the fund has paid tax of $3.50 per share on the retained gain of $10.00 per share, even though the shareholder's tax liability on this gain is only $2.00 per share, the excess tax payment ($1.50 per share) is available to offset other tax liabilities. Consequently, a reinvestment is required to add $1.50 per share to the $6.50 per share of the $10.00 retained gain per share that remains to reflect this tax benefit. This treatment should occur on the last day of the fund's taxable year.

Question 10

Q Internal Revenue Code Section 852(b)(4) provides special rules regarding losses on the sale of mutual fund shares held for 6 months or less. Specifically, if a taxpayer holds shares of a

[159] *I.R.C. 852(b)(3)(D)(i).*

[160] *I.R.C. 852(b)(3)(D)(ii) (shareholder deemed to have paid tax imposed on fund with respect to undistributed gains and is allowed credit or refund); I.R.C. 852(b)(3)(A) (imposing on fund tax on undistributed gains).*

[161] *I.R.C. 852(b)(3)(D)(iii).*

mutual fund for 6 months or less and then sells the shares at a loss, the taxpayer must report that portion of the loss that is equal to capital gain distributions (or undistributed capital gains) from the shares as a long-term capital loss. In addition, a taxpayer holding mutual fund shares for 6 months or less may not claim any loss on the sale of the shares to the extent that the taxpayer has received any exempt-interest dividend. Should Section 852(b)(4) be applied in calculating after-tax returns?

A In order to simplify the computation of after-tax returns, funds are not required to apply these provisions in calculating their after-tax returns.

Congress enacted Section 852(b)(4) to prevent taxpayers from purchasing mutual fund shares shortly before distribution of a capital gain or exempt-interest dividend and then quickly selling the same shares at a loss due to the corresponding fall in the fund's net asset value. In this manner, the taxpayer would have received a capital gain distribution taxed at the lower long-term rate or a tax-exempt dividend, while also incurring a short-term loss that could be used to offset other short-term gain.[162]

Section 852(b)(4) applies only to fund shares held for 6 months or less, while the after-tax return rules require disclosure of after-tax returns after holding periods of at least one, five, and ten years. Thus, Section 852(b)(4) would be relevant to the calculation of after-tax returns only in the limited circumstances where shares are purchased with reinvested distributions within 6 months prior to the end of the measuring period. These circumstances are different from those contemplated by Section 852(b)(4), which is concerned with the intentional purchase and sale of shares in order to generate short-term losses and long-term capital gains distributions or tax-exempt dividends. Even in the circumstances under which Section 852(b)(4) might apply in calculating after-tax returns, its impact would be limited, affecting the after-tax return figure only by affecting the character of the loss corresponding to the amount of any capital gains or tax-exempt dividend received for shares purchased with reinvested distributions within 6 months of the end of the measuring period. As a result, we believe that systems burdens imposed on funds to reflect these provisions in calculating after-tax returns would outweigh any additional precision that would result.

Foreign Tax Credits

Question 11

Q How should the after-tax impact of the foreign tax credit be calculated for a fund that either declares dividends or does not declare any dividends during the applicable period?

A The instructions for computing after-tax returns state that the effect of the foreign tax credit should be taken into account in accordance with federal tax law.[163] As a result, a fund that

[162] *S. Rep. No. 1983, 85th Cong., 2d Sess., sec. 43 (1958); H.R. Rep. No. 432, Part II, 98th Cong., 2d Sess., p. 1192 (1984).*

[163] *Instruction 3 to Item 21(b)(2) of Form N-1A; Instruction 3 to Item 21(b)(3) of Form N-1A.163; Instruction 3 to Item 21(b)(2) of Form N-1A; Instruction 3 to Item 21(b)(3) of Form N-1A.*

elects to pass through the foreign tax credit to its shareholders under Code Section 853 must include in the shareholders' gross income for computing taxes the amount of the credit.[164] For example, if a fund pays a cash dividend of $9.00 per share and a $1.00 per share foreign tax credit is being passed through with this dividend, the amount of the dividend is increased to $10.00 per share to reflect the foreign tax credit gross-up. The amount reinvested would be $6.09, which equals the $9.00 cash dividend, less tax of $3.91 on the $10.00 grossed-up dividend (assuming a 39.1% maximum marginal tax rate), plus $1.00 to reflect the benefit provided to the taxpayer by the $1.00 foreign tax credit.

A fund that pays foreign tax but has no net income to distribute nevertheless may be eligible to pass through a foreign tax credit. Such a fund should take the effect of the foreign tax credit into account. For example, if a fund paid foreign taxes equal to $1.00 per share and elected to pass through the foreign tax credit, the fund should make the appropriate adjustments to its after-tax return as of the same date it treats shareholders of record as having received the grossed-up dividend for purposes of Form 1099-DIV. In this example, the amount reinvested would be $0.609, which equals the $0.00 cash dividend, less tax of $0.391 on the $1.00 deemed dividend (at a 39.1% maximum marginal tax rate), plus $1.00 to reflect the benefit provided to the taxpayer by the $1.00 foreign tax credit.

Redemption Fees; Contingent Deferred Sales Loads

Question 12

Q How should a fund apply redemption fees and contingent deferred sales loads for purposes of the after-tax return calculation?

A Instruction 2 to Item 21(b)(2) of Form N-1A and Instruction 2 to Item 21(b)(3) of Form N-1A provide that all distributions by a fund, less the taxes due on such distributions, are reinvested at the price stated in the prospectus (including any sales load imposed upon reinvestment of dividends) on the reinvestment dates during the period. Instruction 6 to Item 21(b)(2) of Form N-1A and Instruction 6 to Item 21(b)(3) of Form N-1A provide that in determining the value of an investment at the end of the 1-, 5- or 10-year measuring period, a fund should assume a complete redemption, with the deduction of (i) all nonrecurring charges deducted at the end of the period, and (ii) the maximum sales load at the times, in the amounts, and under the terms disclosed in the prospectus.

Accordingly, a fund should apply redemption fees and contingent deferred sales loads for purposes of the after-tax return calculation in the manner provided in the fund's prospectus. For example, if a fund's prospectus states that redemption fees do not apply to shares purchased through the reinvestment of distributions, such fees should not apply to those shares for purposes of the after-tax return calculation.

[164] *I.R.C. 853(b)(2)(A).*

Sources of Tax Data

Question 13

Q What sources should a fund rely upon for historical tax characterizations of distributions and related tax adjustments, *e.g.,* foreign tax credits? How should a fund determine the historical tax characterizations of distributions if these sources are unavailable?

A As a general rule, a fund should rely on tax information reported to fund shareholders on IRS Form 1099-DIV and, in the case of tax-exempt distributions, amounts reported for tax purposes to investors on shareholder statements.

For periods prior to the compliance date for the after-tax return requirements, a fund may not be able to obtain the entire Form 1099-DIV history for all or a portion of the fund's existence, such as where a fund has been acquired by an unaffiliated adviser. In these cases, a fund should use reasonable efforts to fill any gaps in the tax history for a fund. It is advisable for funds to retain written explanations describing these efforts. In the absence of Form 1099-DIV history for periods prior to the compliance date for the after-tax return requirements, sources upon which a fund may rely for purposes of characterizing a distribution as other than ordinary income for purposes of the after-tax return calculation include, but are not limited to:

1. Designations of long-term capital gain distributions in the fund's financial reports;
2. Designations of capital gain distributions to shareholders under Rule 19a-1, where the designation distinguishes between short-term and long-term gains; and
3. Board minutes declaring or ratifying long-term capital gain distributions.

If, notwithstanding such reasonable efforts, a fund is unable to recreate the complete tax history for a fund for periods prior to the compliance date for the after-tax return requirements, the taxable amount and tax character of each distribution should be (1) as specified by the fund on the dividend declaration date, where known, or (2) determined using the procedure described in the answer to Question 14, below, if the fund knows the aggregate tax character of distributions made during a year but does not have tax data relating to specific distributions. Where a fund cannot assign a tax character to a distribution using these means, it should characterize the distribution as ordinary income for purposes of the after-tax return calculation.

Question 14

Q What procedures may a fund use to allocate the tax character of distributions where the fund knows the aggregate tax character of the distributions made during a year but does not have tax data relating to specific distributions?

A Funds typically maintain records of the tax character of each distribution they make to shareholders. However, where records relating to particular distributions are unavailable for periods prior to the compliance date for the after-tax return requirements, the fund should

+allocate the various characteristics of the fund's total distributions for the year ratably over the distributions. For example, if 90% of a fund's total distributions for the year were attributable to tax-exempt interest with the remaining 10% attributable to market discount, each distribution would be treated as 90% tax-exempt interest and 10% market discount. Where designation records are available for some distributions, such as capital gain dividends, but not for others, the designations must be used where they are available. Ratable allocations should be made for the remaining distributions for which the tax characterizations are not available.

Question 15

Q What sources should a third party rely upon for historical tax characterizations of distributions in computing standardized after-tax return for a fund?

A To compute standardized after-tax return, a third party should rely on tax information provided by the fund complex. Where the third party is unable to obtain the entire tax history for all or a portion of a fund's existence, the third party calculating standardized after-tax return for the fund should treat the tax character and taxable amount of each distribution as specified by the fund on the dividend declaration date or, lacking this information, as ordinary income.

Question 16

Q What procedures may a fund use to estimate the tax character of current-year distributions where these distributions have not yet been reported on IRS tax forms?

A Instruction 3 to Item 21(b)(2) of Form N-1A and Instruction 3 to Item 21(b)(3) of Form N-1A provide that "the taxable amount and tax character of each distribution should be as specified by the Fund on the dividend declaration date, but may be adjusted to reflect subsequent recharacterizations of distributions." The Division believes that adjustments to reflect subsequent recharacterizations of distributions are mandatory.[165] In meeting this requirement, a fund should use reasonable efforts to make the most current determination of the tax character of each distribution. It is advisable for funds to retain written explanations of their efforts for this purpose. The tax character specification or any subsequent recharacterization need not be disseminated to shareholders prior to its use in an after-tax return calculation.

Advertisements

Question 17

Q Under the after-tax return rules, funds are required to include standardized after-tax returns in advertisements and sales literature that include any quotation of performance and that represent or imply that the fund is managed to limit or control the effect of taxes on fund

[165]See *Disclosure of Mutual Fund After-Tax Returns, Investment Company Act Release No. 24832 (Jan. 18, 2001) [66 FR 9002, 9011 (Feb. 5, 2001)] (after-tax returns "will be calculated assuming that taxable amount and tax character of each distribution are as specified by the fund on the dividend declaration date, adjusted to reflect subsequent recharacterizations").*

performance.[166] Advertisements and sales literature for a fund that is eligible to use a name suggesting that its distributions are exempt from federal income tax or both federal and state income tax under recently adopted rule 35d-1 are not, however, required to include standardized after-tax returns, unless they voluntarily choose to include after-tax performance information.[167] All fund advertisements and sales literature are required to comply with the new after-tax return rules no later than December 1, 2001, but compliance with rule 35d-1 is not required until July 31, 2002. Prior to July 31, 2002, must a fund that relies on the exception for tax-exempt funds from the requirement to report standardized after-tax returns in advertising and sales literature meet the requirements of rule 35d-1(a)(4)?

A Generally, Yes. Rule 35d-1 was effective on March 31, 2001. Although funds are not required to comply with rule 35d-1 until July 31, 2002, any fund that relies on the exception for tax-exempt funds from the after-tax return advertising rule at any time must comply with rule 35d-1(a)(4) for using a name suggesting that the fund's distributions are exempt from federal income tax *or* from both federal and state income tax. As a practical matter, this means that, prior to July 31, 2002, in order to rely on the exception for tax-exempt funds from the after-tax return advertising rule, a tax-exempt fund, including a single state tax-exempt fund, need only comply with the eligibility requirements under rule 35d-1(a)(4) for using a name suggesting that the fund's distributions are exempt from *federal* income tax. The requirements set forth in rule 35d-1(a)(4) for a fund that has a name suggesting that its distributions are exempt from federal income tax are generally the same as those currently applied by the Division of Investment Management.

Compliance Date

Question 18

Q If a fund files a post-effective amendment that is not an annual update to the fund's registration statement after the February 15, 2002 compliance date, must the fund's prospectus include the new after-tax return disclosure?

A A fund is not required to include the new after-tax return disclosure in its prospectus until it files its first annual update on or after February 15, 2002.[168] If a fund files a post-effective amendment that is not an annual update on or after February 15, 2002, the fund need not include the after-tax return information in its prospectus unless it has previously filed an annual update on or after February 15, 2002.

Question 19

Q If a fund's advertisements and sales materials used on or after December 1, 2001, (the compliance date for after-tax return advertisements and sales materials) include after-tax returns, does the fund also need to revise the risk/return summary of its prospectus at the same time to include the new after-tax return disclosure required by Item 2 of Form N-1A?

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[166]*The compliance date for this requirement was recently extended from October 1, 2001, to December 1, 2001.* See *Disclosure of Mutual Fund After-Tax Returns; Extension of Compliance Date, Investment Company Act Release No. 25175 (Sept. 26, 2001) [66 FR 50102 (Oct. 2, 2001)].*

[167]*Securities Act rule 482(f) [17 CFR 230.482(f)]; Investment Company Act rule 34b-1(b)(1)(iii)(C) [17 CFR 270.34b-1(iii)(C)].*

[168]*Disclosure of Mutual Fund After-Tax Returns,* supra *note 20, 66 FR at 9011.*

A No. The fund will not be required to revise the risk/return summary of its prospectus to include standardized after-tax returns until the February 15, 2002 compliance date for prospectuses (*i.e.*, the fund's first annual update to its existing registration statement filed on or after February 15, 2002).[169]

Question 20

Q The Division has stated that mutual funds may include in their prospectuses standardized before-tax total returns that include the performance of predecessor unregistered accounts under certain circumstances. *MassMutual Institutional Funds* (pub. avail. Sept. 28, 1995) ("*MassMutual*").[170] We have been advised that, in many cases, such a find is unable to compute standardized after-tax returns for the pre-registration period because of different tax treatment for those years (*e.g.,* the absence of any requirement to distribute income to investors by December 31 of each year). How should each fund comply with the after-tax return disclosure requirements in the risk/return summary of its prospectus?

A If such a fund is unable to compute standardized after-tax returns for periods prior to registration because of different tax treatment for those years, the fund may include in the risk/return summary standardized after-tax returns for the post-registration period only, provided that the fund also includes standardized before-tax returns for the post-registration period. This will permit comparisons between after-tax and before-tax returns for the same periods. The fund also may continue to include in the risk/return summary of its prospectus before-tax returns from the date of inception if the predecessor unregistered account.

For example, assume that a fund has six years of performance as a registered entity and three years of performance as an unregistered entity and is unable to compute standardized after-tax returns for the three years prior to registration because of different tax treatment for those years. The fund may include in the risk/return summary standardized after-tax returns for one year, five years, and six years (the post-registration period), provided that the fund also includes standardized before-tax returns for those periods. In addition, the fund may include standardized before-tax returns for nine years (from the date of inception of the predecessor unregistered account) if its circumstances entitle it to rely on *MassMutual*.

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[169] Id.

[170] *Under MassMutual, a fund may include in its standardized performance the performance of an unregistered predecessor investment account where, among other things, (1) the fund was managed in a manner that is in all material respects equivalent to the management of the unregistered predecessor account, and (2) the unregistered predecessor account was created for purposes entirely unrelated to the establishment of a performance record.*

A Plain English Handbook

How to create clear SEC disclosure documents

By the Office of Investor Education and Assistance
U.S. Securities and Exchange Commission
450 5th Street, N.W
Washington, DC 20549
August 1998

This handbook shows how you can use well-established techniques for writing in plain English to create clearer and more informative disclosure documents. We are publishing this handbook only for your general information. Of course, when drafting a document for filing with the SEC, you must make sure it meets all legal requirements.

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Preface

This handbook, and Chairman Levitt's whole drive to encourage "plain English" in disclosure documents, are good news for me. For more than forty years, I've studied the documents that public companies file. Too often, I've been unable to decipher just what is being said or, worse yet, had to conclude that nothing was being said. If corporate lawyers and their clients follow the advice in this handbook, my life is going to become much easier.

There are several possible explanations as to why I and others sometimes stumble over an accounting note or indenture description. Maybe we simply don't have the technical knowledge to grasp what the writer wishes to convey. Or perhaps the writer doesn't understand what he or she is talking about. In some cases, moreover, I suspect that a less-than-scrupulous issuer doesn't want us to understand a subject it feels legally obligated to touch upon.

Perhaps the most common problem, however, is that a well-intentioned and informed writer simply fails to get the message across to an intelligent, interested reader. In that case, stilted jargon and complex constructions are usually the villains.

This handbook tells you how to free yourself of those impediments to effective communication. Write as this handbook instructs you and you will be amazed at how much smarter your readers will think you have become.

Our unoriginal but useful tip: Write with a specific person in mind. When writing Berkshire Hathaway's annual report, I pretend that I'm talking to my sisters. I have no trouble picturing them: Though highly intelligent, they are not experts in accounting or finance. They will understand plain English, but jargon may puzzle them. My goal is simply to give them the information I would wish them to supply me if our positions were reversed. To succeed, I don't need to be Shakespeare; I must, though, have a sincere desire to inform.

No siblings to write to? Borrow mine: Just begin with "Dear Doris and Bertie." •

Acknowledgments

Nancy M. Smith

Director, Office of Investor Education and Assistance

This handbook reflects the work, ideas, and generosity of many individuals and organizations at the SEC and in the private sector.

At the SEC, staff in the Divisions of Corporation Finance and Investment Management, the Offices of Public Affairs and General Counsel, and the Chairman's Office provided insightful comments. In particular, Commissioner Isaac C. Hunt Jr., Nick Balamaci, Barry Barbash, Gregg Corso, Brian Lane, Diane Sanger, Jennifer Scardino, Michael Schlein, Heidi Stam, and Tony Vertuno offered invaluable advice and guidance.

Corporate officials and lawyers enthusiastically helped us to breathe life into our plain English initiatives and this handbook. The Society of Corporate Secretaries, the American Bar Association, and The Bond Market Association invited us to conduct workshops where we tested much of the information in the handbook. Kathleen Gibson, Peggy Foran, Susan Wolf, Bruce Bennett, Jim McKenzie, Jeff Klauder, Fred Green, Mark Howard, Pierre de Saint Phalle, Richard M. Phillips, and Alan J. Davis contributed mightily to our efforts.

Special thanks to Warren Buffett for his support and preface, to Ken Morris of Lightbulb Press, and to the talented staff at Siegel & Gale. I am especially grateful to the staff of my office for giving me the time and support I needed to work on the handbook.

Three people poured their hearts and minds into this handbook from the start: Ann Wallace, from the Division of Corporation Finance; Carolyn Miller, formerly of Siegel & Gale and now with the SEC; and William Lutz, author and Professor of English at Rutgers University. All of the credit and none of the blame goes to them.

And finally, many thanks to Chairman Arthur Levitt, who made it all possible by putting plain English at the top of his agenda so that investors might better understand their investments. •

by Arthur Levitt

Chairman,
U.S. Securities and
Exchange Commission

Introduction

Investors need to read and understand disclosure documents to benefit fully from the protections offered by our federal securities laws. Because many investors are neither lawyers, accountants, nor investment bankers, we need to start writing disclosure documents in a language investors can understand: plain English.

The shift to plain English requires a new style of thinking and writing, whether you work at a company, a law firm, or the U.S. Securities and Exchange Commission. We must question whether the documents we are used to writing highlight the important information investors need to make informed decisions. The legalese and jargon of the past must give way to everyday words that communicate complex information clearly.

The good news is that more and more companies and lawyers are using plain English and filing documents with the SEC that others can study, use, and improve upon. With the SEC's plain English rules in place, every prospectus will have its cover page, summary, and risk factors in plain English.

The benefits of plain English abound. Investors will be more likely to understand what they are buying and to make informed judgments about whether they should hold or sell their investments. Brokers and investment advisers can make better recommendations to their clients if they can read and understand these documents quickly and easily.

Companies that communicate successfully with their investors form stronger relationships with them. These companies save the costs of explaining legalese and dealing with confused and sometimes angry investors. Lawyers reviewing plain English documents catch and correct mistakes more easily. Many companies have switched to plain English because it's a good business decision. They see the value of communicating with their investors rather than sending them impenetrable documents. And as we depend more and more on the Internet and electronic delivery of documents, plain English versions will be easier to read electronically than legalese.

The SEC's staff has created this handbook to help speed and smooth the transition to plain English. It includes proven tips from those in the private sector who have already created plain English disclosure documents. This handbook reflects their substantial contributions and those of highly regarded experts in the field who were our consultants on this project, Dr. William Lutz at Rutgers University and the firm of Siegel & Gale in New York City.

But I hasten to add that the SEC has not cornered the market on plain English advice. Our rules and communications need as strong a dose of plain English as any disclosure document. This handbook gives you some ideas on what has worked for others, but use whatever works for you.

> No matter what route you take to plain English, we want you to produce documents that fulfill the promise of our securities laws. I urge you—in long and short documents, in prospectuses and shareholder reports—to speak to investors in words they can understand. Tell them plainly what they need to know to make intelligent investment decisions. •

What Is a "Plain English" Document?

We'll start by dispelling a common misconception about plain English writing. It does not mean deleting complex information to make the document easier to understand. For investors to make informed decisions, disclosure documents must impart complex information. Using plain English assures the orderly and clear presentation of complex information so that investors have the best possible chance of understanding it.

Plain English means analyzing and deciding what information investors need to make informed decisions, before words, sentences, or paragraphs are considered. A plain English document uses words economically and at a level the audience can understand. Its sentence structure is tight. Its tone is welcoming and direct. Its design is visually appealing. A plain English document is easy to read and looks like it's meant to be read.

This handbook's purpose

This handbook gives you practical tips on how to create plain English documents. All of these were born of experience. They come from experts and those who have already written or rewritten their documents in plain English.

As with all the advice in this handbook, feel free to tailor these tips to your schedule, your document, and your budget. Not all of the tips will apply to everyone or to every document. Pick and choose the ones that make sense for you.

Some of our tips cover very basic mechanical issues, like how to photocopy your working draft. We've included them because they were learned the hard way and have saved people time, money, and aggravation. You'll see them listed in Chapter 8, titled "Time-Saving Tips."

This handbook is by no means the last word on plain English. We expect to change it and add more tips as we learn more about writing securities documents in plain English. So please keep notes on your experiences and copies of your original and rewritten language. We want to hear from you and include your tips and rewrites in the next edition.

Finally, we encourage you to give this handbook out freely. It is not copyrighted, so you can photocopy it without fear of penalty. •

Assemble the team or move ahead on your own

As with a lot of things in life, it's the preparation that often determines the success or failure of an effort to write documents in plain English. Many of you routinely select a team to think and talk about how to write a document from scratch or rewrite an existing document. Or you may do it on your own. In that case, rest assured that one person can do it alone.

The list below describes the types of people who have participated in successful plain English teams. *We're not suggesting that you need to select everyone listed.* Some will not apply to your company or your situation. The people you select, and the point at which you involve them in your plain English project, will depend on your document, your schedule, and your budget.

- **A team leader** who has the authority to make decisions that keep the project moving forward and bring it to a successful conclusion. (More than one plain English project has faltered because the team leader has not had this level of authority.) The team leader may be a company's or an underwriter's lawyer.

- **A lead writer** who ensures the document uses a logical structure and simple, clear language. If more than one person is drafting sections of the document, the lead writer makes sure the final draft has a consistent tone and the individual parts form a coherent whole.

- **Lawyers for the company or the underwriter** who know what information must be included and why.

- **An investor relations expert** who knows firsthand the financial sophistication of your investors. Investor relations people know which questions investors typically ask and where past disclosure documents have failed to make information clear.

- **A compliance officer** who can lend guidance to the writer and who knows, along with your lawyers, what information must be included.

- **A production and operations person** who understands the mechanics and costs of printing and mailing your document, so that your improved document doesn't get ahead of your in-house capabilities or budget.

- **A marketing person** who may have market survey research or polls on your investors. Also, the marketing department is usually attuned to the terminology that your investors can readily understand.

- **An information designer** who is a graphic designer trained to work closely with the writers and to think about how to present complex information visually.

Select documents

You may want to consider these issues as you start writing in plain English:

- How long is the document?

- Will you write all of it, or only sections of it, in plain English?

- How much time do you have before you need to file your document?

You will also want to gather and distribute other documents that your company has written for investors. It's likely that your company has already used plain English in its glossy annual reports and other communications prepared especially for investors. These documents may save you time by showing you the type of language your company is already comfortable using. •

Knowing Your Audience

Knowing your audience is the most important step in assuring that your document is understandable to your current or prospective investors. To write understandable documents, you need to gauge the financial sophistication of your investors.

Through polls and other market survey research tools, some companies know the demographics of their investors well. Other companies rely on their investor relations staff or their underwriters to describe who has bought, or is likely to buy, their securities.

Using whatever information is available, you can create a profile of your investors or prospective investors based on the following questions:

- What are their demographics—age, income, level of education, and job experience?
- How familiar are they with investments and financial terminology?
- What investment concepts can you safely assume they understand?
- How will they read the document for the first time? Will they read it straight through or skip around to the sections that interest them?
- Will they read your document and your competitors' side by side?
- How will they use the document while they own the security? What information will they be looking for later, and is it easy to find?

Your investors or prospective investors may include individuals and institutions with varying degrees of financial sophistication. While your audience will include analysts and other industry experts, you may want to keep in mind that your least sophisticated investors have the greatest need for a disclosure document they can understand. Some companies have faced the differing needs of their investors and other audiences by making basic educational information visually distinctive from the rest of the text so that sophisticated investors can easily recognize and scan it.

"One must consider also the audience . . . the reader is the judge."

Aristotle
Rhetoric

Once you've drawn a profile of your investors, keep it constantly in mind. Some writers keep a photo of a typical investor to make sure they don't lose sight of their readers.

After analyzing who your investors are, you can turn to the document you want to write or rewrite. •

Knowing the Information You Need to Disclose

The steps outlined in this section have been used successfully by others who have written disclosure documents in plain English. As we said earlier, feel free to tailor these steps to your own schedule and team. This is one approach if you are rewriting an existing document, but others may work equally well.

Read and outline the current document

For time-saving tips on how to outline and reorganize your document, read Chapter 8.

Read the entire document once without making any notes or comments on the text. This should give you a general understanding of the information covered in the document and make your next read more productive.

When you read it the second time, make notes on what information is covered and any questions you have. Your notes will also help you to assess if information flows through your document in a logical order.

As you read, consider the following:

- Will the investors understand the language?
- Does the document highlight information that is important to investors?
- Is any important information missing?
- Does the document include information that is not legally required and will not help investors make informed decisions?

Meet to resolve questions

Meet with the authors of the original document or others who understand it and any members of the team who can help to answer the questions you wrote in the margins. Besides the obvious reason for the meeting, another more important goal is

to question the need for everything that appears in the document.

"Because it's always been there" is not reason enough to keep it in your draft. Since much of the language in these documents is recycled from older (or another company's) documents, often no one knows who initially wrote it or why it is needed now. If you've done your legal research and no one knows why the information is important or required, consider taking it out.

Eliminate redundant information

Question the need for repeating any information. Reading the same material two or three times can bore and even trouble readers. Most readers skip over paragraphs if they think they've read them before. If you cut down on repetitious paragraphs or sentences, you'll not only earn the gratitude of your reader, you'll reduce printing and mailing costs.

"Writers must therefore constantly ask: What am I trying to say? Surprisingly often they don't know. They must look at what they have written and ask: Have I said it?"

William Zinsser On Writing Well

Discuss the cover page and the summary

A cover page should be an introduction, an inviting entryway into your document, giving investors some key facts about your offering, but not telling everything all at once. If it looks dense and overgrown with thorny details, no one will want to pick it up and start reading. If it looks like a legal document written *by* lawyers and *for* lawyers, many investors will not even attempt to read it.

To create an inviting cover page, you'll need to strip away much of what is conventionally placed there, but which is not required.

As you review your cover page, question why each item of information is there. It may be important, but does it have to be on the cover page? You usually have a substantial document following the cover page-let some of those other pages carry the information load in logical order.

What would be helpful for investors to see on this page? Look through your investors' eyes and you'll make better decisions about where to place information.

The same goes for the summary. A summary should orient the reader, highlighting the most important points that are presented in greater detail in the prospectus. Many summaries now seem as long as the document itself and consist merely of paragraphs copied straight from the body of the document.

Use defined terms sparingly

Although customary, introducing defined terms on the cover page and in the summary discourages many readers from getting beyond the first pages. Overwhelmed with memorizing a new and unnatural vocabulary, and bothered by constantly having to flip back and hunt for the first time a defined term's definition appears, many an investor will not stick with the document. One plain English expert has advised, don't let a shortcut for the writer become a roadblock for the reader. •

Reorganizing the Document

A few principles of good organization apply universally.

First, present the big picture before the details. Prospectuses routinely start with a detailed description of the securities. You may read pages before you find out what the company produces, or why it is merging or spinning off a subsidiary. It's hard to absorb the details if you don't know why they are being given to you. Imagine trying to put together a complicated jigsaw puzzle without first seeing the picture of the completed puzzle. An individual piece of information means more to your readers if they know how it fits into the big picture.

Second, use descriptive headers and subheaders to break your document up into manageable sections. Prospectuses impart a lot of information. If you present the information in bite-sized pieces, it's easier to digest. Make sure your headings tell the reader what the upcoming sections will cover. Headings like "general" or "background" aren't especially helpful.

Third, always group related information together. This helps you identify and eliminate repetitious information.

Fourth, your audience's degree of investment expertise will affect how you organize the document. If you are writing for financially unsophisticated investors, your document's overall organization may take an educational approach. You may need to explain industry terms or concepts where they first appear.

Fifth, review your document by taking a good look at the flow of information from beginning to end. Start making decisions on how the content should be moved around into a new and logical order based on:

- the audience profile
- the notes you made in the margins
- the decisions you've made on your cover page and summary
- the information you've learned in answering your questions

Once you have finished physically reorganizing the document, you may want to write an outline of your new organization. Your outline can later become your table of contents.

You're now ready to start rewriting your document in plain English.

And, speaking of writing…•

Writing in Plain English

We thought it would be helpful to list the most common problems we've encountered with disclosure documents

Common problems

- Long sentences
- Passive voice
- Weak verbs
- Superfluous words
- Legal and financial jargon
- Numerous defined terms
- Abstract words
- Unnecessary details
- Unreadable design and layout

In the following pages we offer some ways to fix these problems.

For example, here's a common sentence found in prospectuses:

> NO PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION OTHER THAN THOSE CONTAINED OR INCORPORATED BY REFERENCE IN THIS JOINT PROXY STATEMENT/ PROSPECTUS, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED.

Here's one possible plain English rewrite:

> You should rely only on the information contained in this document or that we have referred you to. We have not authorized anyone to provide you with information that is different.

The plain English rewrite uses everyday words, short sentences, active voice, regular print, and personal pronouns that speak directly to the reader.

We've listed just some of the many books on how to write clearly in Chapter 11. We urge you to consult them, too.

Do you think the rewrite captures the meaning of the original? Would you write it differently?

Throughout this chapter, you'll find "before" examples from disclosure documents with plain English "after" examples to illustrate specific principles of plain English. Since some of the "before" examples contain ambiguities that can be successfully resolved only by studying their context in a particular document, we did not attempt to provide rewrites to cover every interpretation. We encourage you to write your own plain English versions to fit your views and your needs. We don't want to create a new generation of plain English "boilerplate."

"Straight forward sentences sound unimpressive to many writers, and officialese, creating tin ears, perpetuates itself."

Although the principles that follow may sound deceptively simple, if you use them, your writing will improve dramatically.

Use the active voice with strong verbs

The plodding verbosity of most disclosure documents makes readers yearn for clear words and short sentences. The quickest fix lies in using the active voice with strong verbs. Strong verbs are guaranteed to liven up and tighten any sentence, virtually causing information to spring from the page. When you start to rewrite or edit your work, highlighting all the verbs can help. You may be surprised by the number of weak verbs, especially forms of "to be" or "to have" that you'll find.

The time you spend searching for a precise and strong verb is time well spent. When a verb carries more meaning, you can dispense with many of the words used to bolster weak verbs.

"A rambling, unwieldy sentence generally hangs from an inert… vague, actionless verb."

Claire Kehrwald Cook
Line by Line

Weak verbs keep frequent company with two more grammatical undesirables: passive voice and hidden verbs. In tandem, they add unnecessary length and confusion to a sentence.

The active and passive voices

If you need it, here's a quick refresher on the active and passive voice.

- **active**
- The investor buys the stock.

In the active voice, the subject of the sentence, the investor, performs the action, buying the stock.

- **passive**
- The stock is bought by the investor.

In the passive voice the subject, the stock, is acted upon. The person or the thing doing the action is introduced with "by." But sometimes, the person or thing doing the action is deleted, leading to…

- **passive with agent deleted**
- The stock is bought.

You don't know who bought the stock. You'll find many examples of the "passive with agent deleted" in disclosure documents.

Readers understand sentences in the active voice more quickly and easily because it follows how we think and process information. Many times the passive voice forces readers to take extra mental steps as they convert the passive into the active.

To recognize the passive voice, ask yourself:

Does the sentence use a form of the verb "to be" with:

- another verb in the past tense; and
- a prepositional phrase beginning with "by"?

Remember that it's harder to recognize the passive voice when the object (the phrase introduced with "by") is left out. When you rewrite the sentence in the active voice, use a strong verb. These examples show how strong verbs and the active voice transform sentences, making them shorter and easier to understand.

"When you make all the verbs active, other economies suggest themselves."

Claire Kehrwald Cook
Line by Line

before
The foregoing Fee Table **is intended** to assist investors in understanding the costs and expenses that
a shareholder in the Fund will bear directly or indirectly.

The before example uses the passive with agent deleted. We don't know who "intended" to assist investors. Note how long it took to get to the meat of the sentence—the costs and expenses. Dispensing with the filler words "…to assist investors in understanding…" moves the reader more quickly to the important points.

after
This table describes the fees and expenses that you may pay if you buy and hold shares of the fund.

Here's another example:

before
The proxies solicited hereby for the Heartland Meeting **may be revoked,** subject to the procedures
described herein, at any time up to and including the date of the Heartland Meeting.

after
You may revoke your proxy and reclaim your right to vote up to and including the day of the meeting by
following the directions on page 10.

The plain English version tells you who may revoke a proxy and where to find the information on how to do it. It replaces the abstract "subject to the procedures described herein" with concrete, everyday words, "by following the directions on page 10." It's not enough merely to translate existing texts-the key is to add useful information.

Don't ban the passive voice, use it sparingly

As with all the advice in this handbook, we are presenting guidelines, not hard and fast rules you must always follow. The passive voice may make sense when the person or thing performing the action is of secondary importance to another subject that should play the starring role in a sentence. Use the passive voice only when you have a very good reason for doing so. When in doubt, choose the active voice.

Find hidden verbs

Does the sentence use any form of the verbs "to be," "to have," or another weak verb, with a noun that could be turned into a strong verb? In these sentences, the strong verb lies hidden in a nominalization, a noun derived from a verb that usually ends in *-tion*. Find the noun and try to make it the main verb of the sentence. As you change nouns to verbs, your writing becomes more vigorous and less abstract.

before	**after**
We made an **application**…	We **applied**…
We made a **determination**…	We **determined**…
We will make a **distribution**…	We will **distribute**…

before
We will provide appropriate **information** to shareholders concerning…

after
We will **inform** shareholders about…

before
We will have no stock **ownership** of the company.

after
We will not **own** the company's stock.

before
There is the possibility of prior Board **approval** of these investments.

after
The Board might **approve** these investments in advance.

Try personal pronouns

"Thanks to the existence of pronouns, we are spared a soporific redundancy in literature, speech, and songs."

Karen Elizabeth Gordon
The Transitive Vampire

No matter how sophisticated your audience is, if you use personal pronouns the clarity of your writing will dramatically improve. Here's why.

First, personal pronouns aid your reader's comprehension because they clarify what applies to your reader and what applies to you.

Second, they allow you to "speak" directly to your reader, creating an appealing tone that will keep your reader reading.

Third, they help you to avoid abstractions and to use more concrete and everyday language.

Fourth, they keep your sentences short.

Fifth, first- and second-person pronouns aren't gender-specific, allowing you to avoid the "he or she" dilemma. The pronouns to use are first-person plural (we, us our/ours) and second-person singular (you, your/yours).

Observe the difference between these two examples:

before
This Summary does not purport to be complete and is qualified in its entirety by the more detailed information contained in the Proxy Statement and the Appendices hereto, all of which should be carefully reviewed.

after
Because this is a summary, it does not contain all the information that may be important to you. You should read the entire proxy statement and its appendices carefully before you decide how to vote.

Bring abstractions down to earth

"Use concrete terms and your readers will have a clearer idea of your meaning. You enhance your words when you allow readers to visualize what you say."

Bryan A. Garner
The Elements of Legal Style

Abstractions abound in the financial industry. What pictures form in your mind when you read these phrases: mutual fund, the Dow Jones Industrial Average, zero coupon bond, call option, or foreign currency trading? Most people don't have an image in their minds when they hear abstract words like these. And yet, it's far easier to comprehend a concept or a situation when your mind can form images.

In a study conducted at Carnegie-Mellon University, a cognitive psychologist and an English professor discovered that readers faced with complex written information frequently resorted to creating "scenarios" effort to understand the text. That is, they often made an abstract concept understandable by using it in a hypothetical situation in which *people performed actions*.

You can make complex information more understandable by giving your readers an example using one investor. This technique explains why "question and answer" formats often succeed when a narrative abstract discussion fails.

Here is an example of how this principle can be used to explain an abstract concept—call options:

> For example, you can buy an option from Mr. Smith that gives you the right to buy 100 shares of stock X from him at $25.00 per share anytime between now and six weeks from now. You believe stock X's purchase price will go up between now and then. He believes it will stay the same or go down. If you exercise this option before it expires, Mr. Smith must sell you 100 shares of stock X at $25.00 per share, even if the purchase price has gone up. Either way, whether you exercise your option or not, he keeps the money you paid him for the option.

Although it is impossible to eliminate all abstractions from writing, always use a more concrete term when you can.

Read this list of progressively less abstract terms and consider how you might make abstract concepts you write about more concrete:

- Asset → Investment → Security → Equity → Stock →
- Common stock → One share of IBM common stock

The following examples show how you can replace abstract terms with more concrete ones and increase your reader's comprehension:

before
Sandyhill Basic Value Fund, Inc. (the "Fund") seeks **capital appreciation** and, secondarily, income by investing in securities, primarily equities, that management of the Fund believes are **undervalued** and therefore represent **basic investment value.**

after
At the Sandyhill Basic Value Fund, we will strive to increase the value of your shares (capital appreciation) and, to a lesser extent, to provide income (dividends). We will invest primarily in undervalued stocks, meaning those selling for low prices given the financial strength of the companies.

"Language that is more concrete and specific creates pictures in the mind of [your] listener, pictures that should come as close as possible to the pictures in your mind."

William Lutz
The New Doublespeak: Why No One Knows What Anyone's Saying Anymore

before
No **consideration** or **surrender** of Beco Stock will be required of shareholders of Beco in return for the shares of Unis Common Stock **issued pursuant to the Distribution.**

after
You will not have to turn in your share of Beco stock or pay any money to receive your shares of Unis common stock from the spin-off.

Omit superfluous words

"…the most valuable of all talent, that of never using two words where one will do."

Thomas Jefferson

Words are superfluous when they can be replaced with fewer words that mean the same thing. Sometimes you can use a simpler word for these phrases:

superfluous	**simpler**
in order to	to
in the event that	if
subsequent to	after
prior to	before
despite the fact that	although
because of the fact that	because, since
in light of	because, since
owing to the fact that	because, since

Another source of superfluous words is "shotgunning": letting loose a blast of words hoping at least one conveys your intended meaning. The simplest solution here is to replace your laundry list of adjectives with a single word or phrase that adequately expresses your intended meaning.

For an expanded explanation of "shotgunning," see Richard Wydick's *Plain English for Lawyers*

Omitting superfluous words is one of the easiest ways to improve your disclosure document because it doesn't require you to revise sentence structure.

before
The following summary **is intended only** to highlight certain information **contained elsewhere** in this Prospectus.

after
This summary highlights some information from this Prospectus.

before
Machine Industries and Great Tools, Inc. **are each subject to the information requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith** file reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission").

after
We file annual, quarterly, and special reports, proxy statements, and other information with the Securities and Exchange Commission (SEC).

before
Drakecorp has filed with the Internal Revenue Service **a tax ruling request concerning, among other things,** the tax **consequences** of the Distribution to the United States holders of Drakecorp Stock. It is expected **that the Distribution of Beco Common Stock to the shareholders of Drakecorp** will be tax-free **to such shareholders** for federal income tax **purposes,** except **to the extent** that cash is received for fractional share **interests.**

after
While we expect that this transaction will be tax free for U.S. shareholders at the federal level (except for any cash paid for fractional shares), we have asked the Internal Revenue Service to rule that it is.

"Vigorous writing is concise. A sentence should contain no unnecessary words…for the same reason that a drawing should have no unnecessary lines and a machine no unnecessary parts."

Strunk and White
The Elements of Style

Write in the "positive"

Positive sentences are shorter and easier to understand than their negative counterparts. For example:

before
Persons other than the primary beneficiary may not receive these dividends.

after
only the primary beneficiary may receive these dividends.

Also, your sentences will be shorter and easier to understand if you replace a negative phrase with a single word that means the same thing. For example:

negative compound	**single word**
not able	unable
not accept	eject
not certain	uncertain
not unlike	similar, alike
does not have	lacks
does not include	excludes, omits
not many	few
not often	rarely
not the same	different
not…unless	only if
not…except	only if
not…until	only when

Use short sentences

"There's not much to be said about the period except that most writers don't reach it soon enough."

William Zinsser
On Writing Well

No one likes to read a sentence that's two pages long. And yet, lengthy, information-packed sentences choke many prospectuses today. To complicate matters further, these sentences are filled with jargon and legalese. The longer and more complex a sentence, the harder it is for readers to understand any single portion of it.

before
The following description encompasses all the material terms and provisions of the Notes offered hereby and supplements, and to the extent inconsistent therewith replaces, the description of the general terms and provisions of the Debt Securities (as defined in the accompanying Prospectus) set forth under the heading Description of Debt Securities" in the Prospectus, to which description reference is hereby made. The following description

- will apply to each Note unless otherwise specified in the applicable Pricing Supplement.

If you really want to root out the problem with this paragraph, you need to think of the deeper reasons why it doesn't work. If you look beyond the language used, you'll find that it presents complex information without first providing a context for the reader.

The rewrites that follow show two ways to provide the context, with and without tabulation.

after

We provide information to you about our notes in three separate documents that progressively provide more detail: 1) the prospectus, 2) the prospectus supplement, and 3) the pricing supplement. Since the terms of specific notes may differ from the general information we have provided, in all cases rely on information in the pricing supplement over different information in the prospectus and the prospectus supplement; and rely on this prospectus supplement over different information in the prospectus.

or

We provide information to you about our notes in three separate documents that progressively provide more detail:

1 The Prospectus
General information that may or may not apply to each note.

2 The Prospectus Supplement
More specific than the prospectus, and to the extent information differs from the prospectus, rely on the different information in this document.

3 The Pricing Supplement
Provides final details about a specific note including its price. To the extent information differs from the prospectus or the prospectus supplement, rely on the different information in this document.

Information-packed sentences leave most investors scratching their heads. So many of these sentences have become "boilerplate" that writers

cut and paste them into new documents without thinking about how they can be improved. Since these sentences can be a little intimidating, we thought we'd tackle another one:

before
The Drake Capital Corporation (the "Company") may offer from time to time its Global Medium-Term Notes, Series A, Due 9 months to 60 Years From Date of Issue, which are issuable in one or more series (the "Notes"), in the United States in an aggregate principal amount of up to U.S. $6,428,598,500, or the equivalent there of in other currencies, including composite currencies such as the European Currency Unit (the "ECU") (provided that, with respect to Original Issue Discount Notes (as defined under "Description of Notes—Original Issue Discount Notes"), the initial offering price of such Notes shall be used in calculating the aggregate principal amount of Notes offered hereunder).

after
The Drake Capital Corporation may offer at various times up to U.S. $6,428,598,500 worth of Global Medium-term notes. These notes will mature from 9 months to 60 years after the date they are purchased. We will offer these notes in series, starting with Series A, and in U.S., foreign, and composite currencies, like the European Currency Unit. If we offer original issue discount notes, we will use their initial offering prices to calculate when we reach $6,428,598,500.

As you can see, one long sentence became four shorter sentences. The paragraph moves from the general to the specific, contains short, common words, and is written in the active voice. You only need to read the paragraph once to understand it.

Replace jargon and legalese with short, common words

Ruthlessly eliminate jargon and legalese. Instead, use short, common words to get your points across. In those instances where there is no plain English alternative, explain what the term means when you first use it.

If you have been in the financial or legal industry for awhile, it may be hard to spot jargon and legalese in your writing. Consider asking someone outside the industry to check your work for incomprehensible words.

"Clearness is secured by using the words that are current and ordinary."

Aristotle *Rhetoric*

Last, don't create new jargon that's unique to your document in the form of acronyms or other words. It's asking too much of your readers to memorize a new vocabulary while they are trying to understand complicated concepts. This holds true for individual and institutional investors. Note the following, which is the first sentence on the cover page of an exchange offer:

NLR Insured Mortgage Association, Inc., a Delaware corporation ("NLR MAE"), which is an actively managed, infinite life, New York Stock Exchange-listed real estate investment trust ("REIT"), and PAL Liquidating REIT, Inc., a newly formed, finite life, self-liquidating Delaware corporation which intends to qualify as a REIT ("PAL Liquidating REIT"), hereby jointly offer, upon the terms and subject to the conditions set forth herein and in the related Letters of Transmittal (collectively, the "Offer"), to exchange (i) shares of NLR MAE's Common Stock, par value $.01 per share ("NLR MAE Shares"), or, at the option of Unitholders, shares of PAL Liquidating REIT's Common Stock, par value $.01 per share ("PAL Liquidating REIT Shares"), and (ii) the right to receive cash payable 60 days after closing on the first of any Acquisitions (as defined below) but in no event later than 270 days (nine months) following consummation of the Offer (the "Deferred Cash Payment"), for all outstanding Limited Partnership Interests and Depository Units of Limited Partnership Interest (collectively, "Units") in each of PAL Insured Mortgage Investors, a California limited partnership ("PAL 84"), PAL Insured Mortgage Investors—Series 85, A California Limited Partnership, a California limited partnership ("PAL 85"), and PAL Insured Mortgage Investors L.P.—Series 86, a Delaware limited partnership ("PAL 86"). See "THE OFFER."

"Lawyerisms are words like aforementioned, whereas, res gestae, and hereinafter. They give writing a legal smell, but they carry little or no legal substance."

Richard C. Wydick *Plain English for Lawyers*

This sentence suffers from many shortcomings. It's long and laden with defined terms and other data that mask the fundamental information: the two companies are offering to exchange their stock for the investors' limited partnership holdings. Some of the information, such as par value and places of incorporation, can be moved to another part of the document. Much of the language modifies the subjects and the objects: this language, too, can be moved to a separate sentence or another section of the prospectus.

This example shows the hazards of creating unfamiliar acronyms. They provide false economies, especially when they are introduced on the cover page and in the first pages of the prospectus. They may have a few words, but they may also frustrate and force the reader to take more time and effort to understand the document. Where acronyms, such as REIT, are widely understood to the investing public, they can safely be used without creating confusion.

Occasionally, it's necessary to assign a shorter word to a long proper noun and use this word throughout the rest of the document. In these rare instances, try to choose a word that has an intuitive, logical relationship to the one it's replacing. This reduces the number of new words or phrases the reader needs to memorize to understand the document.

Choose the simpler synonym

Surround complex ideas with short, common words. For example, use *end* instead of *terminate*, *explain* rather than *elucidate*, and *use* instead of *utilize*. When a shorter, simpler synonym exists, use it.

Keep the subject, verb, and object close together

Short, simple sentences enhance the effectiveness of short, common words. We've covered a number of guidelines for writing shorter sentences, but there are a few more you can use to streamline your writing further.

To be clear, sentences must have a sound structure. Here are a few ways to ensure yours do.

The natural word order of English speakers is *subject-verb-object*. Your sentences will be clearer if you follow this order as closely as possible. In disclosure documents, this order is frequently interrupted by modifiers. For example:

Modifiers are words or phrases that describe or limit the subject, verb, or object.

before
Holders of the Class A and Class B-1 certificates **will be entitled to receive** on each Payment Date, to the extent monies are available therefor (but not more than the Class A Certificate Balance or Class B-1 Certificate Balance then outstanding), **a distribution**.

after
Class A and Class B-I certificate **holders will receive a distribution** on each payment date if cash is available on those dates for their class.

before
The following description of the particular terms of the Notes offered hereby (referred to in the accompanying Prospectus as the "Debt Securities") **supplements, and** to the extent inconsistent therewith **replaces, the description** of the general terms and provisions of the Debt Securities set forth **in the Prospectus**, to which description reference is hereby made.

after
This document **describes** the terms of these notes in greater detail than our prospectus, and may **provide** information that **differs** from our prospectus. If the information does **differ** from our prospectus, please **rely** on the information in this document.

Write using "if-then" conditionals

Conditional statements are very common in disclosure documents—although they are rarely written that way. When we rewrote the last example as a conditional, we followed the natural English word order very closely. That's why the sentence is easier to read.

Here are four rules of thumb to help you write conditional statements effectively:

- **One "if," one "then"** When there is only one *if* and one *then,* starting with the *if* may spare some of your readers from having to read the rest of the sentence. In these cases, the *if* clause defines who or what the "then" clause applies to.

  If you invested in Class A shares, then…

- **One "if," multiple "thens"** When there is only one *if* and more than one *then,* start with the *if* and tabulate the *thens*.

- **Multiple "ifs," one "then"** When there is only one *then* and more than one *if,* start with the *then* and tabulate the *ifs*.

- **Multiples "ifs" and "thens"** When there is more than one *if* and more than one *then,* you'll probably need to break it down into more than one sentence, taking care to specify which *ifs* apply to which *thens*. If the information is still unclear, consider presenting the information in a table.

Keep your sentence structure parallel

A long sentence often fails without a parallel structure. Parallelism simply means ensuring a list or series of items is presented using parallel parts of speech, such as nouns or verbs. Note the quotation in the margin.

In this section, we've shown each parallel structure we've used in bold.

Here's an example from a mutual fund prospectus that lacks parallel structure:

"Parallelism reinforces grammatically equal elements, contributes to ease in reading, and provides clarity and rhythm."

Horner/Webb/Miller *Harbrace College Handbook*

before

If you want to buy shares in Fund X by mail, **fill out** and **sign** the Account Application form, **making** your check payable to "The X Fund," and **put** your social security or taxpayer identification number on your check.

after

If you want to buy shares in Fund X by mail, **fill out** and **sign** the Account Application form, **make** your check payable to "The X Fund," and **put** your social security or taxpayer identification number on your check.

Here is a more subtle example from another mutual fund prospectus:

before

We invest the Fund's assets in short-term money market securities **to provide** you with **liquidity**, **protection** of your investment, and **high** current income.

This sentence is unparallel because its series is made up of two nouns and an adjective before the third noun. It's also awkward because the verb *provide* is too closely paired with the nominalization *protection*.

One logical revision to the original sentence is to change the noun series to a verb series.

after

We invest in short-term money market securities **to provide** you with liquidity, **to protect** your investment, and **to generate** high current income.

All writers, regardless of their degree of expertise, occasionally write unparallel sentences. The best way to rid your document of them is to read through it once solely to find these mistakes. Reading your document aloud can make unparallel constructions easier to spot.

Steer clear of "respectively"

How easy is it to read the following sentence once and understand what it means?

"Many shortcuts are self-defeating; they waste the reader's time instead of conserving it."

"Strunk and White *The Elements of Style*

before

The Senior Notes and the guarantee (the "Guarantee") of the Senior Notes by Island Holdings will constitute unsecured senior obligations of the Issuer and Island Holdings, respectively.

after

The senior notes are an unsecured senior obligation of the issuer, while the guarantee of the senior notes is an unsecured senior obligation of Island Holdings.

Whenever you use "respectively," you force your reader to go back and match up what belongs to what. You may be saving words by using "respectively," but your reader has to use more time and read your words twice to understand what you've written. •

Designing the Document

A plain English document reflects thoughtful design choices. The right design choices make a document easier to read and its information easier to understand. The wrong design choices can make even a well-written document fail to communicate.

Some documents suffer because no one knew how basic design decisions, like typeface selection, dramatically determine whether or not a document is easy to read. Other documents suffer because expensive design features give them artistic appeal, but at the cost of obscuring the text. In a plain English document, design serves the goal of communicating the information as clearly as possible.

Beginning the design process

Check with your in-house printing or graphics department—your company may have already dealt with design issues in other documents or may have skilled designers who can help you with your document. If your company or underwriter has a style manual, it typically will define a required "look" that specifies typefaces and layouts.

Since some standards or guidelines in your style manual may have been adopted when plain English was not a concern, review them to ensure they contribute to good design and ease of reading.

If you are using a designer, keep the following in mind:

- Good design requires clear communication between the writer and the designer. Keep the lines of communication open and flowing.
- Take the time to explain the nuances of your document to your designer.
- Don't move into the design phase until your text is final. Once the document is put into page layout software, or once it is at the printer, making text changes can be tedious and expensive.

If you don't have a design professional, fear not. You can apply many of the simple concepts discussed in this chapter to produce a readable, visually appealing document.

While the field of design extends broadly, this chapter covers five basic design elements and how they contribute to creating a plain English document:

- hierarchy or distinguishing levels of information
- typography

- layout
- graphics
- color

Hierarchy

Much like an outline, a document's hierarchy shows how you've organized the information and helps the reader to understand the relationship between different levels of information.

A typical hierarchy in the prospectus might include:

- the document title
- section headings (first level)
- subsection headings (second level)
- paragraph headings (third level)
- general text (fourth level)

Designers use different typefaces in the headings to distinguish these levels for the reader. As a rule of thumb, there should be no more than six levels in the document, excluding the document's title.

You can signal a new level by varying the same typeface or by using a different typeface. Here's a demonstration of how we've used different typefaces to distinguish levels in this handbook:

Section headings

Subsection headings

General text

Example headings

Typography

Although it may seem like a minor decision, your typeface selection will be one of the elements that most strongly defines the design and readability of your document.

Kinds of typefaces

Typefaces come in two varieties: serif and sans serif.

serif	sans serif
N	N

All serif typefaces have small lines at the beginning or ending strokes of each letter. Virtually all newspapers and many magazines use some form of serif type for their general text because serif fonts are easier to read than sans serif. This handbook uses a serif typeface called Scala for general text. Other popular serif typefaces are: Caslon, Century Schoolbook, Garamond, and Times. Here are some examples:

"Serif type is more readable and is best for text; sans serif type is more legible and is best used for headlines."

Robin Williams
The Mac is Not a Typewriter

serif

This is an example of Scala.

This is an example of Caslon.

This is an example of Century Schoolbook.

This is an example of Garamond.

This is an example of Times.

Sans serif typefaces lack those small connective lines. The type used for most headings throughout this document is a sans serif typeface, Scala Sans. Franklin Gothic, Frutiger, Helvetica and Univers are examples of sans serif typefaces.

sans serif

This is an example of Franklin Gothic.

This is an example of Frutiger.

This is an example of Helvetica.

This is an example of Univers.

Generally, serif typefaces are easier to read in documents like this than sans serif because the small connective lines of serif help to lead your eye more quickly and smoothly over text. It is best to use sans serif typefaces in small quantities—for emphasis or headings, but not for general text. Both serifs and sans serifs work well for headings.

Selecting the right typeface

When choosing a typeface, think carefully about where the typeface will appear in the document. For example, will it be general text, or will it apply to information that needs to be highlighted? Will it introduce a section?

Some typefaces are harder to read than others and were never intended for text. Typefaces like Bodoni Poster or other bold, italic, or condensed typefaces were designed for headlines or for large display type. These examples show how difficult it is to read text in these typefaces.

Bodoni Poster

Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

Robin Williams, *The Mac Is Not a Typewriter*

Franklin Gothic Condensed

Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

Robin Williams, *The Mac Is Not a Typewriter*

You can mix different typefaces, but do so with discretion; not all typefaces work well together. Mixing a serif and sans serif, as we have done in this handbook, can look good and create a clear contrast between your levels. Mixing two serif or two sans serif typefaces can look like a mistake. As a general rule, do not use more than two typefaces in any document, not including the bold or italic versions of a typeface.

Type measurement

All typefaces are measured in points (pts). But don't assume that different typefaces in the same point size are of equal size. For example, here are five typefaces set in 11pt:

This is an example of 11pt Franklin Gothic.

This is an example of 11pt Century Schoolbook.

This is an example of 11 pt Garamond.

This is an example of 11pt Helvetica.

This is an example of 11pt Times.

Choose a legible type size

A point size that is too small is difficult for everyone to read. A point size that is too large is also hard to read. Generally, type in 10pt-12pt is most common. But as you can see from the examples above, some typefaces in 11pt will strain some readers. If you have special concerns about legibility, especially for an elderly audience, you should consider using 12pt or larger.

". . . words consisting of only capital letters present the most difficult reading—because of their equal height, equal volume and, with most, their equal width."

Josef Albers
Interaction of Color

Emphasizing text

It's common in disclosure documents to see blocks of text in bold and uppercase letters. The capitalization and bold type attempt to catch the reader's attention. Unfortunately, those capitals make the text difficult to read. All uppercase sentences usually bring the reader to a standstill because the shapes of words disappear, causing the reader to slow down and study each letter. Ironically, readers tend to skip sentences written in all uppercase.

To highlight information and maintain readability, use a different size or weight of your typeface. Try using extra white space, bold type, shading, rules, boxes, or sidebars in the margins to make information stand

out. In this handbook we use dotted rules to highlight the examples. Whatever method you choose to highlight information, use it consistently throughout your document so your readers can recognize how you flag important information.

before
THE SECURITIES AND EXCHANGE COMMISSION HAS NOT APPROVED OR DISAPPROVED THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

after
The Securities and Exchange Commission has not approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

after
The Securities and Exchange Commission has not approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Layout

Designers think carefully about white space, column width, linespacing, and paragraph length. These design elements determine whether reading is easy or becomes too much of a physical or mental chore.

"... when *everything* (background, structure, content) is emphasized, *nothing* is emphasized; the design will often be noisy, cluttered, and informationally flat."

Edward Tufte
Visual Explanations

Use white space effectively

Generous use of white space on the page enhances readability, helps to emphasize important points, and lightens the overall look of the document. White space especially affects the readers of disclosure documents because these documents usually feature dense blocks of impenetrable text.

You should fight the impulse to fill up the entire page with text or graphics. A wide left or right margin can make the document easier to read. The use of white space between sections or subsections helps readers recognize which information is related.

Use left justified, ragged right text

Research shows that the easiest text to read is left justified, ragged right text. That is, the text is aligned, or flush, on the left with a loose, or ragged, right edge. The text in this handbook is set left justified, ragged right.

Fully justified text means both the right and left edges are flush, or even. When you fully justify text, the spacing between words fluctuates from line to line, causing the eye to stop and constantly readjust to the variable spacing on each line. Currently, most disclosure documents are fully justified. This, coupled with a severe shortage of white space, makes these documents visually unappealing and difficult to read.

Be especially wary of centering text, or using text to form a shape or design. Uneven margins may make a visual impact, but they make reading extremely difficult.

recommended: left justified, ragged right
Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

not recommended: fully justified text
Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

not recommended: centered text
Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

Use linespacing to lighten the page

Linespacing, or "leading" (rhymes with sledding), refers to the amount of space between lines of text. Leading controls the density and readability of the text. Just as type is measured in points, so is leading. A type description of 12/16 means that 12pt type has been set with 4pts of additional leading between the lines. Generous leading can give a long paragraph a lighter, "airier" feeling and make it easier to read.

Avoid setting type without any additional leading (such as 10/10 or 12/12), sometimes referred to as being "set solid." Typically, you should allow *at least* 2pts of leading between lines of type. You may want to add more leading, depending on the "airiness" you would like the document to have. In this document, for ease of reading, the general text has been set at

11/16, and most examples have been set at 10/12. Review the following examples to see how leading affects readability.

11/11
Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

11/13
Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

11/15
Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

Keep lines to a reasonable length

A comfortable line length for most readers is 32 to 64 characters. Any longer than that, and your readers will lose their place when they read from line to line. A safe rule to follow is: the smaller the type size, the shorter the line length. This is why when you pick up any newspaper, magazine, or large book, you'll rarely see text that goes from one side of the page clear to the other, as you do in disclosure documents.

Columns also help your readers to move quickly and easily through large amounts of text. An average column width can vary from 25-40 characters. Remember to use ample white space between columns, too.

don't

Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally

do

Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading. Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

do

Justified text was the style for many years—we grew up on it. But there has been a great deal of research on readability (how easy something is to read) and it shows that those disruptive, inconsistent gaps between the words inhibit the flow of reading.

Besides, they look dumb. Keep your eyes open as you look at professionally-printed work . . . and you'll find there's a very strong trend now to align type on the left and leave the right ragged.

Keep paragraph length relatively short

To reduce dense text, keep paragraphs as short as possible. Even though paragraph length is determined by content, here are some design tips that can help to lighten a long paragraph.

Use bullets to list information whenever possible. This makes information easier to absorb in one quick glance, as the following illustrates:

Sidebars, like this one, are a handy way to convey information that might muddy the general text. Try to keep your sidebars to "snippets" of information.

before

The funds invest mainly in the stocks of U.S. and foreign companies that are showing improved earnings and that sell at low prices relative to their cash flows or growth rates. The Fund also invests in debt, both investment grade and junk bonds, and U.S. Treasury securities.

after

We invest the fund's assets in:

- stocks of U.S. and foreign companies that
  —show improved earnings, and
  —sell at low prices relative to their cash flows or growth rates;
- debt, both investment grade and junk bonds; and
- U.S. Treasuries.

Use tables to increase clarity

Use tables to increase clarity and cut down text. Tables often convey information more quickly and clearly than text. The information in this table is more easily grasped in a table than in narrative form:

before

Our investment advisory agreements cover the Growth Fund, International Fund, Muni Fund, Bond Fund, and the Money Market Fund. The effective date for agreements for the Growth Fund and the International Fund is June 1, 1993, and for the Muni Fund, Bond Fund and Money Market Fund, June 1, 1994.

after

Our Investment Advisory Agreement covers these funds:

Investment Advisory Agreement effective date	Fund name
June 1, 1993	Growth Fund International Fund
June 1, 1994	Muni Fund Bond Fund Money Market Fund

Graphics

Graphics often illuminate information more clearly and quickly than text. This section introduces some basic guidelines about using graphics in your document. To learn more, books and articles cover the topic in rich and rewarding detail. The best known work, *The Visual Display Of Quantitative Information*, by Edward R. Tufte, provides practical advice on creating graphics. In the introduction of his book, he writes about the importance and value of graphics:

> *At their best, graphics are instruments for reasoning about quantitative information. Often the most effective way to describe, explore, and summarize a set of numbers—even a very large set—is to look at pictures of those numbers. Furthermore, of all methods for analyzing and communicating statistical information, well-designed data graphics are usually the simplest and at the same time the most powerful.*

On page 51 of his book, Tufte formulates a number of basic principles to follow in creating excellent graphics. Among them are these:

Graphical excellence is that which gives to the viewer the greatest number of ideas in the shortest time with the least ink in the smallest space.

And graphical excellence requires telling the truth about data.

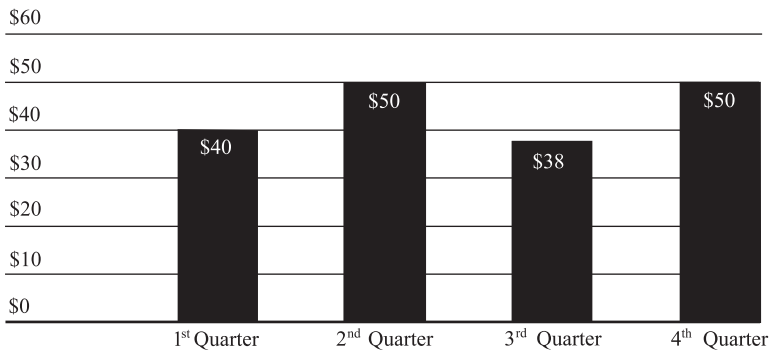
A few experts have studied the use of graphics in securities documents, isolating the areas presenting the most problems. We can boil down their advice to these guidelines.

Keep the design simple

Keep the design of any graphic as simple as possible. Pare away any nonessential design elements so the data stands out. Think of it this way: as much of the ink as possible in a graphic should deal with a data point and not decoration. Some of the worst mistakes occur when design elements interfere with the clear presentation of information, such as needless 3-D effects, drop shadows, patterns, and excessive grid lines. Don't let a design element turn into what Tufte calls "chartjunk."

These examples show how a 3-D bar graph provides initial visual appeal, but is harder to read and understand than a straightforward presentation of the same information. The multiple lines of the 3-D bars confuse some readers because the front of the bars appear to have a lower value than the back of the bars.

before

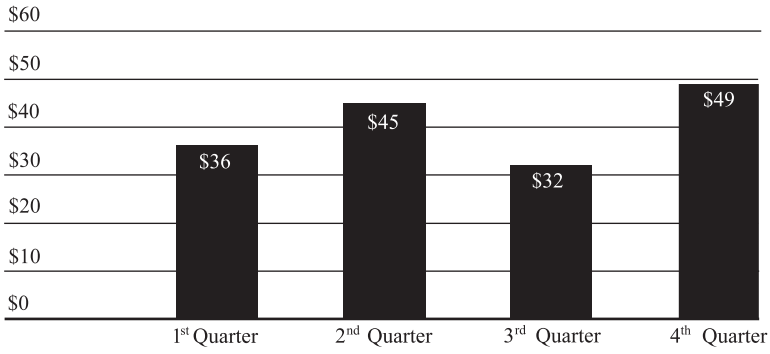


"Extensive studies of annual reports of major corporations in the United States and the United Kingdom have shown that about 25 percent of the graphs they contain are dies torted substantially."

Alan J. Davis
Geographical Information Where to Draw the Line

after

1997 Quarterly Sales Revenue in millions

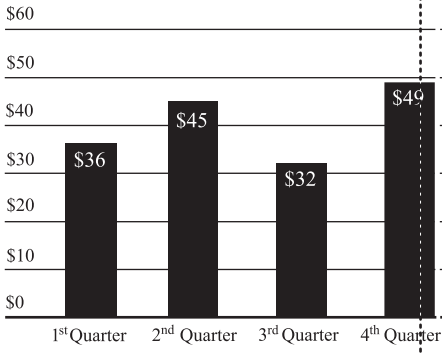


Check proportions of visuals

Generally, you should avoid graphics that start at a non-zero baseline, because they distort differences by destroying correct proportions. Compare these two bar charts to see how the non-zero baseline can mislead the reader as to the magnitude of change from quarter to quarter.

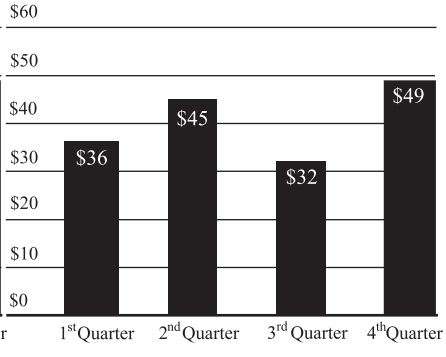
before

1997 Quarterly Sales Revenue in millions



after

1997 Quarterly Sales Revenue in millions



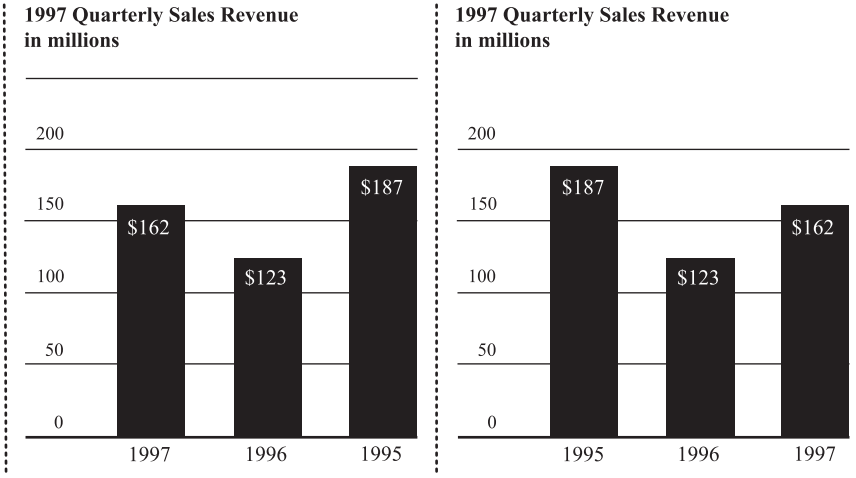
Draw graphics to scale

Any graphic should be proportionately correct or drawn to scale. For example, if you are showing an increase in oil production through a series of oil barrels in ever-increasing sizes, make sure a barrel isn't represented as 50% bigger when production only went up 25% that year.

Be consistent when grouping graphics

If you group graphics side-by-side, avoid changing your scale from one graphic to another, as in the examples above. Also, lining up three graphics that present data in billions, millions, then dollars can mislead the reader.

In graphics showing information over time, time should flow forward, not backward. In these examples, even though the first graphic is clearly labeled, it gives a false visual impression that earnings are going down over time rather than up.



Time-Saving Tips

Following are some tips that have saved time for those who routinely rewrite documents in plain English:

Photocopy the document, single sided, on 11" x I7" paper (ledger paper) to 120% of its original size. This gives you room to make notes in the margins and helps to save your eyesight. Keep your original document handy. You'll use it again later.

Read through the ledger-sized copy and take notes. In the margin of each paragraph, jot down the main and supporting points. (We suggest using a pencil unless you're one of those people who does crossword puzzles in ink.) If you can't find these points too easily, it may mean the paragraph is a hodgepodge of unrelated topics.

This stage of the process can be "space-consuming." In your workspace or in a conference room, tape or tack the pages of your document to the wall. If it's too long, you may want to spread out just your outline and summary.

Then, thinking of your investors, physically move the pages into the order that makes the most sense. If only parts of pages need to be moved, cut them out and move just the parts. Remember to group like information together.

When you start to reorder your document by moving pages or parts of pages, write on the page or section:

- where it appeared in the original document (the page number and paragraph, if applicable); and
- a number or letter to indicate its place in the new draft.

It's a good idea to keep the notes and questions you wrote in the margins distinct from your cross-reference marks by writing them in a different color. Use colored pencils, since it's likely you'll move sections around more than once.

Once you have finished physically reorganizing the document, you may want to outline the new organization. On a separate piece of paper, write the names for the new sections you created. Under each section name, write down its major elements. This is the outline of your plain English draft and, with some revisions, will become your table of contents.

Keep in mind that the most effective outlines are more like sketches—just detailed enough to set priorities—and create logical relationships.

Next to each entry on your outline, be sure to note where this information appeared in the original document. This is very important. Cross-referencing accurately now may save you hours of backtracking later.

Tape your reordered sections on blank pieces of ledger size paper and photocopy them. This will be the master document from which you'll rewrite. As you rewrite, each time you complete a sentence or paragraph, draw a line through it in pencil. This way you'll be sure to account for all the original content in your rewrite. ●

Using Readability Formulas and Style Checkers

Readability formulas determine how difficult a piece of writing is to read. However, you should be aware of a major flaw in every readability formula.

No formula takes into account the content of the document being evaluated. In other words, no formula can tell you if you have conveyed the information clearly. For the most part, they count the numbers of syllables and words in a sentence and the number of sentences in the sample. Of course, if you applied a readability formula to a traditional disclosure document, it would fail miserably. But keep in mind that by some formulas' calculations, Einstein's theory of relativity reads at a 5th grade level.

Some computerized style checkers analyze your grammar and identify the passive voice. They may suggest ways to make your writing more "readable." Take their suggestions as just that—suggestions. The final test of whether any piece of writing meets its goal of communicating information comes when humans read it. •

Evaluating the Document

You can evaluate your document by testing it with a focus group. Experts call this "audience-centered" testing because it focuses on the interaction between a particular document and a representative sample of its readers. While the results are reliable, focus groups require time and money.

Focus group testing tends to work better with shorter documents or portions of longer ones. You can also test the portions of your document that you plan to use repeatedly. At the very least, you'll have helpful feedback on the sections that investors are most likely to read and on the language that appears most frequently in your disclosure documents. Based on the test results, you can isolate the parts that cause the most confusion and fix them.

If you don't have the budget to test your document formally through focus groups, improvise. Ask individuals in your office who most closely resemble your investors to read your draft document and listen closely to their reactions. Ask others who have some distance from the project to read it. A fresh pair of eyes often picks up the "obvious" problems that those who have worked with the document miss. •

Reading List

If you want more information on how to write in plain English, we've listed just a few of the many resources available, including those from the SEC. You may want to visit your local library to review these books or a broader selection. Goldstein and Lieberman's book, *The Lawyer's Guide to Writing Well*, includes a comprehensive list of books about legal writing. We are not endorsing any of these books, but have included them as a resource for your convenience.

Claire Kehrwald Cook, *Line by Line* (Houghton Mifflin, 1985).

Alan J. Davis, *Graphs and Doublespeak, Quarterly Review of Doublespeak*, Volume XVIII, Number 4, July 1992.

Bryan A. Garner, *The Elements of Legal Style* (Oxford University Press, 1991).

, *A Dictionary of Modern Legal Usage* (Oxford University Press, 2nd ed., 1995).

Tom Goldstein and Jethro K. Lieberman, *The Lawyer's Guide to Writing Well* (University of California Press, 1989).

Karen Elizabeth Gordon, *The Transitive Vampire: A Handbook of Grammar for the Innocent, the Eager, and the Doomed* (Times Books, 1984).

, *The New Well-Tempered Sentence, A Punctuation Handbook for the Innocent, the Eager, and the Doomed* (Ticknor & Fields, 1993).

William Lutz, *The New Doublespeak: Why No One Knows What Anyone's Saying Anymore* (HarperCollins, 1996).

David Mellinkoff, *Legal Writing: Sense & Nonsense* (West Publishing Company, 1982).

William Strunk Jr. and E.B. White, *Elements of Style* (Macmillan, 3rd rev. ed., 1981).

Edward R. Tufte, *The Visual Display of Quantitative Information* (Graphics Press, 1983).

Robin Williams, *The Mac Is Not a Typewriter* (Peachpit Press, 1990).

Richard C. Wydick, *Plain English for Lawyers* (Carolina Academic Press, 2nd ed., 1985).

William Zinsser, *On Writing Well* (Harper & Row, 4th ed., 1988).

SEC publications

Before & After Plain English Examples and Sample Analyses (SEC Division of Corporation Finance, April 4, 1998).

Plain English Pilot Program: Selected Plain English Samples (SEC Division of Corporation Finance, January 28, 1998).

Securities Act Release No. 33-7380, Plain English Disclosure, proposing release, (January 14, 1997) 62 FR 3512 (January 21, 1997)

Securities Act Release No. 33-7497, Plain English Disclosure, adopting release, (January 28, 1998) 63 FR 6370 (February 6, 1998). •

Keeping in Touch with Us

We hope that this handbook will prove useful to you in drafting and creating plain English documents. Although we have drawn the suggestions in the handbook from those who have written plain English documents and from experts in the field, we realize that much more will be learned along the way that can benefit all of us.

We would appreciate receiving your suggestions on how we can improve this handbook. We would also like to collect as many examples of "befores" and their plain English "afters" as possible, as well as any tips that helped you save time and energy.

Please forward your suggestions and "before" and "after" examples to:

Nancy M. Smith
Director
Office of Investor Education and Assistance
SEC
450 5th Street, N.W.
Washington, D.C. 20549•

Plain English at a Glance

Plain English means creating a document that is	You create a plain English document by
• visually inviting, • logically organized, and • understandardable on the first reading	• knowing your readers, and • presenting information your readers need in an order they'll understand

Summary of the plain English rules

Rule 421(b)	Rule 421(d)
Entire Prospectus	**Cover and Back Pages, Summary, And Risk Factors**
Clear, concise, and understandable	Use plain English principals in the Organization, language, and design of documents
• short sentences whenever possible	Substantially use:
• bullet lists whenever possible	• short sentences
• descriptive headers and subheaders	• definite, concrete, everyday words
• avoid relying on glossaries and defined terms	• active voice
• avoid legal and highly technical business terms	• tables and bullet lists
Note	• no legal jargon, highly technical business terms

Avoid

- legalistic, overly complex presentations
- vague boilerplate
- excerpts from legal documents
- repetition

This is a summary, so please read the entire rule to make sure you comply with every aspect of it.

- no multiple negatives

Entire Prospectus—Design

In designing the entire prospectus:

- may use pictures, logos, charts, graphs, or other design elements
- encouraged to use tables, schedules, charts and graphics for financial data
- must draw graphs and charts to scale
- cannot use misleading design and information

§230.421
Presentation of information in prospectuses

* * * * *

(b) You must present the information in a prospectus in a clear, concise and understandable manner. You must prepare the prospectus using the following standards:

(1) Present information in clear, concise sections, paragraphs, and sentences. Whenever possible, use short, explanatory sentences and bullet lists;

(2) Use descriptive headings and subheadings.

(3) Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus. Define terms in a glossary or other section of the document only if the meaning is unclear from the context. Use a glossary only if it facilitates understanding of the disclosure; and

(4) Avoid legal and highly technical business terminology.

Note to §230.421(b):

In drafting the disclosure to comply with this section, you should avoid the following:

1. Legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;

2. Vague "boilerplate" explanations that are imprecise and readily subject to different interpretations;

3. Complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and

4. Disclosure repeated in different sections of the document that increases the size of the document but does not enhance the quality of the information.

* * * * *

(d)(1) To enhance the readability of the prospectus, you must use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section.

(2) You must draft the language in these sections so that at a minimum it substantially complies with each of the following plain English writing principles.

(i) Short sentences;

(ii) Definite, concrete, everyday words;

(iii) Active voice;

(iv) Tabular presentation or bullet lists for complex material, whenever possible;

(v) No legal jargon or highly technical business terms; and

(vi) No multiple negatives.

(3) In designing these sections or other sections of the prospectus, you may include pictures, logos, charts, graphs, or other design elements so long as the design is not misleading and the required information is clear. You are encouraged to use tables, schedules, charts and graphic illustrations of the results of operations, balance sheet, or other financial data that present the data in an understandable manner. Any presentation must be consistent with the financial statements and non-financial information in the prospectus. You must draw the graphs and charts to scale. Any information you provide must not be misleading.

Instruction to §230.421

You should read Securities Act Release No. 33-7497 (January 28, 1998) for information on plain English principles. •

Frequently Asked Questions Regarding N-1A & Profile Prospectus
Division of Investment Management: Letter to ICI October 2, 1998

Dear Mr. Tyle:

In the time that has passed since the Commission adopted amendments to Form N-1A and the new profile rule, members of the fund industry have asked us a variety of questions seeking clarification or interpretations of certain new disclosure rules. In our May 19, 1998 letter to you, we answered a number of those questions. The purpose of this letter is to set out our views about various issues raised with us since we last wrote to you. We believe our responses will be of interest to the entire fund industry and ask that you distribute our letter to the membership of the Investment Company Institute. We also will make this letter and our May letter available on the Commission's web site (http://www.sec.gov/rules/othrindx.htm).

For the convenience of the industry, we have used a question-and-answer format in this letter. We begin with issues arising with respect to Form N-1A.

Form N-1A

Bar Chart and Performance Table

III. Q: Should the disclosure of a fund's highest and lowest return for a quarter during the 10 calendar years or other period of the bar chart be for calendar quarters or fiscal quarters?

A: Consistent with the other information in the bar chart and the performance table, the highest and lowest quarterly performance information should be based on calendar quarters.

IV. Q: Item 2(c)(2)(ii) of Form N-1A requires that, if a fund's fiscal year is other than a calendar year, it must include year- to-date return information as of the end of the most recent quarter in a footnote to the bar chart. If such a fund does not have a full calendar year of performance information, must it provide year-to-date return information?

A: No. As with the bar chart itself, year-to-date return information is not required, and is not permitted, until a fund has annual return information for at least one calendar year.

V. Q: May a load fund include in the performance table returns reflecting both the sales load and load-waived returns?

A: No. Instruction 2(a) to Item 2(c)(2) requires calculation of average annual total returns in accordance with Item 21(b)(1). That Item requires a fund to include the maximum sales loads (including deferred sales loads) and recurring account fees in the calculation of average annual total returns.

VI. Q: Must a money market fund include the performance table in its prospectus and, if so, must the table include a comparison to a broad-based securities market index?

A: Item 2(c)(2)(iii) of Form N-1A requires a fund, including a money market fund, that has annual return information for at least one calendar year to include the performance table in its prospectus. While the performance table generally must include the returns of an appropriate broad-based securities market index, consistent with the requirements of Item 5, Management's Discussion of Fund Performance, a money market fund need not compare its performance to a broad-based securities market index. A money market fund may, at its option, include information for one or more other indices as permitted by Instruction 6 to Item 5(b).

VII. Q: May a non-money market fund that does not disclose yield information in its risk/return summary provide a telephone number that investors can use to obtain current yield information?

A: Yes. Instruction 2(d) to Item 2(c)(2)of Form N-1A requires a non-money market fund that discloses yield to provide a toll-free (or collect) telephone number that investors can use to obtain current yield information. This requirement does not preclude a non-money market fund that does not disclose yield in its prospectus from providing a telephone number for that purpose. Thus, a non-money market fund, like a money market fund, has the option of providing yield information in its prospectus or disclosing a telephone number that investors can use to obtain current yield information.

Fee Table

VIII. Q: May funds with fees and/or expenses that are subject to reimbursements or waivers show the net amount of those fees or expenses in the fee table?

A: Yes, under certain circumstances. If a fund's fees in the fee table are subject to a contractual limitation that requires reimbursement or waiver of expenses, a fund may add two lines to the fee table: one line showing the amount of the reimbursement or waiver, and a second line showing the fund's net expenses after subtracting the fee reimbursement or expense waiver from the total fund operating expenses. A fund should place these additional lines immediately under the "Total Annual Fund Operating Expenses" line of the fee table and should use appropriate descriptive captions. A footnote to the fee table should describe the contractual arrangement. A fund could, for example, use a format such as the following:

Annual Fund Operating Expenses (expenses that are deducted from Fund assets)

Management Fees	xx %
Distribution [and/or Service](12b-1) Fees	xx %
Other Expenses	xx %
_____	xx %
_____	xx %
_____	xx %
Total Annual Fund Operating Expenses	xx %
Fee Waiver [and/or Expense Reimbursement]	xx %
Net Expenses	xx %

Fee waivers or expense reimbursements that are not contractually imposed may be disclosed only in a footnote to the fee table. The Commission stated in its release adopting amendments to Form N-1A ("Form N-1A Adopting Release") that disclosure of the gross level of fund operating expenses would give investors clearer information about the long-term costs of an investment in a fund.[171] The Commission was concerned that allowing a fund to show operating expenses net of the waiver or reimbursement would lead investors to focus on costs resulting from temporary or discretionary waiver and reimbursement arrangements rather than long-term costs. In meeting the provisions of Form N-1A, a fund for which the investment adviser (or other party) intends to reimburse expenses or waive fees, but is not contractually obligated to do so, may include a footnote to the fee table showing fund operating expenses net of waivers or reimbursements. We recognize that circumstances may require modifications to the fee table. When such circumstances arise, we will work with a fund as it develops a presentation that is appropriate for the fund and meets the spirit of the new requirements.

Purchase and Sale Information

IX. Q: The Form N-1A Adopting Release states that "as long as the purchase and sale information in a fund's prospectus is not reduced below the minimum [disclosure] required by Form N-1A, the fund would be able to create and use a separate purchase and sale disclosure document as supplemental sales literature."[172] What is the minimum disclosure required in the prospectus?

A: The minimum disclosure required in a prospectus depends upon the facts and circumstances specific to a particular fund. The following types of disclosures, however, are examples of those that would not be required to appear in the prospectus: (1) a description of every possible way to purchase or redeem fund shares; (2) a description of every restriction or process related to purchasing or redeeming fund shares (e.g., requirements that checks be drawn in U.S. dollars, and disclosure about share certificates); and (3) detailed information about various types of accounts, such as different types of tax-deferred accounts. Among the information that would be required is disclosure of any material restrictions that a fund imposes on the right of redemption and disclosure of minimum investment requirements.

X. Q: Item 18(a) of Form N-1A provides that a fund may incorporate purchase and redemption information required by Item 18(a) into its Statement of Additional Information ("SAI") by reference to a separate disclosure document that may be provided to investors with the SAI or separately. If a fund elects to provide purchase and redemption information in a separate disclosure document that it incorporates by reference into the SAI, can the SAI, in turn, be incorporated by reference into the fund's prospectus without violating the Commission's rule that restricts double incorporation by reference? Are the delivery requirements for this separate document the same as for the complete SAI?

A: Rule 10(d) [17 CFR 229.10(d)] generally prohibits double incorporation by reference—an incorporation by reference that is twice removed from the primary document. Funds that choose

[171] *Investment Company Act Release* No. IC-23064 (Mar. 13, 1998) [63 FR 13916, 13925].
[172] 63 FR at 13932-13933.

to incorporate the SAI into the prospectus should include, rather than incorporate, the information required by Item 18(a) in a separate section of the SAI and provide that section individually and apart from the SAI to investors who request additional purchase and redemption information. Since the purchase and redemption information would be a separable section of the SAI and not a separate document, the fund would avoid double incorporation by reference when the SAI is incorporated by reference into the prospectus.

Item 1 of Form N-1A requires a fund that receives a request for the SAI or the shareholder report to send the requested document within 3 business days of receipt of the request. The same delivery requirement would apply to a request for a separate section of the SAI containing additional information on purchase and redemption procedures. We note that a fund that chooses to use these SAI disclosure options must provide a complete SAI to investors who request the SAI and do not limit their request to information on purchase and redemption procedures.

Compliance

XI. Q: May a post-effective amendment that is not yet required to comply with amended Form N-1A reflect some, but not all, of the amended requirements?

A: Generally, no. The staff would not object, however, if, prior to updating its entire registration statement, a fund chose to: (i) move the 10-year financial highlights table from the front of the prospectus and delete average commission rate information from that table; (ii) move from the prospectus to the SAI disclosure about technical, legal, or operational matters as permitted by Form N-1A, as amended; (iii) omit, as exhibits to its registration statement, model retirement plans used to offer fund shares, schedules showing the calculation of performance information, and voting trust agreements; or (iv) omit the table showing the number of holders of each class of fund shares from Part C of its registration statement.

Three-Day Mailing Requirement

XII. Q: Must a fund ensure that a third-party intermediary selling its shares complies with the requirement to send the SAI, annual or semi-annual report (and, in the case of the profile, the prospectus) to an investor within 3 business days of receipt of a request?

A: Yes, if the third-party intermediary is named in the prospectus (or profile) or otherwise acts as an agent of the fund. In the Form N-1A Adopting Release and the release adopting the profile rule ("Profile Adopting Release"),[173] the Commission stated that funds are required to mail SAIs and prospectuses to investors within 3 days of a request because prompt delivery of the those documents to investors is essential to the disclosure formats contemplated by Form N-1A and the profile. Recognizing that many funds are distributed through financial intermediaries and that investors may look to those intermediaries to provide information, the Commission

[173]*Investment Company Act Release No. IC-23065 (Mar. 13, 1998) [63 FR 13968] (adopting profile rule).*

allowed a fund to indicate in its prospectus or profile that an investor may obtain an SAI or shareholder report (or, in the case of the profile, the prospectus) from a financial intermediary. When a financial intermediary is named in the prospectus (or profile) as a party to contact in order to obtain information or when a financial intermediary otherwise acts as an agent for a fund, the fund remains obligated to ensure that the information is sent to investors within 3 business days of receipt of a request. In those cases, the fund can contract with intermediaries to ensure their compliance with the 3-day mailing requirement.

A fund, however, is not responsible for ensuring that a third-party intermediary complies with the 3-day mailing requirement if: (1) the third-party intermediary is not an agent of the fund; (2) the prospectus or profile provides the fund's toll-free (or collect) telephone number for investors to call to obtain a copy of the specified documents from the fund; (3) the prospectus or profile does not mention that intermediary as a source for obtaining these documents and does not generally instruct investors to contact an intermediary to obtain documents; and (4) an investor directly contacts the third-party intermediary to request one or more of these documents.

Rule 498

Profile Filings

XIII. Q: Must a fund that has previously filed a definitive form of profile with the Commission subsequently file the updates to the bar chart and performance table as required by rule 498(c)(2)(iii)?

A: Yes. Rules 497(k)(1)(iii)(A) and (B), respectively, require a fund that has filed a definitive form of profile with the Commission to file any subsequent material and non-material changes to the information disclosed under rules 498 (c)(2)(i)- (iii). The Instruction to rule 498(c)(2)(iii) gives a fund the option to reflect updated performance information to the bar chart and the performance table by affixing a label or sticker to the profile or by other reasonable means. If a fund updates the bar chart and the performance table in accordance with the Instruction, the fund should file the label, sticker, or "other reasonable means" of updating performance information under the applicable sub-paragraph of rule 497(k)(1)(iii). If a fund reflects updated performance information to the bar chart and the performance table by reprinting and distributing the entire form of profile, however, the fund should refile the complete, revised definitive form of profile under the applicable sub-paragraph of rule 497(k)(1)(iii).

XIV. Q: Under what sub-paragraph of rule 497(k)(1)(iii) must a fund that has previously filed a definitive form of profile with the Commission file routine updates to the bar chart, the performance table, and the fee table required by rule 498(c)(2)?

A: Those kinds of updates should be filed under rule 497(k)(1)(iii)(B). A fund should submit routine updates to the bar chart, the performance table, and the fee table in the profile on EDGAR form type 497K3B.

XV. Q: If a fund has filed a definitive form of profile with the Commission and subsequently tailors the definitive profile for use by investors in participant-directed defined contribution plans, must the fund file a new form of profile under rule 497(k)(1)(i) and observe a 30-day waiting period?

A: No. Rule 498(d) permits a registrant to modify certain information included in a profile to be used for a fund that is offered as an investment option for certain defined contribution plans, tax-deferred arrangements, or variable contracts. If a profile modified under rule 498(d) contains material changes to the information disclosed under rules 498(c)(2)(i)-(iii), the fund must file the revised definitive form of profile under rule 497(k)(1)(iii)(A) on EDGAR form type 497K3A. Conversely, if a profile modified under rule 498(d) contains non-material changes to the information disclosed under rules 498(c)(2)(i)-(iii) (e.g., routine updates to the bar chart, performance table, and fee table; omission of, or changes to, the disclosure required by rules 498(c)(2)(vi)-(ix); changes to the profile legend), the fund must file the revised definitive form of profile under rule 497(k)(1)(iii)(B) on EDGAR form type 497K3B. In each instance, the definitive form of profile reflecting modifications under rule 498(d) must be filed with the Commission no later than the fifth business day after the profile's first date of use.

XVI. Q: If a fund uses a separate application to purchase fund shares with the profile, must the fund file that application with the Commission?

A: Yes. A fund that uses a separate application with the profile must file the application with its profile in three circumstances:

(1) when it files its first profile under rule 497(k)(1)(i)(EDGAR form type 497K1),

(2) when it files its definitive form of profile under rule 497(k)(1)(ii) (EDGAR form type 497K2), and

(3) whenever it revises the form of application used with the profile. In this case, the profile should be refilled with the revised application under rule 497(k)(1)(iii)(B)(EDGAR form type 497K3B).

Registrants are reminded that, under rule 498(c)(3), an application used with a profile must note with equal prominence that an investor has the option of purchasing fund shares after reviewing the profile or after requesting and reviewing the fund's prospectus (and other information).

Specific Requirements

XVII. Q: May a fund modify the legend required by rule 498(c)(1)(iv) that should appear on the cover page or at the beginning of the profile?

A: No. In contrast to the disclosure required by rule 498(c)(2)(ii) which allows some flexibility in the wording of a required legend, a fund must include the rule 498(c)(1)(iv) legend verbatim on the cover page or at the beginning of the profile.

XVIII. Q: If a fund reprints its profile when it updates its performance, should the reprinted profile reflect the date that the profile was first used, and the date that the profile was revised, or should the profile reflect only the date of the reprint?

A: The profile should reflect only the date of the reprint.

XIX. Q: What is contemplated by the requirement to provide a brief summary of services available to typical investors in a fund (see rule 498(c)(2)(ix) and related Instruction)?

A: A fund may comply with this requirement by listing the services commonly used by a typical fund investor. We recognize that available services vary among different fund groups and therefore believe it is appropriate to provide funds with flexibility to determine which services to disclose.

XX. Q: If a fund group decides to include more than one fund in a profile, does the same combination of funds that is described in the profile have to appear in a prospectus for the funds?

A: No. There is no requirement that profiles maintain a one-to-one correlation with prospectuses. For example, a single profile may be used to offer multiple funds, each having a separate prospectus; or multiple profiles may be used to offer funds included in a single prospectus.

XXI. Q: May a fund include information in the profile other than the disclosure specified by rules 498(c)(2)(i)-(ix)?

A: Generally, no. The profile is intended to be a standardized summary of key information in a fund's prospectus. Consistent with this purpose, rule 498(b) limits profile disclosure to information required or not precluded by paragraph (c) of the rule. Based on the limitations imposed by rule 498(b), a fund could not include in the profile, for example, a list of the fund's top ten portfolio holdings, cumulative performance information, or a discussion of the potential rewards of investing in the fund, since these items are inconsistent with maintaining the profile as a standardized summary. Funds are reminded, however, that they must include sufficient information in the profile necessary to avoid material misstatements or materially misleading disclosure.

XXII. Q: May a fund include in a profile performance information appearing in a fund's prospectus under the Nicholas Applegate[174] and Bramwell[175] no-action letters?

A: No, for the reasons outlined in our answer to question 19. Performance information that is consistent with the Nicholas Applegate and Bramwell no-action letters is neither required nor permitted by rule 498 and may not be included in a profile.

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[174] *Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996) (fund to include in its prospectus performance information of private accounts managed by the fund's investment adviser that had substantially similar investment objectives, policies, and strategies).*

[175] *Bramwell Growth Fund (pub. avail. Aug. 7, 1996) (fund to include in its prospectus standardized total return information of another registered investment company previously managed by the fund's portfolio manager that had substantially similar investment objectives and policies).*

XXIII. Q: If a fund's fiscal year is other than a calendar year, the fund must include its year-to-date return information as of the end of the most recent quarter in a footnote to the bar chart in the prospectus. See rule 498(c)(2)(iii) (incorporating Item 2(c)(2)(ii) of Form N-1A). Given that the profile is updated quarterly, is it necessary for a fund to include the footnote to the bar chart in the profile?

A: No. Because the performance table is updated quarterly, a fund may omit the footnote to the bar chart in a profile.

XXIV. Q: Rule 498(c)(2)(iii) requires funds to "[u]pdate the return information as of the end of each succeeding calendar quarter as soon as practicable after the completion of the quarter." Which return information must be updated quarterly?

A: As indicated in the Profile Adopting Release, a fund must update quarterly the return information in its performance table (i.e., the fund's average annual total returns and the returns of any index included in the table).[176]

XXV. Q: Under rule 498(c)(2)(iii), at what point must a new fund include the performance table in its profile?

A: A fund that has annual returns for at least one calendar year must include the performance table in the profile. See rule 498(c)(2)(iii) (incorporating Item 2(c)(2)(iii) of Form N-1A).

XXVI. Q: The Instruction to rule 498(c)(2)(iii) provides that a fund may update the performance table by affixing a label or sticker, or by other reasonable means. Based on this Instruction, could a fund update the performance table by including the updated performance information in a cover letter introducing the profile?

A: No. Although the Instruction to rule 498(c)(2)(iii) states that a fund may update performance information by affixing a label or sticker, or by other reasonable means, a profile may not incorporate information by reference to another document. Cross-references in a profile to another document are also restricted. These restrictions were intended to ensure that the profile is a self-contained disclosure document. For these reasons, we believe that a fund may not update its profile with a separate document, even if that separate document is a letter that accompanies the profile.

XXVII. Q: Instruction 2(c) to Item 2(c)(2) of Form N-1A states that, if a fund selects an index that is different from the index used in the performance table for the immediately preceding period, the fund must explain the reason(s) for the selection of a different index and provide information for both the newly selected and the former index. Given that rule 498(c)(2)(iii) incorporates Item 2(c)(2)(iii) of Form N-1A, must a fund that changes an index previously used in the profile's performance table comply with the Form N-1A Instruction?

A: No. Consistent with the profile's intended purpose as a standardized summary of key information in a fund's prospectus, we would not object if a fund omitted the explanation and information specified in Instruction 2(c) to Item 2(c)(2) of Form N-1A from the performance table in the profile.

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[176] *63 FR 13977.*

XXVIII. Q: Must a fund describe all sales load waivers in the profile?

A: No. Under rules 498(c)(2)(vi) and (vii), a fund that offers them should include a statement that waivers are available for initial sales loads and for sales loads or charges assessed upon redemption. It need mention specifically only those waivers that would apply to a typical purchaser.

Using the Profile with Rule 482 Materials

XXIX. Q: If an advertisement designed to meet the requirements of rule 482 under the Securities Act of 1933 does not accompany a profile, may the advertisement include language inviting an investor to request and read a profile prior to investment?

A: Funds may add language to a rule 482 advertisement that invites an investor to request a profile or a prospectus, so long as the advertisement refers to both the profile and the prospectus and the reference to the profile is no more prominent than the reference to the prospectus.

XXX. Q: May rule 482 material be bound to or wrapped around the profile?

A: Yes, if it is clear that the wrapper is not part of the profile and each document complies with the rule regulating its content as a stand-alone document.

XXXI. Q: Assume that a full page of newspaper copy combines a profile with a rule 482 advertisement for the same fund. Should the profile be separated from the rule 482 advertisement?

A: Yes. As discussed in response to question 24, the Commission intended that the profile be a short, summary, self-contained disclosure document. In our view, in light of this purpose, rule 482 advertisements and profiles should not appear as a single document in newspaper copy. We would not object, however, if both documents are used together in newspaper copy so long as the boundaries of each document are distinct and each document includes its required content.

Sincerely,

Barry D. Miller
Associate Director

Updated as of: January 23, 2003

Staff Responses to Questions about Regulation S-P

The staff of the Division of Investment Management has prepared the following responses to questions about Regulation S-P, which implements the privacy provisions in Title V of the Gramm-Leach-Bliley Act ("GLBA").[1] The adopting release for Regulation S-P[2] can be found at: www.sec.gov/rules/final/34-42974.htm. These responses represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Securities and Exchange Commission, and the Commission has neither approved nor disapproved this information.

Scope of Regulation S-P

Question 1

Q: Does Regulation S-P[3] apply to a financial institution, such as a "hedge fund," that meets the criteria for exclusion from regulation under sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 ("ICA")?

A: No. GLBA authorized the Commission to adopt and enforce rules implementing GLBA with respect to "investment companies" under the ICA.[4] A financial institution[5] that meets the criteria in sections 3(c)(1) or 3(c)(7) of the ICA is not an "investment company" under that statute, and therefore is not subject to Regulation S-P.[6] GLBA gives the Federal Trade Commission regulatory authority for any financial institution that is not subject to the jurisdiction of any other regulator under that Act.[7]

Consumer and Customer Relationship

Question 2

Q: Does a wrap account client who has a written contract with the wrap account sponsor, but not with the wrap account's investment adviser, have a customer relationship with the investment adviser?

A: Yes. Regulation S-P defines a customer relationship as a continuing relationship between a consumer and a financial institution.[8] Examples of a customer relationship include an individual who has an advisory contract with an investment adviser.[9] Division staff has stated that for purposes of the brochure delivery rule under the Investment Advisers Act,[10] a contractual relationship exists between a wrap account client and the portfolio manager, even in the absence of a written contract.[11] We believe the same analysis applies under the privacy rules, and therefore that a wrap account client has a customer relationship with the portfolio manager for purposes of Regulation S-P.[12]

Question 3

Q: Does an investment adviser that has only institutional clients, including pension plans, have customers to whom the adviser must provide privacy notices under Regulation S-P?

A: No. Regulation S-P requires an investment adviser to provide certain privacy notices to its customers and consumers.[13] Under the regulation, a "consumer" or a "customer" must be an *individual*.[14] Therefore a client that is not an individual, such as a pension plan, is neither a consumer nor a customer of the adviser.[15]

Question 4

Q: Is an individual who purchases investment company ("fund") shares through a broker-dealer a customer of the fund under Regulation S-P even if the fund has no direct contact with the individual[16]?

A: Yes, if the individual owns the fund shares in his or her own name. The examples in Regulation S-P provide that an individual who is the record holder of fund shares is the fund's customer.[17] If the broker-dealer is the record holder of fund shares for the benefit of the individual, the individual would not be a fund customer under Regulation S-P.[18]

Privacy Notices

Question 5

Q: Can an initial or annual privacy notice be incorporated into another document (such as an account statement, annual report, prospectus, trade confirmation, Form ADV, or adviser's brochure)?

A: Regulation S-P does not prohibit financial institutions from combining a privacy notice with another document.[19] Any privacy notice, however, must be clear and conspicuous.[20] Therefore a privacy notice that is combined with another document must be distinct from and not hidden in other information in the document.[21] In addition, a financial institution must deliver a privacy notice to customers each year even if other information in the combined document need not be delivered annually (such as an investment adviser's brochure).[22]

Question 6

Q: Must a privacy notice provided jointly by multiple financial institutions in a fund complex separately name each institution to which the privacy policy applies?

A: No, as long as the notice clearly identifies the financial institutions covered by the privacy policy as members of the fund complex. For example, a privacy policy for the ABC fund complex could state that it applies to all funds that include the ABC name. Conversely, however, if the privacy policy applies to additional funds that do not include the ABC name, the policy should specifically identify those additional funds.

Question 7

Q: Regulation S-P permits a financial institution to deliver a single annual privacy notice to multiple customers who share an address ("household") if the notice is in or accompanies a shareholder report or a prospectus delivered under the Commission's householding rules.[23] Can a fund satisfy the annual privacy notice requirement by delivering the notice in or with documents that are delivered to multiple shareholders at the same address ("householding"), even if those documents (such as account statements) are not covered by the Commission's householding rules?

A: Yes, if the fund obtained consent to household those types of documents in the manner set forth under the Commission's householding rules.[24]

Question 8

Q: Regulation S-P requires that funds deliver: (i) an initial privacy notice to new customers not later than when the customer relationship is established, and (ii) an annual privacy notice to all customers. Regulation S-P also requires, as a one-time phase-in of the initial notice requirement, that funds deliver by July 1, 2001 an initial privacy notice to each individual who is a record owner of fund shares as of that date.[25] As noted in the response to question 7 above, funds may include an *annual* privacy notice in or with certain documents that are householded under Commission rules. Can a fund also household the initial privacy notice that must be sent to existing customers by July 1, 2001?

A: Yes, in certain circumstances. Regulation S-P permits householding of annual privacy notices because the Commission believed that customers whose documents are householded also would consent to having their annual privacy notices householded.[26] The Commission was unwilling to make the same assumptions for customers whose documents are not householded.[27] The Commission also did not permit broker-dealers, funds, or investment advisers to household initial notices.[28] A customer must receive an initial notice no later than when the customer relationship is established, and therefore is likely to receive the initial notice before he or she has notice of householding. The concern that a fund might provide a single initial notice to new customers who are unaware that documents will be householded does not extend, however, to the initial notice provided to existing customers (by July 1, 2001) whose documents are householded. Accordingly, the staff would not recommend enforcement action to the Commission if, prior to July 1, 2001, a fund households initial privacy notices (i) in the manner provided for householding annual privacy notices,[29] or (ii) for documents that do not fall under the Commission's householding rules, as provided in the response to question 7 above.

The staff's position would *not* permit a fund to household an initial notice that is combined with an opt out notice.[30] Regulation S-P does not permit financial institutions to household opt out notices. An opt out notice must provide a reasonable means for the consumer (or customer) to opt out,[31] and the Commission did not assume that customers whose disclosure documents are householded would consent to householding the means by which the customer must exercise his or her right to opt out.[32] Therefore, if a fund is required to deliver opt out notices (because,

for example, it shares information with nonaffiliated parties outside of an exception), the fund cannot household delivery of the opt out notices.[33]

Question 9

Q: Can a fund deliver to a customer with multiple accounts a single initial or annual privacy notice that applies to all the accounts?

A: Yes, as long as (i) the privacy notice makes clear each of the accounts to which it applies, (ii) the privacy notice is accurate with respect to the privacy policies applicable to each account, and (iii) a customer with multiple accounts who receives a single notice can reasonably be expected to receive actual notice in writing with respect to each account.[34] For example, a customer who receives multiple account statements in a single envelope or who receives a consolidated account statement can reasonably be expected to receive actual notice of a fund's privacy policy that is included in the envelope with the account statement(s).

Question 10

Q: Does posting an institution's privacy policy on its website satisfy the notice requirements for the institution's website users?

A: An institution must provide privacy notices so that each consumer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, electronically.[35] An institution cannot reasonably expect that all its customers will receive actual notice in writing of a privacy notice that is posted at a particular location, whether that location is an advertising site, the institution's premises, or the institution's web site.[36] As provided in the examples in Regulation S-P, an institution may reasonably expect that a consumer (or customer) will receive actual notice if, for a consumer (or customer) who conducts transactions electronically, the institution posts the notice on the website and requires the consumer to acknowledge receipt of the notice as a necessary step to obtaining a particular financial product or service.[37] The examples also provide that an institution may reasonably expect that a customer will receive actual notice of the institution's *annual* notice, if the customer uses the institution's web site to access financial products and services electronically and agrees to receive notices at the web site, and the institution posts its current privacy notice continuously in a clear and conspicuous manner on the web site.[38]

Question 11

Q: Can a fund provide the initial privacy notice to a new customer *after* the customer invests, when it delivers the fund's prospectus and confirmation?

A: No. GLBA requires a fund to provide an initial notice to customers no later than the time the customer relationship is established. Regulation S-P provides that an individual establishes a customer relationship with a fund when the individual purchases fund shares in his or her own name (*i.e.*, the trade date).[39] Thus, an initial privacy notice provided with a prospectus and confirmation would need to be provided to the investor no later than the trade date.

Regulation S-P provides exceptions to this delivery rule in certain circumstances. A fund may provide the initial privacy notice within a reasonable time after it establishes a customer relationship if: (i) establishing the customer relationship is not at the customer's election; (ii) providing notice no later than when the fund establishes a customer relationship would substantially delay the customer's transaction and the customer agrees to receive the notice at a later time; or (iii) a nonaffiliated broker or dealer establishes a customer relationship between the fund and a consumer without the fund's prior knowledge.[40]

Question 11.01

Q: When must an insurance company separate account provide an initial privacy policy to a new customer who purchases a variable annuity or variable life contract[41]?

A: GLBA requires a fund to provide an initial privacy notice to customers not later than the time the customer relationship is established. An individual establishes a customer relationship with an insurance company separate account when the individual purchases a variable annuity or variable life contract (*i.e.*, the date the separate account issues the contract).[42] Thus, the separate account must provide an initial privacy notice to its customer not later that the time it issues the contract.

Question 11.02

Q: If a variable annuity or variable life contract provides for a full refund of the purchase payments upon rescission by a new customer during the "free-look" period,[43] can an insurance company separate account provide the initial privacy notice to the customer when it delivers the variable contract before the end of the free-look period?

A: Yes. The release adopting Regulation S-P states that in most circumstances, a fund (including an insurance company separate account) "should give the initial notice at a point when the consumer still has a meaningful choice about whether to enter into the customer relationship."[44] If an investor may fully recover investment costs upon rescission of the contract, then, as of the date the variable contract is delivered, the investor still has a meaningful choice as to whether there will be a continuing relationship.[45] In those circumstances, the staff would not recommend enforcement action to the Commission if an insurance company separate account provides the initial privacy notice to the investor when it delivers the variable annuity or variable life contract before the end of the free-look period.[46]

Question 12

Q: When must a closed-end fund provide an initial privacy notice to new investors who purchase fund shares on the secondary market?

A: Closed-end funds are subject to the same initial privacy notice delivery requirements as open-end funds (*see* response to question 11 for these requirements). Therefore, if an investor buys shares of a closed-end fund that he or she does not already own through a broker or dealer

affiliated with the fund, the fund must provide an initial privacy notice to the investor no later than when the fund establishes the customer relationship (*i.e.*, when the investor purchases fund shares in his or her own name).[47] If an investor purchases the shares of a closed-end fund that he or she does not already own through a broker or dealer *unaffiliated* with the fund, the fund would have a reasonable time to provide an initial notice to the investor after the customer relationship is established.[48] Under these circumstances, a "reasonable time after . . . establish[ing] a customer relationship" includes a reasonable time after the fund learns of the customer's purchase of the fund shares.

Exceptions to Opt Out

Question 13

Q: Must an investment adviser permit its customers to opt out before the adviser shares nonpublic personal information about the customers with (i) a nonaffiliated broker-dealer in order to execute trades on behalf of the customers or (ii) a nonaffiliated custodian that holds securities on behalf of the customers?

A: No. Regulation S-P permits financial institutions in certain circumstances to share nonpublic personal information about consumers (and customers) with nonaffiliated third parties without providing them with notice of and opportunity to opt out.[49] These circumstances include sharing information with a nonaffiliate (i) as necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes, (ii) in connection with processing or servicing a financial product or service a consumer authorizes, and (iii) in connection with maintaining or servicing the consumer's account with the institution.[50] Under these exceptions, an investment adviser need not provide a customer the opportunity to opt out before sharing nonpublic personal information about the customer with (i) a nonaffiliated broker-dealer in order to execute trades the customer has authorized and (ii) a nonaffiliated custodian that holds securities on behalf of the customer.

Monitoring Third Parties

Question 14

Q: Is an investment adviser responsible for the privacy policies of broker-dealers that execute transactions the adviser's clients have authorized, or of funds that the adviser recommends to its clients?

A: No. A financial institution is not responsible under Regulation S-P for the privacy practices of a nonaffiliated third party with whom the institution shares information under an exception listed in sections 248.14 or 248.15 (such as a broker that executes transactions the client has authorized). Regulation S-P limits the ability of these nonaffiliates to use and share information they have received in those circumstances.[51] If the nonaffiliate receiving the information under an exception is a broker-dealer, fund, or investment adviser registered with the Commission, the Commission could enforce the provisions of Regulation S-P with respect to the nonaffiliate.[52]

Endnotes

[1]Pub. L. No. 106-102, 113 Stat. 1338, §§ 501-527 (1999) (codified at 15 U.S.C. §§ 6801-6827). The staff responses were first issued on April 9, 2001, and have been updated, as noted above.

[2]Privacy of Consumer Financial Information (Regulation S-P), Investment Company Act Release No. 24543 (June 22, 2000) [65 Fed. Reg. 40334 (June 29, 2000)] ("Adopting Release").

[3]*See* 17 CFR Part 248; Adopting Release, *supra* note 2.

[4]*See* GLBA, *supra* note 1, §§ 504(a)(1), 505(a)(4). GLBA also gave the Commission regulatory authority under the Securities Exchange Act of 1934 with respect to broker-dealers, and under the Investment Advisers Act of 1940 with respect to investment advisers registered with the Commission. *Id.* §§ 504(a)(1), 505(a)(3), (5).

[5]GLBA defines "financial institution" to mean "any institution the business of which is engaging in financial activities as described in section 4(k) of the Bank Holding Company Act of 1956." *Id.* § 509(3)(A).

[6]*See* 15 U.S.C. 80a-3(c)(1) (issuer whose outstanding securities are owned by no more than 100 persons and that is not making and does not propose to make a public offering of its securities is not an investment company); 15 U.S.C. 80a-3(c)(7) (issuer whose securities are owned only by "qualified purchasers" and that is not making and does not propose to make a public offering of its securities is not an investment company).

[7]*See* GLBA, *supra* note 1, at §§ 504(a)(1), 505(a)(7). Under GLBA, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision are the regulators for national and state banks; the National Credit Union Administration is the regulator for federally insured credit unions; and state insurance authorities are the regulators for insurance providers. *Id.* § 505(a)(1), (2), (6). In addition, the Commodity Futures Modernization Act of 2000 ("CFMA") provides that the Commodity Futures Trading Commission ("CFTC") is the regulator, for purposes of GLBA, for futures commission merchants, commodity trading advisors, commodity pool operators, and introducing brokers subject to the CFTC's jurisdiction under the CFMA. CFMA, Pub. L. No. 106-554, § 124, 114 Stat. 2763, 2763A-411 (2000).

[8]17 CFR 248.3(k)(1).

[9]*See* 17 CFR. 248.3(k)(2)(B).

[10]*See* 17 CFR 275.204-3.

[11]*See* National Regulatory Services, Inc., SEC No-Action Letter (Dec. 2, 1992) ("NRS") at n.4.

[12]It may be unclear when the customer relationship with the portfolio manager is established in a wrap account and, therefore, when the portfolio manager must provide the initial notice to the customer. Regulation S-P provides that a customer relationship is established when the consumer enters into a contract with the adviser. *See* 17 CFR 248.4(c)(3)(iii). The staff has previously stated that it believes the contractual relationship arises no later than the time the portfolio manager begins to provide services to the client. *See* NRS, *supra* note 11,. at text following n. 4. Therefore, a portfolio manager must provide an initial privacy notice to a wrap account client no later than when it begins to provide services to the client.

[13]The adviser must provide to customers: (i) an initial privacy notice generally not later than when the customer relationship is established, and (ii) an annual privacy notice after that. 17 CFR 248.4(a)(1), 248.5(a)(1). *See also* 17 CFR 248.8 (requiring a financial institution to provide a revised privacy notice before sharing nonpublic personal information about a consumer with a nonaffiliate other than as described in the initial privacy notice provided to the consumer). If an adviser intends to share nonpublic personal information about a consumer with a nonaffiliated third party (other than under an exception), the adviser must provide the consumer with an initial notice and opportunity to opt out of the sharing. 17 CFR 248.10(a)(1).

[14]*See* 17 CFR 248.3(g)(1) (a "consumer" is an individual who obtains or has obtained a financial product or service from a financial institution primarily for personal, family, or household purposes, or that individual's legal representative); 17 CFR 248.3(j), 248.3(k)(1) (a "customer" is a consumer who has an ongoing relationship with the institution).

[15]*See* Adopting Release, *supra* note 2, at n.43. Beneficiaries of a pension plan that is the adviser's client also would not be the adviser's customers. Any individual accommodation clients to whom the adviser provides personal financial services would, however, be the adviser's customers for purposes of Regulation S-P.

[16]Funds may have indirect contact with individual shareholders, who receive fund prospectuses and shareholder reports through a broker-dealer.

[17]*See* 17 CFR 248.3(k)(2)(i)(C). *See also* Adopting Release, *supra* note 2, at text preceding n.59.

[18]A fund may receive nonpublic personal information about a beneficial shareholder from a broker-dealer under an exception in sections 248.14 or 248.15 (to provide tax information directly to the shareholder for example). *See* 17 CFR 248.14, 248.15. A fund that receives nonpublic personal information about shareholders under an exception in sections 248.14 or 248.15 is limited in the ways in which it can share or use that information. *See* 17 CFR 248.11(a).

[19]*See* Adopting Release, *supra* note 2, at text following n.28 (discussion of combined notices). *See also* 17 CFR 248.3(c)(2)(ii)(E) (examples of methods for making a privacy notice "clear and conspicuous" when it is combined with another document).

[20]*See* 17 CFR 248.4(a)(1), 248.5(a)(1), 248.7(a)(1).

[21]*See 17 CFR 248.3(c) (a clear and conspicuous notice is designed to call attention to the nature and significance of the information in the notice); 17 CFR 248.3(c)(2)(E) (examples of design techniques that call attention to the nature and significance of a privacy notice combined with other information include using distinctive type size, style, and graphic devices).*

[22]*See* 17 CFR 275.204-3(c)(1) (an investment adviser must deliver or offer in writing to deliver to each of its clients a written disclosure statement).

[23]*See* 17 CFR 248.9(c)(2); 17 CFR 230.154 (permitting public companies to household prospectuses); 17 CFR 270.30d-1(f) (permitting management companies to household semi-annual stockholder reports); 17 CFR 270.30d-2(b) (permitting unit investment trusts to household semi-annual shareholder reports).

[24]*See* 17 CFR 230.154(a)(3) (requiring written consent to household prospectuses); 17 CFR 230.154(b) (conditions for implied consent to household prospectuses); 17 CFR 230.154(c) (annual notice to shareholders of right to revoke consent); 17 CFR 270.30d-1(f)(1)(iii) (requiring written consent to household shareholder reports); 17 CFR 270.30d-1(f)(2) (conditions for implied consent to household shareholder reports); 17 CFR 270.30d-1(f)(3) (annual notice to shareholders of right to revoke consent); 17 CFR 270.30d-2(b) (incorporating requirements of rule 30d-1(f) for householding reports to shareholders of unit investment trusts).

[25]17 CFR 248.18(b)(1).

[26]*See* Adopting Release, *supra* note 2, at text following n.139.

[27]*See id.*

[28]The Commission noted that (i) it believed any reduction in the number of initial notices consumers might receive would be minimal, and (ii) individuals who share the same address may not become consumers of the financial institution at the same time. *Id.* at text following n.139.

[29]*See* 17 CFR 248.9(c)(2). The staff also would not recommend enforcement action to the Commission if a fund delivers an annual notice in or with an annual report or proxy statement under the conditions in 17 CFR 240.14a-3(e).

[30]A financial institution may combine an opt out notice with an initial notice. *See* 17 CFR 248.7(b).

[31]*See* 17 CFR 248.7(a)(iii). By contrast, an initial or annual notice must include an explanation of the consumer's right to opt out, including the method by which the consumer may exercise the right to opt out. *See* 17 CFR 248.6(a)(6).

[32]Certain methods of opt out, such as a check-off box, would require a separate form for each customer to exercise the opt out right. Other means, such as a toll-free number, would allow multiple customers to opt out even if they received one form. The Commission did not, however, provide an exception for householding opt out notices based on the means of opt out.

[33]When a fund delivers an opt out notice, it also must include a copy of the privacy notice. *See* 17 CFR 248.7(c) (fund that provides an opt out notice after the initial notice must include a copy of the initial notice with the opt out notice).

[34]*See* 17 CFR 248.4(a) (initial notice must be clear and conspicuous and accurately reflect the financial institution's privacy policies), 248.5(a)(1) (same for annual notice), 248.9(a) (privacy notices must be delivered so that each consumer can reasonably be expected to receive actual notice). The regulation does not prohibit an institution from providing a single privacy notice to a customer regarding all the customer's accounts. *See* 17 CFR 248.4(d)(2) (if the initial, revised, or annual notice that a fund most recently provided to a customer was accurate with respect to a new financial product or service, the fund need not provide the customer a new privacy notice).

[35]17 CFR 248.9(a).

[36]*See* 17 CFR 248.9(b)(2) (an institution may not reasonably expect that a consumer will receive actual notice of the institution's privacy policies if the institution only posts the policies in a branch office, generally publishes advertisements of the policies, or sends a notice by e-mail to a consumer who does not obtain financial products or services from the institution electronically).

[37]17 CFR 248.9(b)(1)(iii).

[38]17 CFR 248.9(c)(1)(i).

[39]*See* 17 CFR 248.4(c)(3)(iv).

[40]17 CFR 248.4(e)(1).

[41]Variable contracts are securities under the Securities Act of 1933. *See, e.g., SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71-73 (1959). Variable annuity and variable life insurance payments are allocated to a segregated asset account, or "separate account," which typically is registered as an investment company under the ICA. *See Prudential Ins. Co. v. SEC,* 326 F.2d 383 (3d Cir.), *cert. denied*, 377 U.S. 953 (1964). *See also* 15 U.S.C. 80a-2(a)(37) (definition of "separate account" under the ICA).

[42]*See* 17 CFR 248.4(c)(3)(iv) (a customer relationship with a fund is established when the consumer (who is the record owner) purchases shares the fund has issued).

[43]Variable annuity and variable life contracts typically contain a "free-look" provision that gives the contract owner the right to return the contract within a specified period for a refund. *See* Frederick R. Belamy & Steven B. Boehm, The Investment Company Regulation Deskbook §17.4[1] (Amy L. Goodman, ed., 1997).

[44]Adopting Release, *supra* note 2, at text accompanying n.98.

[45]*See* 17 CFR 248.3(k)(1) (defining "customer relationship" to mean a continuing relationship between a consumer and a financial institution).

[46]This position is in comity with the requirements of the National Association of Insurance Commissioners' Privacy of Consumer Financial and Health Information Model Regulation. *See* National Association of Insurance Commissioners, Privacy of Consumer Financial and Health Information Model Regulation, Art. II, § 5.A(1) (initial privacy notice must be provided not later than when the customer relationship is established); Art. II, § 5.C(2)(a) (customer relationship is established upon delivery of the insurance contract).

[47]*See* 17 CFR 248.5(a)(1); 248.4(c)(3)(iv). If the investor already owns shares of the fund, he or she already will have received an initial privacy notice, and need not receive another initial notice.

[48]*See* 17 CFR 248.4(e)(1)(iii).

[49]*See* 17 CFR 248.13, 248.14, 248.15.

[50]17 CFR 248.14(a)(1)-(2). *See also* 17 CFR 248.14(b)(1) ("necessary to effect, administer, or enforce a transaction" includes information sharing that is required or is a usual, appropriate, or acceptable method to carry out the transaction or the product or service business of which the transaction is a part, and record, service or maintain the customer's account in the ordinary course of providing the financial service).

[51]*See 17 CFR 248.11(a).*

[52]*See* GLBA, *supra* note 1, at § 505(a)(3)-(5). Another regulator specified in GLBA would enforce the privacy regulations with respect to a nonaffiliated financial institution subject to that regulator's jurisdiction. *See supra* note 7. *See also* Adopting Release, *supra* note 2, at text preceding n.157.

U.S. Securities and Exchange Commission

Staff Responses to Questions Regarding Disclosure of Fund of Funds Expenses

The staff of the Division of Investment Management has prepared the following responses to certain questions raised in connection with amendments to the fee table adopted in the Fund of Funds release in June 2006.[177] These amendments require funds to disclose in their fee tables the expenses of investing in other funds under a line item titled "Acquired Fund Fees and Expenses" ("AFFE").

These responses represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Securities and Exchange Commission, and the Commission has neither approved nor disapproved this information.

All responses refer to Item 3 of Form N-1A, but apply equally to similar items in Forms N-2 and N-3.

Question 1

Q: Instruction 3(f)(i) to Item 3 of Form N1-A requires a fund that invests in other funds (Acquired Funds) to disclose the fees and expenses associated with those investments. An "Acquired Fund" includes any company that would be an investment company under section 3(a) of the Investment Company Act but for the exceptions to that definition provided in sections 3(c)(1) and 3(c)(7) of the Act. In addition to hedge funds and other pooled investment vehicles discussed in the Adopting Release, some structured finance vehicles, such as collateralized debt obligations, may rely on section 3(c)(1) or 3(c)(7) of the Act. Must their expenses be included in an acquiring fund's fee table?

A: No. AFFE is intended to include the expenses of investments in investment companies, hedge funds, private equity funds, and other entities traditionally considered pooled investment vehicles. Accordingly, the staff would not recommend enforcement action if a fund does not include in the fee table expenses associated with investments in structured finance vehicles, collateralized debt obligations, or other entities not traditionally considered pooled investment vehicles.

Question 2

Q: Must an Acquiring Fund include in its calculation of AFFE, expenses the Acquired Fund incurred through its investment in other investment companies?

A: No. Instruction 3(f)(iv) to Item 3 of Form N-1A provides that the total annual operating expense ratio used for purposes of calculating AFFE is the annualized expense ratio disclosed

[177] *Fund of Funds Investments, Investment Company Act Release No. 27399 (June 20, 2006) [71 FR 36640 (June 27, 2006)] ("Adopting Release"). The Release can be found at: http://www.sec.gov/rules/final/2006/33-8713.pdf.*

in the Acquired Fund's most recent shareholder report. This expense ratio does not include expenses an Acquired Fund has incurred through its investment in other companies. (See question 3, however, with respect to disclosures for feeder funds.)

Question 3

Q: Are feeder funds required to include the AFFE in their prospectus fee tables?

A: Yes. Open-end feeder funds filing on Form N-1A must disclose in their fee tables the aggregate expenses of the feeder fund and the master fund (*see* Instruction 1(d)(i) to Item 3 of Form N-1A). The Form N-1A requirement pre-dates the new fund of fund disclosure amendments and has not been changed; the Commission added a similar Form N-2 requirement *(see* Instruction 10.h to Item 3 of Form N-2).

Question 4

Q: Instruction 3(f)(iv) to Item 3 of Form N-1A states that the annual operating expense ratio to be used for purposes of calculating AFFE is the ratio disclosed in an Acquired Fund's most recent shareholder report. Does "most recent" refer to the report available as of the Acquiring Fund's fiscal year end or as of the date of the Acquiring Fund's prospectus update in which the AFFE information will appear?

A: The term "most recent" refers to the Acquired Fund's shareholder report available *at the time the Acquiring Fund calculates the AFFE*. The Acquiring Fund should use the Acquired Fund's required expense ratio presented in the financial highlights table contained in the most recent annual or semi-annual report when the Acquiring Fund calculates the AFFE. If the semi-annual report is the most recent report, however, the Acquiring Fund must use an annualized expense ratio (*see* footnote 78 of the Adopting Release and accompanying text).

Question 5

Q: Instruction 3(f)(ii) to Item 3 of Form N-1A sets forth the formula for AFFE, which includes a calculation of the daily expense ratio and the number of days invested in an Acquired Fund. Should weekend days be included in these elements of the AFFE?

A: Yes, except for the calculation of average invested balance.

Daily Expense Ratio. The numerator in the AFFE formula includes a calculation of the daily expense ratio where "F" is the total annual expense ratio for each acquired fund and "FY" is the number of days in the fiscal year. Because F is an annualized expense ratio, FY must be either 365 or 366 days. Therefore, for purposes of calculating the daily expense ratio, weekend days must be included.

Average Invested Balance and Number of Days Invested in each Acquired Fund. The numerator in the AFFE formula also includes a calculation of average invested balance ("AI") in each acquired fund and the number of days invested in each Acquired Fund ("D").

Average invested balance is calculated based on, at a minimum, the monthly investment balance in the Acquired Fund. Therefore, average invested balance can be calculated using daily, weekly or monthly investment balances. The number of days invested is calculated using calendar days, which includes weekends (*see* Instruction 3(f)(v) to Item 3 of Form N-1A).

Question 6

Q: Instruction 3(f)(v) to Item 3 of Form N-1A states that the numerator for calculating average invested balance ("AI") for purposes of AFFE, is the amount initially invested in the Acquired Fund during the most recent fiscal year plus the amounts invested in the Acquired Fund measured no less frequently than monthly. Are the monthly measurements based on the market value of the investment in the Acquired Fund?

A: Yes. The amounts invested in an Acquired Fund are calculated using the value of the investment in the Acquired Fund as of the measurement date, which would take into account market appreciation (except for money market investments priced at amortized cost) (*see* footnote 72 of the Adopting Release). For example, if the Acquiring Fund calculates average daily investment in a registered open-end fund, the Acquiring Fund would base the value of that investment on the Acquired Fund's NAV at the end of each day, which would include any unrealized appreciation or loss with respect to the Acquiring Fund's investment.

Question 7

Q: As note above, an "Acquired Fund" includes any company that would be an investment company under section 3(a) of the Investment Company Act but for the exceptions to that definition provided in sections 3(c)(1) and 3(c)(7) of the Act. If an Acquiring Fund lends portfolio securities and invests the cash collateral received in a money market fund or other cash sweep vehicle that meets the definition of "Acquired Fund," must the Acquiring Fund include the fees and expenses associated with the investment of the cash collateral in the calculation of AFFE?

A: No. Fees and expenses associated with investment of cash collateral received in connection with loans of portfolio securities in a money market fund or other cash sweep vehicle that meets the definition of Acquired Fund do not have to be included in the calculation of AFFE.

Question 8

Q: If an Acquiring Fund's investment in an Acquired Fund is a debt rather than equity interest, must the Acquiring Fund include expenses associated with the debt in the AFFE?

A: An Acquiring fund investing in debt must include any transaction fees it paid in connection with acquiring or disposing of a debt interest in an Acquired Fund *but not* its pro rata portion of the cumulative expenses charged by the Acquired Fund because these expenses do not impact its debt interest in the Acquired Fund. *See* Instruction 3(f)(ii) to Item 3 of Form N-1A and Footnote 73 of the Adopting Release and accompanying text.

United States
Securities and Exchange Commission
Washington, D.C. 20549
Division of Investment Management

July 30, 2010

Karrie McMillan, Esq.
General Counsel
Investment Company Institute
1401 H Street, NW
Suite 1200
Washington, DC 20005

Re: Derivatives-Related Disclosures by Investment Companies

Dear Ms. McMillan:

As you are aware, the staff of the Securities and Exchange Commission is conducting a review to evaluate the use of derivatives by mutual funds, exchange-traded funds, and other investment companies.[178] This review is ongoing, and includes, among other things, exploring whether existing prospectus disclosures adequately address the particular risks created by derivatives. At this time, we are writing to provide some observations we have made about current derivatives-related disclosures by investment companies in registration statements and shareholder reports. We are providing these observations now, prior to completion of our review, because we believe these observations may give investment companies immediate guidance to provide investors with more understandable disclosures related to derivatives, including the risks associated with them.[179] We request that you communicate our observations to all of your members.

Registration Statement Disclosures

Form N-lA, the form used by mutual funds to register under the Investment Company Act of 1940 and to offer their securities under the Securities Act of 1933, requires a fund to disclose its principal investment strategies, including the type or types of securities in which the fund principally invests or will invest.[180] Further, Form N-1A requires a mutual fund to disclose the

[178] *See "SEC Staff Evaluating the Use of Derivatives by Funds," SEC Press Release 2010-45 (Mar 25, 2010), available at: http://www.sec.gov/new5/press/2010/2010-45.htm.*

[179] *While we primarily refer to registered open-end management investment companies, or mutual funds, in this letter, our observations also generally relate to other types of registered investment companies and business development companies.*

[180] *See Items 4(a) and 9(b) of Form N-1A. Whether a particular strategy, including a strategy lo invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the fund's investment objectives, and how the strategy affects the fund's potential risks and returns. See Instr. 2 to Item 9(b) of Form N-1A. In assessing what is a principal investment strategy, a fund should consider, among other things, the amount of the fund's assets expected to be committed to the strategy, the amount of the fund's assets expected to be placed at risk by the strategy, and the likelihood of the fund losing some or all of those assets from implementing the strategy. Id.*

principal risks of investing in the fund, including the risks to which the fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, or total return.[181] Investment strategies used by a fund that are not principal strategies and the risks of those strategies should generally be disclosed in the fund's Statement of Additional Information.[182]

When this disclosure framework was adopted in 1998, the Commission noted that it intended the prospectus disclosure to focus on a fund's principal investment strategies in order to provide investors with more useful information about the fund's investment approach and how the fund's portfolio will be managed.[183] The Commission stated that a fund should disclose in its prospectus those strategies that it expects to be the most important means of achieving the fund's objectives and that the fund anticipates will have a significant effect on its performance.[184] The Commission also stated that it intended to focus the prospectus disclosure on how a fund achieves or intends to achieve its investment objectives, and to move the disclosure away from the practice of listing all types of securities in which it may invest.[185] That is, the approach was designed to focus disclosure on a fund's anticipated investment operations, rather than on investments that the fund might make.[186]

We have observed derivatives-related disclosures by some funds that we believe may not be consistent with the intent of Form N-1A's requirements described above and which could be improved. Our primary observation is that some funds provide generic disclosures about derivatives that, in our view, may be of limited usefulness for investors in evaluating the anticipated investment operations of the fund, including how the fund's investment adviser actually intends to manage the fund's portfolio and the consequent risks.[187]

The generic disclosures vary from highly abbreviated disclosures that briefly identify a variety of derivative products or strategies, to lengthy, often highly technical, disclosures that detail a wide variety of potential derivative transactions without explaining the relevance to the fund's investment operations. Regardless of the style and format, funds with generic derivatives-related disclosures: (1) typically state as a principal investment strategy that they will or may engage in derivative transactions, and then often enumerate all or virtually all types of derivatives as potential investments; (2) may provide generic language about the purpose for using derivatives (e.g., derivatives may be used for "hedging or non-hedging purposes"); and (3) may characterize broadly the extent of the transactions (e.g., the fund may invest "all" of its assets in

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[181] *See Items 4(b) and 9(c) of Form N-lA.*

[182] *See Item 16(b) of Form N-lA.*

[183] *See Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916, 13926 (Mar 23, 1998)].*

[184] *Id.*

[185] *Id. ("(D)isclosing information about all of the securities in which a fund might invest does nor help a typical fund investor evaluate how the fund's portfolio will be managed or the overall risks of investing in the fund.").*

[186] *Id.*

[187] *Id. See also Items 4(a) and 9(b) of Form N-lA (requiring a fund to disclose how it "intends to achieve its investment objectives").*

derivatives).[188] Whereas funds with abbreviated disclosures typically list the types of derivatives, with little or no explanation of the nature of the instruments, those with lengthy, often highly technical, disclosures typically provide an extensive and complex explanation of the various derivatives that might be used and is not always provided in plain English.

Funds that provide abbreviated disclosures typically also provide generic risk disclosure, which, while appropriately citing various potential risks (e.g., correlation, counterparty, credit, leverage, liquidity, market, and valuation risks), again provide limited explanation of those risks and may not be tailored to the specific derivative instruments in which a fund invests or will invest principally. Funds that provide lengthy, often highly technical, disclosures generally provide risk disclosure that is more tailored to each specific type of derivative, but the complex and lengthy disclosure reduces its usefulness for investors.

The types of generic disclosures discussed above may not enable investors to distinguish which, if any, derivatives are in fact encompassed in the principal investment strategies of the fund or specific risk exposures they will entail. Indeed, while more abbreviated disclosures could lead some investors to believe that a fund's exposure to derivatives is minimal, we have observed that some funds employing this type of disclosure, in fact, appear to invest significantly in derivatives and thereby may have substantial exposure to derivatives-related risks. Conversely, the comprehensive nature of lengthy, often highly technical, derivatives-related disclosures could lead some investors to believe that a fund with such disclosure would have substantial exposure to derivative transactions, yet we have observed that some funds providing this disclosure actually appear to have relatively small exposure to derivatives.[189]

Reliance upon generic, even standardized, derivatives-related disclosures is further evidenced by the practice of some fund complexes that provide the same derivatives-related disclosures for multiple funds, even though the various funds have significantly different exposures to derivatives.[190] Such a practice again demonstrates that the disclosure is not always being tailored to each particular fund and thus may not provide investors with meaningful information about the fund's anticipated investment operations or how the fund's portfolio will be managed.

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[188] Our observation about the practice by some funds of listing under principal investment strategies all possible fund investments is not limited lo derivatives. When the staff of the Division of Investment Management observes such disclosure, it will continue [o provide comments, as appropriate, that consistent with the intent of Form N-l A's requirements, a fund should not list all types of possible investments, but rather focus on the principal strategies and investments that the fund intends to use to achieve its investment objectives.

[189] We have also observed funds with derivatives-related disclosures in their registration statements that do not appear to communicate the significant derivatives exposure reflected in the financial statements or the Management's Discussion of Fund Performance ("MDFP"), contained in the annual reports to shareholders. Below, we include observations about derivatives-related disclosures included in fund shareholder reports and financial statements. See infra "Shareholder Reports and Financial Statements Disclosures"; see also infra footnotes 18 and 19 and accompanying text (describing MDFP disclosure requirements).

[190] For example, some funds may use all types of derivatives, others use some types, and still others use derivatives sparingly. Investors are left with no way to distinguish the risk exposure of a particular fund. While the fund's financial statements and the MDFP in its annual report may help explain the risk exposure, the prospectus itself should include adequate disclosure for an investor to determine the principal investment strategies and risks of the fund.

Given these observations, we believe that all funds that use or intend to use derivative instruments should assess the accuracy and completeness of their disclosure, including whether the disclosure is presented in an understandable manner using plain English. Further, any principal investment strategies disclosure related to derivatives should be tailored specifically to how a fund expects to be managed and should address those strategies that the fund expects to be the most important means of achieving its objectives and that it anticipates will have a significant effect on its performance.[191] In determining the appropriate disclosure, a fund should consider the degree of economic exposure the derivatives create, in addition to the amount invested in the derivatives strategy.[192] This disclosure also should describe the purpose that the derivatives are intended to serve in the portfolio (e.g., hedging, speculation, or as a substitute for investing in conventional securities),[193] and the extent to which derivatives are expected to be used.

Additionally, the disclosure concerning the principal risks of the fund should similarly be tailored to the types of derivatives used by the fund, the extent of their use, and the purpose for using derivative transactions.[194] The risk disclosure in the prospectus for each fund should provide an investor with a complete risk profile of the fund's investments taken as a whole, rather than a list of the risks of various derivative strategies, and should reflect anticipated derivatives usage.

Finally, a fund should assess the completeness and accuracy of the derivatives-related disclosures in its registration statement in light of its actual operations. In particular, a fund should assess, based upon its actual operations, whether it is meeting the disclosure requirements to completely and accurately disclose its anticipated principal investment strategies and risks. A fund should review its use of derivatives when it updates its registration statement annually—particularly disclosures in its shareholder reports and assess whether it needs to revise the disclosures in its registration statement that describes its principal derivatives strategies and risks.

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[191] In the staffs view, referencing all types of derivatives, if such derivatives are not expected to be used in connection with the fund's principal strategies, is not consistent with the intent of Form N-l A's requirements. Any strategy that is not a principal investment strategy, including one involving derivatives, should be clearly described as non-principal in the registration statement See Item 16(b) of Form N-l A.

[192] See Instr. 2 to Item 9(b) of Form N-lA. Derivatives-related disclosure should also be provided commensurate with the level of derivatives exposure of a fund. For example, a small investment in some derivatives does not necessarily correlate with little effect on a fund's performance because of the impact of leverage Alternatively, a fund may have significant exposure to derivatives, but that exposure may not make the fund substantially riskier (e.g., exposure by an international fund to currency forwards, entered into to hedge against the currency risk of securities that trade in those currencies would more likely reduce the fund's overall risk, rather than increase it).

[193] For example, some funds invest in the combination of an equity-linked derivative and fixed-income securities to create the economic equivalent of investing directly in the underlying equity security. Some funds invest in derivatives in an attempt to enhance returns, i.e., to magnify the gain. Still other funds may invest in interest rate swaps to hedge against their interest rate exposure.

[194] As noted, some funds generically describe the risks of investing in derivatives, yet different derivatives are subject lo varying risks. For example, derivatives that are not traded on an exchange may be subject to heightened liquidity and valuation risks.

Shareholder Reports and Financial Statements Disclosures

We also have observations regarding mutual fund disclosures contained in shareholder reports and financial statements. Mutual funds (except for money market funds) must provide Management's Discussion of Fund Performance ("MDFP") in their annual report to shareholders.[195] Among other things, the MDFP must discuss the factors that materially affected the fund's performance during its most recently completed fiscal year, including the relevant market conditions and the investment strategies and techniques used by the fund's investment adviser.[196]

We have observed some funds that appear to have significant derivatives exposure in their financial statements, yet their MDFP includes limited or, in some cases, no discussion of the effect of those derivatives on the funds' performance. Other funds also include limited or, in some cases, no MDFP derivatives-related disclosure, yet their registration statements disclose principal investment strategies that include the use of derivatives. Additionally, we have observed some funds with MDFP derivatives-related disclosure that is solely forward looking and does not discuss the impact of derivatives on performance for the most recently completed fiscal year.

Given these observations, we remind funds that the MDFP is intended to provide shareholders with information about the factors that materially affected the fund's performance during its most recently completed fiscal year and also should not be limited solely to forward-looking information.[197] Further, the MDFP should be consistent with operations reflected in the financial statements, and a fund whose performance was materially affected by derivatives should discuss that fact, whether or not derivatives arc reflected in the portfolio schedule at the close of the fiscal year.

Additionally, we have observations related to derivatives-related disclosures contained in the annual and semi-annual financial statements of funds required by U.S. GAAP and Regulation S-X. We note that some funds can improve certain disclosures prescribed by FASB Accounting Standards Codification Topic 815: *Derivatives and Hedging* ("Topic 815"), which requires, among other things, funds to provide qualitative disclosures about their objectives and strategies for using derivative instruments.[198] Additionally, for sellers of credit derivative instruments, Topic 815 requires entities to disclose the payment/performance risk associated with the instruments.[199]

In our reviews of fund financial statements, we have found that some funds could improve their disclosures when meeting Topic 815's requirement to provide qualitative disclosures about their objectives and strategies for using derivative instruments by addressing the effect of using derivatives during the reporting period. While many funds state that they "may" engage in cer-

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[195] *See Item 27(b)(7) of Form N-1A.*

[196] *Id.*

[197] *See Investment Company Act Release No. 19382 (Apr. 6, 1993) [58 FR 19050, 19053 (Apr. 12. 1993)] ("[T]he item [requiring MDFP disclosure] requires funds to explain what happened during the previous fiscal year and why it happened. The narrative must describe what techniques or strategies, within the fund's investment objectives and limitations, management used that, together with market conditions and events, resulted in the performance of the fund.").*

[198] *See FASB ASC 815-10-50-1A.*

[199] *See FASB ASC 81S-10-50-4K.*

tain types of derivatives transactions, they do not provide qualitative information about how the funds achieved their objectives and strategies by using derivative instruments during the reporting period. The financial statements and accompanying notes should inform shareholders how a fund actually used derivatives during the period to meet its objectives and strategies.

Topic 815 also requires sellers of credit derivatives to disclose, among other things, the nature of the credit derivative, including, but not limited to, the current status of payment/performance risk of the credit derivative.[200] Funds that sell protection through credit default swaps often include credit spreads as part of their disclosures. We note that some of these funds could improve their disclosures by explaining the relevance of those spreads. For example, these funds could explain the significance of the size of the credit spreads in relation to the likelihood of a credit event or the possible requirement for funds to make payments to counterparties.

Also in our reviews of fund financial statements, we have noted that, while most funds disclose counterparties to forward currency and swap contracts reported in the schedule of investments, some funds do not.[201] In addition to the risks associated with a particular derivative instrument (e.g., credit, currency, or interest rate risks), over-the-counter derivatives are subject to the risk of nonperformance by the counterparty. Accordingly, in the staffs view, the identification of the counterparty is a material component of the description and should be disclosed.

* * *

We will continue to review fund registration statements and shareholder reports to evaluate fund disclosures related to derivatives. Among other things, we will continue to review fund registration statements to assess whether a fund's principal investment strategies and risks are presented in plain English, and discuss the relevance of derivative transactions to the fund's investment operations. Where appropriate, we will query whether the strategies listed are, in fact, principal investment strategies and whether the risk disclosure is tailored to those strategies. We also will continue to compare a fund's investment objectives, strategies and risks in its registration statement to its shareholder reports to assess whether the disclosures regarding the fund's operations appear to be consistent with its registration statement disclosures. Similarly, we will continue to review financial statement disclosures, including assessing whether derivatives-related disclosures in financial statements appears to be consistent with the MDFP. Accordingly, we encourage all funds that use derivative transactions to review their disclosures related to derivatives to assess whether they are meeting their disclosure obligations and whether their disclosures could be improved.

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[200] *Id.*

[201] *See generally Rule 12-13 of Regulation S-X, at footnote 1 [17 CFR 210.12-13].*

We hope that this letter will help your members provide investors with more understandable disclosures related to derivatives. If you have any questions regarding our observations related to registration statement disclosures, please contact Frank J. Donaty at 202-551-6925 or Brent J. Fields at 202-551-6921, Assistant Directors in the Office of Disclosure and Review, or related to shareholder reports and financial statements disclosures, please contact Richard F. Sennett at 202-551 -6918, Chief Accountant in the Office of the Chief Accountant, Division of Investment Management.

Sincerely,

Barry D. Miller
Associate Director
Office of Legal and Disclosure

Excerpt from 2014 Money Market Fund Reform Release Regarding Form N-1A Disclosure
[Release No. 33-9616, IA-3879; IC-31166]
July 23, 2014

E. Amendments to Disclosure Requirements

We are amending a number of disclosure requirements related to the liquidity fees and gates and floating NAV requirements adopted today, as well as other disclosure enhancements discussed in the proposal. These disclosure amendments improve transparency related to money market funds' operations, as well as their overall risk profile and any use of affiliate financial support. In the sections that follow, we first discuss amendments to rule and form provisions applicable to various disclosure documents, including disclosures in money market funds' advertisements, the summary section of the prospectus, and the statement of additional information ("SAI").[202] Next, we discuss amendments to the disclosure requirements applicable to money market fund websites, including information about money market funds' liquidity levels, shareholder flows, market-based NAV per share (rounded to four decimal places), imposition of liquidity fees and gates, and any use of affiliate sponsor support.

1. Required Disclosure Statement

a. Overview of Disclosure Statement Requirements

As discussed in the Proposing Release, and as modified to reflect commenters' concerns, we are adopting amendments to rule 482 under the Securities Act and Item 4 of Form N-lA to revise the disclosure statement requirements concerning the risks of investing in a money market fund in its advertisements or other sales materials that it disseminates (including on the fund website) and in the summary section of its prospectus (and, accordingly, in any summary prospectus, if used).

Money market funds are currently required to include a specific statement concerning the risks of investing in their advertisements or other sales materials and in the summary section of the fund's prospectus (and, accordingly, in any summary prospectus, if used).[203] In the Proposing Release, we proposed to modify the format and content of this required disclosure. Specifically, we proposed to require money market funds to present certain disclosure statements in a bulleted format. The content of the proposed disclosure statements would have differed under each

[202] *In keeping with the enhanced disclosure framework we adopted in 2009, the amendments are intended to provide a layered approach to disclosure in which key information about the new features of money market funds would be provided in the summary section of the statutory prospectus (and, accordingly, in any summary prospectus, if used) with more detailed information provided elsewhere in the statutory prospectus and in the SAI. See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 FR 4546 (Jan. 26, 2009)] ("Summary Prospectus Adopting Release") at paragraph preceding section III (adopting rules permitting the use of a summary prospectus, which is designed to provide key information that is important to an informed investment decision).*

[203] *Rule 482(b)(4); Item 4(b)(l)(ii) of Form N-1A. Money market funds are currently required to include the following statement: An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund.*

of the proposed reform alternatives. Under each reform alternative, the proposed statement would have included identical wording changes designed to clarify, and inform investors about, the primary risks of investing in money market funds generally, including new disclosure emphasizing that money market fund sponsors are not obligated to provide financial support. Additionally, the proposed statement under the fees and gates alternative would have included disclosure that would call attention to the risks of investing in a money market fund that could impose liquidity fees or gates, and the proposed statement under the floating NAV alternative would have included disclosure to emphasize the particular risks of investing in a floating NAV money market fund.

Comments regarding the amended disclosure statement were mixed. Two commenters generally supported the proposed amendments to the disclosure statement under both alternatives, and one commenter expressed general support for the proposed disclosure under the fees and gates alternative.[204] Two commenters generally opposed the proposed disclosure statement, arguing that it would overstate the risks relative to other mutual funds and overwhelm investors with standardized mandated legends, which investors might ignore as "boilerplate."[205] Some commenters expressed concerns with particular aspects of the proposed disclosure, such as the required disclosure regarding sponsor support.[206] These comments are discussed in more detail below.

Today we are adopting amendments to the requirements for disclosure statements that must appear in money market funds' advertisements or other sales materials, and in the summary section of money market funds' statutory prospectus. As discussed in more detail below, these amendments are being adopted largely as proposed, but with some modifications to the proposed format and content. These modifications respond to comments we received and also reflect that we are adopting a liquidity fees and gates requirement for all non-government money market funds, including municipal money market funds, as well as a floating NAV requirement for institutional prime funds. As we stated in the Proposing Release, we are modifying the current disclosure requirements because we believe that enhancing the disclosure required to be included in fund advertisements and other sales materials, and in the summary section of the prospectus, will help change the investment expectations of money market fund investors, including any erroneous expectation that a money market fund is a riskless investment.[207] In addition, without such modifications, we believe that investors may not be fully aware of potential restrictions on fund redemptions or, for floating NAV funds, the fact that the value of their money market fund shares will, as a result of these reforms, increase and decrease as a result of the changes in the value of the underlying securities.[208]

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[204]*See CFA Institute Comment Letter (noting that the proposed disclosures would put investors on notice that money market funds are not riskless and would provide the information in a clear and succinct manner); HSBC Comment Letter (generally supporting both statements but suggesting additions to cross-reference the prospectus's risk warnings and to make clear fees and gates would be used to protect investors); Federated II Comment Letter; Comment Letter of Federated Investors (Disclosure Requirements for Money Market Funds and Current Requirements of Rule 2a-7) (Sept. 17, 2013) ("Federated VIII Comment Letter") (concurring with the risk disclosure under the fees and gates alternative).*

[205]*See ABA Business Law Section Comment Letter; NYC Bar Committee Comment Letter.*

[206]*See, e.g., Dreyfus Comment Letter; NYC Bar Committee Comment Letter.*

[207]*See Proposing Release, supra note 25, at sections III.A.8 and III.B.8.*

[208]*Id.*

Specifically, we are requiring money market funds that maintain a stable NAV to include the following disclosure statement in their advertisements or other sales materials and in the summary section of the statutory prospectus:

> You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The Fund may impose a fee upon the sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors.[209] An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.[210]

Funds with a floating NAV will also be required to include a similar disclosure statement in their advertisements or other sales materials and in the summary section of the statutory prospectus, modified to account for the characteristics of a floating NAV, as follows:

> You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon the sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other govern-

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[209] *Government funds that are not subject to the fees and gates requirements pursuant to rule 2a-7(c)(2)(iii) may omit the following sentence: 'The Fund may impose a fee upon the sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity fails below required minimums because of market conditions or other factors." See rule 482(b)(4)(iii); Form N-lA Item 4(b)(l)(ii)(C).*

[210] *See Rule 482(b)(4)(ii); Form N-lA Item 4(b)(l)(ii)(B). Besides the amendments to the disclosure statement requirements set forth in Rule 482(b)(4)(ii) and Form N-lA Item 4(b)(l)(ii)(B), we also are adopting non-substantive changes to the text of these rule and form provisions. If an affiliated person, promoter, or principal underwriter of the fund, or an affiliated person of such person, has contractually committed to provide financial support to the fund, the fund would be permitted to omit the last sentence from the disclosure statement in advertisements and sales materials for the term of the agreement. See Note to paragraph (b)(4), rule 482(b)(4). Likewise, if an affiliated person, promoter, or principal underwriter of the fund, or an affiliated person of such person, has contractually committed to provide financial support to the fund, and the term of the agreement will extend for at least one year following the effective date of the fund's registration statement, the fund would be permitted to omit the last sentence from the disclosure statement that appears in the fund's registration statement. See Instruction to Item 4(b)(1)(H) of Form N-1A.*

The proposal likewise would have permitted a similar omission from the proposed disclosure statement. See Proposing Release, supra note 25, at nn.429 and 431. As proposed, such omission would have been permitted if "an affiliated person, promoter, or principal underwriter of the fund, or an affiliated person of such person, has entered into an agreement to provide financial support to the fund." We have modified the language of the Note to paragraph (b)(4), rule 482(b)(4) and the Instruction to Item 4(b)(1)(ii) of Form N-1A to clarify that the omission would be permitted only in the case of contractual commitments to provide financial support, and not in the case of informal agreements that may not be enforceable.

As discussed in more detail below, we are adopting amendments that would require money market funds to disclose current and historical instances of affiliate financial support on Form N-CR and Form N-lA, respectively. See infra sections III.F.3, III.E.7.

ment agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.[211]

Below we describe in detail the ways in which the format and content of the required disclosure statement that we are adopting today differ from that which we proposed, as well as the reasons for these differences.

b. Format of the statement

We have decided not to adopt the proposed requirement that funds provide the statement in a bulleted format. One commenter argued that prescribing a specific graphical format is not necessary and might be difficult to execute in certain forms of advertising, such as social media.[212] We agree. We also believe that refraining from requiring funds to provide the disclosure statement in a bulleted format, in combination with other modifications discussed below that shorten the disclosure statement, addresses concerns raised by commenters that the length of the proposed disclosure statement could draw attention away from other important information in an advertisement or sales materials.[213]

c. Disclosure concerning general risk of investment loss

As proposed, the required disclosure statement would have included a bulleted statement providing: "You could lose money by investing in the Fund." We are adopting identical content in the required disclosure statement. As discussed in the proposal, we have taken into consideration investor preferences for clear, concise, and understandable language in adopting the required disclosure and also have considered whether strongly-worded disclaimer language would more effectively convey the particular risks associated with money market funds than more moderately-worded language would.[214] We received one comment on this language arguing that it is duplicative with other language in the required disclosure statement.[215] We have responded to this comment by shortening and modifying the required disclosure statement.[216]

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[211] *See Rule 482(b)(4)(i); Form N-lA Item 4(b)(l)(ii)(A). Besides the amendments to the disclosure statement requirements set forth in Rule 482(b)(4)(i) and Form N-lA Item 4(b)(l)(ii)(A), we also are adopting non-substantive changes to the text of these rule and form provisions. Funds may omit the last sentence regarding sponsor support under certain circumstances, such as when a fund's sponsor has contractually committed to provide support to the fund. See supra note 908; Instructions to Item 4(b)(l)(ii) of Form N-1A; Note to paragraph (b)(4), rule 482(b)(4). The proposal likewise would have permitted this omission from the proposed disclosure statement. See Proposing Release, supra note 25, at nn.307 and 313. As discussed in more detail below, we are adopting amendments that would require money market funds to disclose current and historical instances of affiliate financial support on Form N-CR and Form N-lA, respectively. See infra sections III.F.3, III.E.7.*

[212] *See ABA Business Law Section Comment Letter.*

[213] *See NYC Bar Committee Comment Letter (noting that, particularly in inherently brief formats like advertisements, there is a risk that mandated legends may crowd out material informational content); ABA Business Law Section Comment Letter (arguing that the proposed disclosure statement could take up so much of the space available in an advertisement that it will discourage investors from viewing other important information in the communication).*

[214] *See Proposing Release, supra note 25, at nn.316-317.*

[215] *See Federated VIII Comment Letter.*

[216] *As proposed, the required disclosure statement included the statements "You could lose money by investing in the Fund" and "Your investment in the Fund therefore may experience losses." As adopted, the required disclosure statement no longer includes the second statement, which could be construed to be repetitive with the first.*

d. Disclosure concerning fees and gates

As proposed, the required disclosure statement would have included bulleted statements providing: "The Fund may impose a fee upon sale of your shares when the Fund is under considerable stress" and "The Fund may temporarily suspend your ability to sell shares of the Fund when the Fund is under considerable stress." Instead of including these bullet points in the required disclosure, we are adopting similar content in the required disclosure statement providing: "The Fund may impose a fee upon the sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors." One commenter, while generally supporting the proposed statement, suggested that the statement be amended to say that the fund could impose a fee or a gate "in order to protect shareholders of the Fund."[217] One commenter expressed concerns about requiring the inclusion of statements about fees and gates in advertisements or other sales materials, arguing that the description of circumstances and conditions under which fees and gates might be imposed is difficult to reduce to a brief statement.[218] No commenters explicitly supported the inclusion of the term "considerable stress," and several commenters argued that this term was not clear, and may cause investors to believe that funds could impose fees and gates arbitrarily or, conversely, only during extreme market events.[219] To address this concern, one commenter suggested requiring a different term than "considerable stress," arguing that this term overstates the prospect for imposing fees or gates.[220] Other commenters suggested that the disclosure state explicitly that a fee or gate could be imposed as a result of a reduction in the fund's liquidity.[221] Commenters also suggested that any disclosure regarding fees and gates could be combined into a single statement.

After considering the comments, we continue to believe that disclosure about fees or gates should be included in advertisements, sales materials, and the summary section of the prospectus. Even some commenters that expressed concerns about including the disclosure in advertisements acknowledged that the possible imposition of fees and gates is information that is likely to be important to investors.[222] As we stated in the Proposing Release, we are concerned that investors will not be fully aware of potential restrictions on fund redemptions. To address commenters' concerns regarding the ambiguity of the term "considerable stress," we have revised the statement, as suggested by commenters, to make clear that funds could impose a fee or gate in response to a reduction in the fund's liquidity. The statement does not include a reference that a fee or gate could be imposed "to protect investors of the fund," as suggested by one commenter. We believe that including the additional suggested language could detract from the statement's emphasis that a fee or gate could be imposed, which could in turn diminish shareholders' awareness of potential restrictions on fund redemptions. The language we have adopted reflects commenter suggestions that any disclosure regarding fees or gates be combined into a

[217] *See HSBC Comment Letter.*

[218] *See NYC Bar Committee Comment Letter.*

[219] *See NYC Bar Committee Comment Letter; ABA Business Law Section Comment Letter; Dreyfus Comment Letter.*

[220] *See Dreyfus Comment Letter.*

[221] *See NYC Bar Committee Comment Letter; ABA Business Law Section Comment Letter.*

[222] *See ABA Business Law Section Comment Letter; NYC Bar Committee Comment Letter.*

single statement. We believe that the adopted language also responds to commenter concerns about the difficulty of briefly describing the conditions under which fees and gates might be imposed by providing that fees and gates could be imposed if "the Fund's liquidity falls below required minimums because of market conditions or other factors."

e. Disclosure concerning sponsor support

As proposed, the required disclosure statement would have included a bulleted statement providing: "The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time." We are adopting identical content in the required disclosure statement. Several commenters opposed the inclusion of a reference to sponsor support in the required disclosure statement.[223] Some commenters argued that the disclosure would raise sponsor support to an unwarranted level of prominence, noting that there have not been any studies to determine whether investors actually rely on the potential for sponsor support as a factor when determining whether to invest in a money market fund.[224] Commenters also were concerned that investors will not understand the disclosure in fund advertisements, since advertisements will not afford space or opportunity to explain to investors who the fund's "sponsor" is and what "financial support" means.[225]

We continue to believe that the disclosure statement should include a statement that the fund's sponsor has no obligation to provide financial support. In the Proposing Release, we recognized that particular instances of sponsor support were not particularly transparent to investors in past years because sponsor support generally was not immediately disclosed, and was not required to be disclosed by the Commission.[226] But although investors might not have known of particular instances of sponsor support, we believe that many investors, particularly institutional investors, have historically understood that there was a possibility of financial support from the money market fund's sponsor and that this possibility has affected investors' perceptions about the level of risk in investing in money market funds.[227] We therefore disagree with the commenter who suggested that investors were generally unaware of this practice preceding and during the financial crisis.[228] For this reason, we believe that it is important to emphasize to investors that they should not expect a fund sponsor to provide financial support to the fund.

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[223] *See Dreyfus Comment Letter; NYC Bar Committee Comment Letter; ABA Business Law Section Comment Letter. But see CFA Institute Comment Letter; HSBC Comment Letter (both generally supporting the proposed disclosure statement, including the language discussing sponsor support).*

[224] *See, e.g., ABA Business Law Section Comment Letter; NYC Bar Committee Comment Letter.*

[225] *Id.*

[226] *Proposing Release, supra note 25, at section II.B.3.*

[227] *See, e.g., Roundtable Transcript, supra note 63 (Lance Pan, Capital Advisors Group) ("over the last 30 or 40 years, [investors] have relied on the perception that even though there is risk in money market funds, that risk is owned somehow implicitly by fund sponsors. So once they perceive that they are not able to get that additional assurance, I believe that was one probably cause of the run.").*

[228] *See NYC Bar Committee Comment Letter (arguing that the Commission's discussion of the lack of transparency regarding instances of sponsor support shows that the proposed risk statement addresses a practice that investors were not aware of during the financial crisis).*

For similar reasons, we disagree with one commenter who argued that requiring this disclosure is at odds with the requirement that funds publicly disclose instances of sponsor support.[229] As discussed below, we are requiring funds to disclose current and historical instances of sponsor support because we believe that such disclosure will help investors better understand the risks of investing in the funds.[230] This reporting, which should help investors understand instances when the fund has come under stress, provides historical information about the fund. The required disclosure statement, on the other hand, is a forward-looking risk statement that reminds current and prospective investors that sponsors do not have an obligation to provide sponsor support and that investors should not expect that sponsors will provide support in the future.

Finally, we are not persuaded that the disclosure regarding sponsor support should not appear in advertisements because this disclosure will not be understood by investors. We recognize that upon reading the disclosure statement, investors might have questions regarding financial support from sponsors, as commenters indicated, including questions regarding who the fund's "sponsor" is, or what constitutes "financial support."[231] We believe, however, that funds can address this issue through more complete disclosure elsewhere in the fund prospectus if they believe it is necessary.

f. Disclosure for floating NAV funds

As proposed, the required disclosure statement for floating NAV funds would have included bulleted statements providing: "You should not invest in the Fund if you require your investment to maintain a stable value" and "The value of the Fund will increase and decrease as a result of changes in the value of the securities in which the Fund invests. The value of the securities in which the Fund invests may in turn be affected by many factors, including interest rate changes and defaults or changes in the credit quality of a security's issuer." Instead of including these bullet points in the required disclosure, we are adopting similar content in the required disclosure statement providing: "Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them." While one commenter questioned whether the proposed disclosure was necessary for investors in institutional prime funds,[232] we believe it is important to emphasize to investors the potential impact of a floating NAV.[233] In response to suggestions by commenters,[234] we have decided not to require

[229] *See Dreyfus Comment Letter.*

[230] *See infra notes 1007-1010 [315-318], 1132 and accompanying text.*

[231] *See ABA Business Law Section Comment Letter; NYC Bar Committee Comment Letter.*

[232] *See Dreyfus Comment Letter ("[W]e also question the Commission's concern that investors will fail to understand that the value of the [floating NAV] MMF will fluctuate. We question at what point investors will be given the benefit of the doubt for understanding the product in which they are invested and when such concerns will cease to drive additional regulatory action.")*

[233] *Cf. ABA Business Law Section Comment Letter (suggesting that "floating NAV money market funds include in their advertisements a statement that their principal value will fluctuate so that an investor's shares, when redeemed may be worth more or less than their original cost"); CFA Institute Comment Letter (stating that "[d]isclosures are needed to alert investors to the potential for loss of principal and interest").*

[234] *See NYC Bar Committee Comment Letter; ABA Business Law Section Comment Letter.*

that the disclosure statement include the proposed statement that investors that require a stable value not invest in the fund. We were persuaded by commenters that the term "stable value" is often used by financial advisers when referring to certain investment products, at least some of which do have a variable NAV.[235] We are also not including in the disclosure requirements the proposed statements about the relationship between the fund share price and the value of the fund's underlying securities and the risk factors that can affect the value of the fund's underlying securities. We were persuaded by one commenter who noted that discussion of specific risk factors will be addressed in other areas of the prospectus, including the summary prospectus.[236] We also believe that not including these statements addresses more general concerns expressed by commenters regarding the length and efficacy of the proposed disclosure statement.[237]

2. Disclosure of Tax Consequences and Effect on Fund Operations— Floating NAV

As discussed in the Proposing Release, the requirement that institutional prime money market funds transition to a floating NAV will entail certain additional tax- and operations-related disclosure, but these disclosure requirements do not necessitate rule and form amendments.[238] As noted above, taxable investors in institutional prime money market funds, like taxable investors in other types of mutual funds, may now experience taxable gains and losses.[239] Currently, funds are required to describe in their prospectuses the tax consequences to shareholders of buying, holding, exchanging, and selling the fund's shares.[240] Accordingly, we expect that, pursuant to current disclosure requirements, floating NAV money market funds would include disclosure in their prospectuses about the tax consequences to shareholders of buying, holding, exchanging, and selling the shares of the floating NAV fund. In addition, we expect that a floating NAV money market fund would update its prospectus and SAI disclosure regarding the purchase, redemption, and pricing of fund shares, to reflect any changes resulting from the fund's use of a floating NAV.[241] We also expect that a fund that intends to qualify as a retail money market fund would disclose in its prospectus that it limits investment to accounts beneficially owned by natural persons.[242] The Proposing Release requested comment on the disclosure that we expect

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[235] *See NYC Bar Committee Comment Letter (noting that "stable value" commonly refers to a "retirement product that will use a combination of government bonds, guaranteed return insurance wrappers and potentially other synthetic instruments to deliver a minimum rate of return").*

[236] *See Dreyfus Comment Letter.*

[237] *See ABA Business Law Section Comment Letter; NYC Bar Committee Comment Letter. The required disclosure statement that we are adopting today (see supra text accompanying note 909) is about 30% shorter than the proposed bulleted disclosure statement. (We have modified the proposed bulleted disclosure statement to encompass the proposed language referencing fluctuating share price as well as the ability of a fund to impose fees or gates. The Proposing Release conceived of two separate reform approaches, each with its own disclosure statement, while this Release combines the approaches into a single reform package, and the disclosure statement we are adopting therefore references both reform elements, as appropriate.)*

[238] *Prospectus disclosure regarding the tax consequences of these activities is currently required by Form N-1A. See Item 11(f) of Form N-1A.*

[239] *See supra section III LB.6.*

[240] *See Item 11(f) of Form N-1A.*

[241] *We expect that a floating NAV money market fund would include this disclosure (as appropriate) in response to, for example, Item 11 ("Shareholder Information") and Item 23 ("Purchase, Redemption, and Pricing of Shares") of Form N-1A.*

[242] *See supra note 692 and accompanying text.*

floating NAV money market funds would include in their prospectuses about the tax consequences to shareholders of buying, holding, exchanging, and selling shares of the fund, as well as the effects (if any) on fund operations resulting from the transition to a floating NAV. We received no comments directly discussing this disclosure.

3. Disclosure of Transition to Floating NAV

Currently, a fund must update its registration statement to reflect any material changes by means of a post-effective amendment or a prospectus supplement (or "sticker") pursuant to rule 497 under the Securities Act.[243] As discussed in the Proposing Release, we would expect that, to meet this existing requirement, at the time that a stable NAV money market fund transitions to a floating NAV (or adopts a floating NAV in the course of a merger or other reorganization), it would update its registration statement to include relevant related disclosure, as discussed in sections III.E.l and III.E.2 of this Release, by means of a post-effective amendment or a prospectus supplement. Two commenters explicitly supported that such disclosures be made when transitioning to a floating NAV.[244] We continue to believe that a money market fund must update its registration statement by means of a post-effective amendment or "sticker" to reflect relevant disclosure related to a transition to a floating NAV.

4. Disclosure of the Effects of Fees and Gates on Redemptions

As we discussed in the proposal, pursuant to the existing requirements in Form N-lA, funds must disclose any restrictions on fund redemptions in their registration statements.[245] As discussed in more detail below, we expect that, to comply with these existing requirements, money market funds (other than government money market funds that are not subject to the fees and gates requirements pursuant to rule 2a-7(c)(2)(iii) and that have not chosen to rely on the ability to impose liquidity fees and suspend redemptions) will disclose in the registration statement the effects that the potential imposition of fees and/or gates, including a board's discretionary powers regarding the imposition of fees and gates, may have on a shareholder's ability to redeem shares of the fund. This disclosure should help investors evaluate the costs they could incur in redeeming fund shares—one of the goals of this rulemaking.

Commenters generally agreed that this disclosure would help investors understand the effects of fees and gates on redemptions.[246] One commenter specifically agreed that Items 11(c)(1) and 23 of Form N-lA would require money market funds to fully describe the circumstances under which liquidity fees could be charged or redemptions could be suspended or reinstated.[247] In addition, two commenters noted that the prospectus should include disclosure of a board's discretionary

[243] *See 17 CFR 230.497.*

[244] *See HSBC Comment Letter; PWC Comment Letter.*

[245] *See Items 11(c)(1) and 23 of Form N-1A.*

[246] *See, e.g., UBS Comment Letter; Chamber II Comment Letter; Federated VIII Comment Letter.*

[247] *See Federated VIII Comment Letter (suggesting that Form N-lA also would require money market funds to describe how shareholders would be notified thereof, as well as other implications for shareholders, such as the tax consequences associated with the money market fund's receipt of liquidity fees).*

powers regarding the imposition of fees and gates, which would serve to emphasize further the nature of money market funds as investments subject to risk.[248] The Proposing Release requested comment on the utility of including additional disclosure about the operations and effects of fees and redemption gates, including (i) requiring information about the basic operations of fees and gates to be disclosed in the summary section of the statutory prospectus (and any summary prospectus, if used) and (ii) requiring details about the fund's liquidation process. One commenter argued against the utility of such additional disclosure in helping investors to understand the effects of fees and gates on redemptions.[249] We agree and decided against making any changes to the rule text in this regard.

As discussed in the Proposing Release, we expect money market funds to explain in the prospectus the various situations in which the fund may impose a liquidity fee or gate.[250] For example, money market funds would briefly explain in the prospectus that if the fund's weekly liquid assets fall below 30% of its total assets and the fund's board determines it is in the best interests of the fund, the fund board may impose a liquidity fee of no more than 2% and/or temporarily suspend redemptions for a limited period of time.[251] We also expect money market funds to briefly explain in the prospectus that if the fund's weekly liquid assets fall below 10% of its total assets, the fund will impose a liquidity fee of 1% on all redemptions, unless the board of directors of the fund (including a majority of its independent directors) determines that imposing such a fee would not be in the best interests of the fund or determines that a lower or higher fee (not to exceed 2%) would be in the best interests of the fund.[252]

As discussed in the Proposing Release, we expect money market funds to incorporate additional disclosure in the prospectus or SAI, as the fund determines appropriate, discussing the operations of fees and gates in more detail. Prospectus disclosure regarding any restrictions on redemptions is currently required by Item 11(c)(1) of Form N-1A. In addition to the disclosure required by Item 11(c)(1), we believe that funds could determine that more detailed disclosure about the operations of fees and gates, as further discussed in this section, would appropriately appear in a fund's SAI, and that this more detailed disclosure is responsive to Item 23 of Form N-lA ("Purchase, Redemption, and Pricing of Shares"). In determining whether and/or to what extent to include this disclosure in the prospectus or SAI, money market funds should rely on the principle that funds should limit disclosure in prospectuses generally to information that "would be most useful to typical or average investors in making an investment decision."[253] Detailed or

[248] *See UBS Comment Letter; Chamber II Comment Letter.*

[249] *See Federated VIII Comment Letter (arguing that: (i) requiring disclosure in the summary prospectus about "an exigent circumstance (i.e., charging liquidity fees or suspending redemptions) which is highly unlike[ly] to ever occur" would be "highly inconsistent with the Commission's goal of 'providing prospectuses that are simpler, clearer, and more useful to investors'"; and (ii) no money market funds have relied on rule 22e-3 to suspend the redemption of shares and liquidate the fund since the rule's adoption, and thus suggesting that disclosure about a fund's liquidation process would not be useful to investors).*

[250] *Proposing Release, supra note 25, at section III.B.8.*

[251] *See Items 11(c)(1) and 23 of Form N-1A.*

[252] *See Items 11(c)(1) and 23 of Form N-1A.*

[253] *See Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916 (Mar. 23, 1998)], at section I.*

highly technical discussions, as well as information that may be helpful to more sophisticated investors, dilute the effect of necessary prospectus disclosure and should be placed in the SAI.[254]

Based on this principle, we anticipate that funds generally would consider the following disclosure to be appropriate for the prospectus, as disclosure regarding redemption restrictions provided in response to Item 11(c)(1) of Form N-lA: (i) means of notifying shareholders about the imposition and lifting of fees and/or gates (e.g., press release, website announcement); (ii) timing of the imposition and lifting of fees and gates, including (a) an explanation that if a fund's weekly liquid assets fall below 10% of its total assets at the end of any business day, the next business day it must impose a 1% liquidity fee on shareholder redemptions unless the fund's board of directors determines that doing otherwise is in the best interests of the fund, (b) an explanation that if a fund's weekly liquid assets fall below 30% of its total assets, it may impose fees or gates as early as the same day, and (c) an explanation of the 10 business day limit for imposing gates; (iii) use of fee proceeds by the fund, including any possible return to shareholders in the form of a distribution; (iv) the tax consequences to the fund and its shareholders of the fund's receipt of liquidity fees; and (v) general description of the process of fund liquidation[255] if the fund's weekly liquid assets fall below 10%, and the fund's board of directors determines that it would not be in the best interests of the fund to continue operating.[256]

In addition, we expect that a government money market fund that is not subject to the fees and gates requirements pursuant to rule 2a-7(c)(2)(iii), but that later decides to rely on the ability to impose liquidity fees and suspend redemptions, would update its registration statement to reflect the changes by means of a post-effective amendment or a prospectus supplement pursuant to rule 497 under the Securities Act. In addition, a government fund that later opts to rely on the ability to impose fees and gates provided in rule 2a-7(c)(2)(iii) should consider whether to provide any additional notice to its shareholders of that election.[257]

5. Historical Disclosure of Liquidity Fees and Gates

We are amending Form N-lA, generally as proposed, but with certain modifications as discussed below, to require that money market funds provide disclosure in their SAIs about historical occasions in which the fund has considered or imposed liquidity fees or gates.[258] As proposed, we would have required funds to disclose: (i) the length of time for which the fund's weekly liquid assets remained below 15%: (ii) the dates and length of time for which the fund's board of directors determined to impose a liquidity fee and/or temporarily suspend the fund's

[254]*Id.*

[255]*See supra section 1II.A.4.*

[256]*One commenter argued that it was unnecessary to describe the process of fund liquidation in either the prospectus or SAI. See Federated VIII Comment Letter. We note that we are not mandating particular disclosures, but rather providing examples of the types of disclosures we believe that money market funds could provide in the prospectus or SAI. We further note that it is important for funds to ensure that investors are fully aware of the ability of the fund to permanently suspend redemptions and liquidate.*

[257]*We note that 60-day notice is required by our rules for other significant changes by funds, for example, when a fund changes its name. See rules 35d-1(a)(2)(h) and (a)(3)(iii).*

[258]*As we proposed, this historical disclosure would only apply to such events that occurred after the compliance date of the amendments. See Proposing Release, supra note 25, at n.983.*

redemptions; and (iii) a short discussion of the board's analysis supporting its decision to impose a liquidity fee (or not to impose a liquidity fee) and/or temporarily suspend the fund's redemptions.[259] As discussed below, we are adopting modified thresholds for imposing fees and gates from what was proposed; consequently, the amendments we are adopting to Form N-lA to require historical disclosure of liquidity fees and gates have been modified from the proposed amendments to conform to these amended threshold levels. In addition, in a change from the proposed historical disclosure requirements, the Form N-lA amendments we are adopting require a fund to disclose the size of any liquidity fee imposed during the specified look-back period. We have also determined not to adopt the proposed requirement to disclose "a short discussion of the board's analysis supporting its decision to impose a liquidity fee (or not to impose a liquidity fee) and/or temporarily suspend the fund's redemptions" for the reasons detailed below.

Specifically, we are amending Form N-lA to require that money market funds (other than government money market funds that are not subject to the fees and gates requirements pursuant to rule 2a-7(c)(2)(iii))[260] provide disclosure in their SAIs regarding any occasion during the last 10 years (but not for occasions that occurred before the compliance date of these amended rules)[261] on which (i) the fund's weekly liquid assets have fallen below 10%, and with respect to each such occasion, whether the fund's board of directors determined to impose a liquidity fee and/or suspend the fund's redemptions, or (ii) the fund's weekly liquid assets have fallen below 30% (but not less than 10%) and the fund's board of directors determined to impose a liquidity fee and/or suspend the fund's redemptions.[262] With respect to each occasion, we are requiring funds to disclose: (i) the length of time for which the fund's weekly liquid assets remained below 10% (or 30%, as applicable); (ii) the dates and length of time for which the fund's board of directors determined to impose a liquidity fee and/or temporarily suspend the fund's redemptions; and (iii) the size of any liquidity fee imposed.[263]

We proposed to require a fund to provide disclosure in its SAI regarding any occasion during the last 10 years (but not before the compliance date) in which the fund's weekly liquid assets had fallen below 15%, and with respect to each such occasion, whether the fund's board of directors determined to impose a liquidity fee and/or suspend the fund's redemptions.[264] As discussed previously, the final amendments contain modified thresholds for imposing fees and gates from what was proposed,[265] and we are therefore modifying the disclosure requirements to conform to these amended threshold levels.

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[259]*See Proposing Release, supra note 25, at section III.B.8.d.*

[260]*Rule 2a-7(c)(2)(iii).*

[261]*See infra section III.N.*

[262]*See amended Item 16(g)(1) of Form N-1A. The disclosure required by Item 16(g)(1) should incorporate, as appropriate, any information that the fund is required to report to the Commission on Items E.1, E.2, E.3, E.4, F.1, F.2, and G.1 of Form N-CR. See Instruction 2 to Item 16(g)(1). This represents a slight change from the proposal, in that the required disclosure is now the same as what would be disclosed in the initial filings of Form N-CR. We have made this change to reduce the burdens associated with such disclosure so that funds need only prepare this information once in a single manner. For the reasons discussed in section 1II.F of this Release, Form N-CR includes a new requirement that funds report their level of weekly liquid assets at the time of the imposition of fees or gates, and accordingly, we are also requiring similar disclosure here. See Form N-CR Items E.3 and F.1.*

[263]*See Instructions to amended Item 16(g)(1) of Form N-1A.*

[264]*See Proposing Release, supra note 25, at section III.B.8.d.*

[265]*See supra section III.A.2.*

As proposed, the SAI disclosure requirements would not have directly required a fund to disclose the size of any liquidity fee imposed. We are modifying the SAI disclosure requirements to require a fund to disclose the size of any liquidity fee it has imposed during the specified look-back period. As discussed below in the context of the Form N-CR disclosure requirements we are adopting, because we are revising the default liquidity fee from the proposed 2% to 1%, and thus we expect that there may be instances where liquidity fees are above or below the default fee (rather than just lower as permitted under the proposal), we are requiring that funds disclose the size of the liquidity fee, if one is imposed.[266]

One commenter specifically supported the proposed 10-year "look-back" period for the historical disclosure, noting that a 10-year period should capture a number of different market stresses delivering a meaningful sample.[267] Another commenter suggested limiting SAI disclosure to a five-year period prior to the effective date of the registration statement incorporating the SAI disclosure, although this commenter did not provide specific reasons why this shortened look-back period would be appropriate.[268] After further consideration, and given that commenters did not provide any specific reasons for implementing a shortened look-back period, we continue to believe that a 10-year look-back period provides shareholders and the Commission with a historical perspective that would be long enough to provide a useful understanding of past events. We believe that this period would provide a meaningful sample of stresses faced by individual funds and in the market as a whole, and to analyze patterns with respect to fees and gates, but would not be so long as to include circumstances that may no longer be a relevant reflection of the fund's management or operations.

As discussed in the Proposing Release, we continue to believe that money market funds' current and prospective shareholders should be informed of historical occasions in which the fund's weekly liquid assets have fallen below 10% and/or the fund has imposed liquidity fees or redemption gates. While we recognize that historical occurrences are not necessarily indicative of future events, we anticipate that current and prospective fund investors could use this information as one factor to compare the risks and potential costs of investing in different money market funds. The DERA Study analyzed the distribution of weekly liquid assets and found that 83 prime funds per year, corresponding to 2.7% of the prime funds' weekly liquid asset observations, saw the percentage of their total assets that were invested in weekly liquid assets fall below 30%. The DERA Study further showed that less than one (0.6) fund per year, corresponding to 0.01% of the prime funds' weekly liquid asset observations, experienced a decline of total assets that were invested in weekly liquid assets to below 10%.[269] We believe that funds will, in general, try to avoid the need to disclose decreasing percentages of weekly liquid assets and/or the imposition of a liquidity fee or gate, as required under the new amendments to Form N-lA,[270] by keeping the percentage of their total assets invested in weekly liquid assets at or above 30%. Of those 83 funds that reported a percentage of total assets invested in weekly liquid assets below 30%, it is unclear how many, if

[266] *See infra note 1316 and accompanying text.*

[267] *See HSBC Comment Letter.*

[268] *See Federated VIII Comment Letter.*

[269] *See DERA Study, supra note 24, at 27.*

[270] *See supra* n*otes 960 and 961 [268-269] and accompanying text.*

any, would have attempted to keep the percentage of their total assets invested in weekly liquid assets at or above 30% to avoid having to report this information on their SAI (assuming they were to impose, at their board's discretion, a liquidity fee or gate).

The required disclosure will permit current and prospective shareholders to assess, among other things, patterns of stress experienced by the fund, as well as whether the fund's board has previously imposed fees and/or redemption gates in light of declines in portfolio liquidity. This disclosure also provides investors with historical information about the board's past analytical process in determining how to handle liquidity issues when the fund experiences stress, which could influence an investor's decision to purchase shares of, or remain invested in, the fund. In addition, the required disclosure may impose market discipline on portfolio managers to monitor and manage portfolio liquidity in a manner that lessens the likelihood that the fund would need to implement a liquidity fee or gate.[271] One commenter explicitly supported the utility of these disclosure requirements in providing investors with useful information regarding the frequency of the money market fund's breaching of certain liquidity thresholds, whether a fee or gate was applied, and the level of fee imposed, stating that "[t]his will allow investors to make informed decisions when determining whether to invest in [money market funds] and when comparing different [money market funds]."[272] No commenter argued that disclosure about the historical fact of occurrence of fees and gates would not be useful to investors. However, some commenters raised concerns about the potential redundancy of the proposed registration statement, website, and Form N-CR disclosure requirements.[273]

As discussed above, we also have determined not to adopt the proposed requirement for a fund to disclose "a short discussion of the board's analysis supporting its decision to impose a liquidity fee (or not to impose a liquidity fee) and/or temporarily suspend the fund's redemptions" in its SAI (or as discussed below, on its website).[274] We note that Form N-CR, as proposed, also would have required a fund imposing a fee or gate to disclose a "discussion of the board's analysis" supporting its decision, and a number of commenters objected to this proposed requirement.[275] In particular, commenters raised concerns that the disclosures proposed to be required in Form N-CR and Form N-lA would not be material to investors, would be burdensome to disclose, would chill deliberations among board members and hinder board confidentiality, and would encourage opportunistic litigation.[276] Commenters also argued that disclosure of the board's analysis is not

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[271] *See supra notes 157 and 162 and accompanying text.*

[272] *HSBC Comment Letter.*

[273] *See, e.g., Dreyfus Comment Letter; S1FMA Comment Letter.*

[274] *However, as discussed below in section 1IJ.F.5, Form N-CR will require a fund to disclose the primary considerations or factors taken into account by the fund's board in its decision to impose a liquidity fee or gate.*

[275] *See infra section III.F.5.*

[276] *See infra notes 1289-1293 and accompanying text. Most commenters made these arguments in reference to the proposed Form N-CR disclosure requirement; however, several commenters also specifically referenced the proposed identical Form N-lA disclosure requirement. See SIFMA Comment Letter; Stradley Ronon Comment Letter.*

necessary to disclose patterns of stress in a fund and that this disclosure is not likely to be a meaningful indication of the board's analytical process going forward.[277]

We discuss these commenters' concerns in detail in section III.F below and also provide our analysis supporting our attempt to balance these concerns with our interest in permitting the Commission and shareholders to understand why a board imposed (or did not impose) a liquidity fee or gate. As a result of these considerations and the analysis discussed in section III.F below, we have adopted a Form N-CR requirement to require disclosure of the primary considerations or factors taken into account by the fund's board in its decision to impose a liquidity fee or gate. However, in order to avoid unnecessary duplication in the disclosure that will appear in a fund's SAI and on Form N-CR, we have determined not to require parallel disclosure of these considerations or factors in the fund's SAI. Instead, a fund will only be required to present certain summary information about the imposition of fees and/or gates in its SAI (as well as on the fund's website[278]), and will be required to present more detailed discussion solely on Form N-CR[279]. To inform investors about the inclusion of this more detailed information on Form N-CR, funds will be instructed to include the following statement as part of their SAI disclosure about the historical occasions in which the fund has considered or imposed liquidity fees or gates: "The Fund was required to disclose additional information about this event [or "these events," as appropriate] on Form N-CR and to file this form with the Securities and Exchange Commission. Any Form N-CR filing submitted by the Fund is available on the EDGAR Database on the Securities and Exchange Commission's Internet site at http://www.sec.gov."[280] In adopting these modified SAI disclosure requirements, we have attempted to balance concerns about potentially duplicative disclosure[281] with our interest in presenting the primary information about the fund's historical imposition of fees or gates that we believe shareholders may find useful in assessing fund risks.

6. Prospectus Fee Table

As proposed, we are clarifying in the instructions to Item 3 of Form N-lA ("Risk/Return Summary: Fee Table") that the term "redemption fee," for purposes of the prospectus fee table, does not include a liquidity fee that may be imposed in accordance with rule 2a-7.[282] Commenters

[277] *See SIFMA Comment Letter; Stradley Ronon Comment Letter (both stating that requiring disclosure of the board's analysis is not necessary to disclose patterns of stress in a fund, and that patterns of stress will be apparent via the proposed disclosures of historical sponsor support and liquidity shortfalls). We note that the Proposing Release does not specifically state that disclosure of the board's analysis supporting its decision to impose a liquidity fee or temporarily suspend the fund's redemptions would permit shareholders to assess patterns of stress. Rather, the Proposing Release states that the proposed historical disclosure of liquidity fees and gates (which disclosure would include a discussion of the board's analysis supporting its decision to impose a liquidity fee or gate) generally would assist shareholders in assessing patterns of stress. See Proposing Release, supra note 25, at section lll.B.8.d. We continue to believe that historical disclosure of fees and gates, which would include disclosures of historical liquidity shortfalls, would assist shareholders in understanding patterns of stress faced by the fund. See supra notes 969-970 and accompanying text. We believe that this historical disclosure complements the disclosure of historical instances of sponsor support in understanding patterns of stress.*

[278] *See infra section III.E.9.f.*

[279] *See infra section III.F.5.*

[280] *See instructions to amended Item 16(g)(1) of Form N-1A.*

[281] *See supra note 971 [279] and accompanying text. As discussed in more detail in section III.F.5 below, while similar information is required to be included on Form N-CR and on Form N-lA, we believe each of these different disclosures to be appropriate because they serve distinct purposes. See infra* notes 1308-1309 and accompanying text.

[282] *See Instruction 2(b) to amended Item 3 of Form N-1A.*

on this aspect of our proposal agreed that the liquidity fee should not be included in the prospectus fee table.[283] For example, one commenter stated that the fees and expenses table is intended to show a typical investor the range of anticipated costs that will be borne by the investor directly or indirectly as a shareholder, but is not an ideal presentation for the kind of highly contingent cost that would be represented by a liquidity fee.[284]

As discussed in the Proposing Release and as adopted today, a liquidity fee will only be imposed when a fund experiences stress, and because we anticipate that a particular fund would impose this fee rarely, if at all,[285] we continue to believe that the prospectus fee table, which is intended to help shareholders compare the costs of investing in different mutual funds, should not include the liquidity fee.[286] We also note, as discussed above, that shareholders will be adequately informed about liquidity fees through other disclosures in funds' SAI and summary section of the statutory prospectus (and, accordingly, in any summary prospectus, if used).[287] If a fund imposes a liquidity fee, shareholders will also be informed about the imposition of this fee on the fund's website[288] and possibly by means of a prospectus supplement.[289] A fund could also provide complementary shareholder communications, such as a press release or social media update.[290] Accordingly, we are adopting the clarifying instruction to Item 3 as proposed.

7. Historical Disclosure of Affiliate Financial Support

As discussed above in section II.B.4, voluntary support provided by money market fund sponsors and affiliates has played a role in helping some money market funds maintain a stable share price, and, as a result, may have lessened investors' perception of the level of risk in money market funds. Such discretionary sponsor support was, in fact, not unusual during the financial crisis.[291] Today we are adopting, with certain modifications from the proposal to address commenter concerns, amendments that require that money market funds disclose current and historical instances of affiliate "financial support." The final amendments define "financial support" in the same way it is defined in Form N-CR,[292] and specify that funds should incorporate certain

[283] *See, e.g., HSBC Comment Letter; NYC Bar Committee Comment Letter; Dreyfus Comment Letter.*

[284] *See NYC Bar Committee Comment Letter.*

[285] *See supra note 247 and accompanying text.*

[286] *Instruction 2(b) to Item 3 of Form N-lA currently defines "redemption fee" to include any fee charged for any redemption of the Fund's shares, but does not include a deferred sales charge (load) imposed upon redemption.*

[287] *See supra section I1I.E.4.*

[288] *See infra section III.E.9.f.*

[289] *See infra text accompanying notes 1126 and 1127*

[290] *See infra text following note 1123.*

[291] *See, e.g., DERA Study, supra note 24, at nn.23-24 and accompanying text.*

[292] *See Instruction 1 to Item 16(g)(2) of Form N-lA; Form N-CR Part C (defining financial support as "including any (i) capital contribution, (ii) purchase of a security from the Fund in reliance on § 270.17a-9, (iii) purchase of any defaulted or devalued security at par, (iv) execution of letter of credit or letter of indemnity, (v) capital support agreement (whether or not the Fund ultimately received support), (vi) performance guarantee, or (vii) any other similar action reasonably intended to increase or stabilize the value or liquidity of the Fund's portfolio; excluding, however, any (i) routine waiver of fees or reimbursement of Fund expenses, (ii) routine inter-fund lending (iii) routine inter-fund purchases of Fund shares, or (iv) any action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the Fund's portfolio.").*

information that the fund is required to report on Form N-CR in their SAI disclosure.[293] We discuss this definition in detail, including the modifications we have made to address commenter concerns, in section III.F.[294] This represents a slight change from the proposal, in that the required disclosure is now identical to what would be disclosed in the initial filings of Form N-CR. We have made this change to reduce the burdens associated with such disclosure so that funds need only prepare this information once in a single manner.[295]

In the Proposing Release, we requested comment on amending rule 17a-9 (which allows for the discretionary support of money market funds by their sponsors and other affiliates) to potentially restrict the practice of sponsor support, but did not propose any specific changes to the rule. While a few commenters suggested, in response to this request for comment, that we prohibit affiliates from providing discretionary support to maintain a money market fund's share value,[296] other commenters opposed making any changes to rule 17a-9, arguing that transactions facilitated by the rule are in the best interests of shareholders.[297] We continue to believe, as discussed in the Proposing Release, that permitting financial support (with adequate disclosure) will provide fund affiliates with the flexibility to protect shareholder interests, and we are not amending rule 17a-9 at this time.[298] Many commenters supported the various financial support disclosures we are adopting today.[299] We believe that these disclosure requirements will provide transparency to shareholders and the Commission about the frequency, nature, and amount of affiliate financial support.

a. General requirements

We are adopting, with some changes from the proposal, amendments to Form N-lA to require a money market fund to disclose in its SAI historical instances in which the fund has received financial support from a sponsor or fund affiliate.[300] Specifically, each money market fund will be required to disclose any occasion during the last 10 years (but not for occasions that occurred before the compliance date of these amended rules) on which an affiliated person, promoter, or

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[293]*See Instruction 3 to Item 16(g)(2) of Form N-1A.*

[294]*See infra section III.F.3.*

[295]*See Item 16(g)(2) of Form N-1A. The disclosure required by Item 16(g)(2) should incorporate, as appropriate, any information that the fund is required to report to the Commission on Items C.1, C.2, C.3, C.4, C.5, C.6, and C.7 of Form N-CR. See Instruction 2 to Item 16(g)(2).*

[296]*See, e.g., Systemic Risk Council Comment Letter; Capital Advisors Comment Letter; see also HSBC Comment Letter (supporting amending rule 17a-9, arguing that transactions facilitated by the rule can result in shareholders having unjustified expectations of future support being provided by sponsors).*

[297]*See ICI Comment Letter; Dreyfus Comment Letter; ABA Business Law Comment Letter.*

[298]*See Proposing Release, supra note 25, at text accompanying n.607.*

[299]*See, e.g., Oppenheimer Comment Letter ("We support the SEC's proposal to require money market funds to disclose current and historical instances of sponsor support for stable NAV funds [.].'"). See also, e.g., Angel Comment Letter; American Bankers Ass'n Comment Letter; Federated VIII Comment Letter; Comment Letter of Occupy the SEC (Sept. 16, 2013) ("Occupy the SEC Comment Letter"); Thrivent Comment Letter.*

[300]*See Item 16(g)(2) of Form N-1A.*

principal underwriter of the fund, or an affiliated person of such person,[301] provided any form of financial support to the fund. For the reasons discussed in the Proposing Release, we believe that the disclosure of historical instances of sponsor support will allow investors, regulators, academics, market observers and market participants, and other interested members of the public to understand better whether a particular fund has required financial support in the past and the extent of sponsor support across the fund industry.[302] As proposed, with respect to each such occasion, funds would have been required to describe the nature of support, the person providing support, the relationship between the person providing support and the fund, the date the support provided, the amount of support,[303] the security supported and its value on the date support was initiated (if applicable), the reason for support, the term of support, and any contractual restrictions relating to support.[304] We are adopting the proposed disclosure requirements, with the exception of the requirements for a fund to describe the reason for support, the term of support, and any contractual restrictions relating to support.

While multiple commenters supported the proposed requirement for money market funds to disclose historical instances of financial support in the fund's SAI,[305] other commenters expressed a number of concerns about this proposed requirement.[306] For example, one commenter opposed this disclosure, stating that "many investors would extrapolate such disclosure as an implied guarantee of future support by the sponsor of the fund."[307] Another commenter rejected the notion that past sponsor support is indicative of a sponsor's management style and further observed that disclosure of historical support contradicts the proposed disclosure that a fund's sponsor has no legal obligation to provide support.[308] While we acknowledge these concerns, we believe it is important for investors to understand the nature and extent that a fund's sponsor has discretionarily supported the fund in order to allow them to fully appreciate the risks of investing in the fund.[309] Although we recognize that historical occurrences are not necessarily indicative of future events and that support does not equate to poor fund management, we

[301] *Rule 2a-7 currently requires a money market fund to notify the Commission by electronic mail, directed to the Director of Investment Management or the Director's designee, of any purchase of money market fund portfolio securities by an affiliated person, promoter, or principal underwriter of the fund, or an affiliated person of such person, pursuant to rule 17a-9. See current rule 2a-7(c)(7)(iii)(B). As proposed, we are eliminating this requirement today, as it would be duplicative with the proposed Form N-CR reporting requirements discussed below. See rule 2a-7(f)(3); see also infra note 1254. However, because the definition of "financial support" as adopted today includes the purchase of a security pursuant to rule 17a-9 (as well as similar actions), we believe that the scope of the persons covered by the definition should reflect the scope of persons covered by current rule 2a-7(c)(7)(iii)(B). The term "affiliated person" is defined in section 2(a)(3) and, in the context of an investment company, includes, among other persons, the investment adviser of the investment company.*

[302] *See Proposing Release, supra note 25, at text following n.607.*

[303] *See infra section 111.F.3 for Commission guidance on the amount of support to be disclosed.*

[304] *See proposed Item 16(g)(2) of Form N-1A. See infra notes 1226-1243 and accompanying text for a discussion of actions that would be deemed to constitute "financial support" and additional discussion of what is required to be reported.*

[305] *See supra note 997 [305].*

[306] *See, e.g., U.S. Bancorp Comment Letter; Dreyfus Comment Letter.*

[307] *See U.S. Bancorp Comment Letter.*

[308] *See Dreyfus Comment Letter.*

[309] *See supra notes 51-55 and accompanying discussion; see also, e.g., Proposing Release, supra note 25, at n.607 and accompanying text.*

continue to expect that these disclosures will permit investors to assess the sponsor's past ability and willingness to provide financial support to the fund. This disclosure also should help investors gain a better context for, and understanding of, the fund's risks, historical performance, and principal volatility.

A number of commenters stated that any disclosure of financial support, including the historical disclosures, should only apply to stable NAV funds.[310] We disagree. Transparency of financial support is important for stable NAV funds, given the potential for a "breaking the buck" event absent the receipt of affiliate financial support. It is equally important, for both floating and stable NAV money market funds, that investors have transparency about the extent to which the fund's principal stability or liquidity profile is achieved through financial support as opposed to portfolio management. This is particularly the case when financial support for a floating NAV fund could obviate the need for it to impose a liquidity fee or redemption gate.[311] We therefore believe that transparency of such support will help investors better evaluate the risks with respect to both stable and floating NAV funds.[312]

Some commenters also suggested we shorten the look-back period. For example, one commenter proposed a look-back period of 3 to 5 years (rather than 10 years, as proposed).[313] We believe, however, that a look-back period of less than 10 years would be too short to achieve our goals. As we noted in the Proposing Release,[314] the 10-year look-back period will provide shareholders and the Commission with a historical perspective that is long enough to provide a useful understanding of past events, and to analyze patterns with respect to financial support received by the fund, but not so long as to include circumstances that may no longer be a relevant reflection of the fund's management or operations. We also note that, historically, episodes of financial support have occurred on average every 5 to 10 years.[315] Accordingly, a shorter look-back period would result in disclosure that not does reflect the typical historical frequency of instances of financial support.

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[310] *See, e.g., ICI Comment Letter; IDC Comment Letter; Oppenheimer Comment Letter; Comment Letter of State Street Global Advisors (Sept. 17, 2013) (USSGA Comment Letter").*

[311] *See generally, ABA Business Law Section (with respect to retaining rule 17a-9, stating that "the possibility of economic support from an affiliated person would remain important to money market funds that have a floating NAV because [...] liquidity concerns [remain] significant to money market funds (and other funds holding the same investments). [...] In addition, retaining [rule 17a-9] would not undercut the Commission's goal of providing transparency of money market fund risks, particularly in light of the Commission's companion proposals calling for disclosure of historical instances of economic support from sponsors of money market funds.").*

[312] *See Proposing Release, supra note 25, at section III.F.l.a (discussing reasons why funds should disclose historical sponsor support).*

[313] *See, e.g., Dreyfus Comment Letter (stating that "[s]imilar kinds of information (e.g., management fees and 12b-l fees paid, officers and directors biographies, financial highlights) generally [are] required in the registration statement only for a 3-5 year period."); Federated VIII Comment Letter (recommending five years). But see Occupy the SEC Comment Letter (explicitly supporting the proposed 10-year look-back period for disclosing events of financial support).*

[314] *See Proposing Release, supra note 25, at discussion following n.614.*

[315] *See Proposing Release, supra note 25, at section IIB, Table 1.*

We proposed to limit historical disclosure of events of affiliate financial support to instances that occur after the compliance date of the amendments to Form N-1A.[316] Several commenters generally supported this approach, suggesting that this disclosure requirement should only apply to events that occur after the compliance date of the disclosure reforms.[317] We continue to believe that these disclosures should only apply to affiliate financial support events that occur after the compliance date of the disclosure reforms, in large part because to do otherwise would require funds and their affiliates to incur significant costs as they reexamine a variety of past transactions to determine whether such events fit our new definition of affiliate financial support.

Finally, a few commenters suggested disclosing historical financial support in Form N-MFP, N-CR, or N-CSR, rather than in the SAI (as proposed).[318] One commenter noted that to the extent this disclosure will serve as a reporting function for analysis by regulators, other forms such as Form N-MFP have been developed for that particular purpose.[319] Commenters also raised concerns about the potential redundancy of the proposed registration statement, website, and Form N-CR disclosure requirements.[320] Because these historical sponsor support disclosures are intended to benefit investors, as well as regulators, we believe that the SAI is the most accessible and efficient format for such disclosure. As discussed in section III.F.3, we note that the contemplated SAI disclosure would consolidate historical instances of sponsor support that have occurred in the past 10 years, which would permit investors to view this information in a user-friendly manner, without the need to review prior form filings to piece together a fund's history of sponsor support. We also believe that, to the extent investors may not be familiar with researching filings on EDGAR, including this disclosure in a fund's SAI, which investors may receive in hard copy through the U.S. Postal Service or may access on a fund's website, as well as on EDGAR, may make this information more readily available to these investors than disclosure on other SEC forms that are solely accessible on EDGAR.

As discussed above, we are not adopting the proposed requirements that a fund include the reason for support, the term of support, and any contractual restrictions relating to support in its required SAI disclosure.[321] Instead, a fund will only be required to present certain summary information about the receipt of financial support in its SAI (as well as on the fund's website[322]), and will be required to present more detailed discussion solely on Form N-CR.[323] To inform investors about the inclusion of this more detailed information on Form N-CR, funds will be instructed to include the following statement as part of the historical disclosure of affiliate financial support appearing in the fund's SAI: "The Fund was required to disclose additional information about this event [or "these events," as appropriate] on Form N-CR and to file this form with the Securities and Exchange Commission. Any Form N-CR filing submitted by the Fund is available on the EDGAR Database on the Securities and Exchange Commission's Inter-

[316] *As we proposed, this historical disclosure would only apply to such events that occurred after the compliance date of the amendments. See Proposing Release, supra note 25, at text accompanying n.983.*

[317] *See Federated VI1 Comment Letter; SIFMA Comment Letter.*

[318] *See, e.g., Dreyfus Comment Letter; U.S. Bancorp Comment Letter.*

[319] *See Dreyfus Comment Letter.*

[320] *See, e.g., Dreyfus Comment Letter; SIFMA Comment Letter.*

[321] *See supra note 1002 [310] and accompanying text.*

[322] *See infra section III.E.9.g.*

[323] *See infra section III.F.3.*

net site at http://www.sec.gov."[324] In adopting these modified SAI disclosure requirements, we have attempted to appropriately consider concerns about potentially duplicative disclosure[325] as well as our belief, as discussed above, that the SAI is the most accessible and efficient format for investors to receive historical disclosures about affiliate financial support, and our interest in presenting the primary information about such financial support that we believe shareholders may find useful in assessing fund risks.

b. Historical support of predecessor funds

We also are amending, generally as we proposed, the instructions to Form N-lA to clarify that funds must disclose any financial support provided to a predecessor fund (in the case of a merger or other reorganization) within the 10-year look-back period. As discussed in the Proposing Release, this amendment will provide additional transparency by providing investors the full extent of historical support provided to a fund or its predecessor. Specifically, except as noted below, the amended instructions state that if the fund has participated in a merger or other reorganization with another investment company during the last 10 years, the fund must additionally provide the required disclosure with respect to the other investment company.[326]

Rather than require that funds disclose financial support provided to a predecessor fund in all cases (as proposed), we are revising the instruction to permit a fund to exclude such disclosure where the person or entity that previously provided financial support to the predecessor fund is not currently an affiliated person (including the adviser), promoter, or principal underwriter of the disclosing fund.[327] A few commenters expressed concern about historical disclosures with respect to third-party reorganizations, asserting that past financial support would be irrelevant to shareholders where the surviving fund had a new manager unaffiliated with the prior manager.[328] These commenters noted that this disclosure requirement could adversely affect potential merger transactions with funds that have received sponsor support.[329]

We agree with these commenters that historical sponsor support information about a predecessor fund may be less relevant when the fund is not advised by, or otherwise affiliated with, the entity that had previously provided financial support to the predecessor fund. Accordingly, we are adopting an exclusion to this disclosure requirement based on whether the current fund continues to have any affiliation with the predecessor fund's affiliated persons (including the predecessor fund's adviser), promoter, or principal underwriter.[330] We expect this approach should mitigate commenter concerns of adverse effects on fund mergers.

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[324]*See Instructions to amended Item 16(g)(2) of Form N-1A.*

[325]*See supra note 1018 [326] and accompanying text. As discussed in more detail in section III.F.3 below, while similar information is required to be included on Form N-CR and Form N-lA, we believe each of these different disclosures to be appropriate because they serve distinct purposes. See discussion following infra notes 1248 and 1249 and accompanying text.*

[326]*See Instruction 2 to Item 16(g)(2). Additionally, if a fund's name has changed (but the corporate or trust entity remains the same), the fund may want to consider providing the required disclosure with respect to the entity or entities identified by the fund's former name. See Proposing Release, supra note 25, at n.619.*

[327]*Id. In the Proposing Release we had proposed to require disclosure of financial support provided to a predecessor fund in all cases. See Proposing Release, supra note 25, at n.618 and accompanying discussion.*

[328]*See, e.g., Federated VIII Comment Letter; SIFMA Comment Letter.*

[329]*See id.*

[330]*See Instruction 2 to Item 16(g)(2).*

APPENDIX III

Division of Investment Management
Generic Comment Letters and Selected Guidence Updates

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Accountants Generic Comment Letters

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Guidance Updates

January 11, 1990

Dear Registrant:

The Division of Investment Management has prepared this letter to assist investment company registrants in preparing filings in 1990. This letter provides general guidance to investment companies filing registration statements and post-effective amendments in connection with the public offering of securities. These comments represent the views of the staff of the Office of Disclosure Review and not necessarily those of the Securities and Exchange Commission (the "Commission").

I. Filing Requirements

A. Updating the Registration Statement

Section 10(a)(3) of the Securities Act of 1933 ("1933 Act") provides for the annual updating of prospectuses. Rule 485 under the 1933 Act prescribes an updating process for open-end management companies and unit investment trusts. When a prospectus is used more than nine months after the effective date of the registration statement, the information contained in it must be as of a date not more than 16 months prior to use. If financial statements in a filing are as of a date 245 days or more prior to the date the filing is expected to become effective, updated financial statements must be furnished. (See Rule 3-18 of Regulation S-X.)

The initial post-effective amendment filed for the purpose of complying with the undertaking required by Item 32(b) of Form N-1A must include a per share table (see Instruction 1 to Item 3 of Form N-1A) at least as current as the most current balance sheet and be accompanied by a consent of the independent public accountant.

The staff will make every effort to provide timely comments on post-effective amendments filed under Rule 485(a). To assist the staff in its review of amendments, the registrant, in addition to providing a red-lined copy to highlight disclosure changes made from the most recently filed amendment, should enumerate in the transmittal letter the material changes which require the amendment to be filed under Rule 485(a).

The staff seeks to give comments within forty-five days after receipt of a post-effective amendment by the Commission. If the registrant has not received comments within forty-five days, it would be appropriate to contact the staff to ascertain the status of the filing.

To expedite the processing of post-effective amendments filed under Rule 485(a), the staff urges the registrant to use selective review procedures.[1] Based on the information available to the staff, the branch will determine the level of review. Registrants are reminded that requests for acceleration of effectiveness will be considered as an acknowledgment by the issuer of its statutory obligations under the federal securities laws to provide appropriate disclosure of material information.

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[1]*Investment Company Release No. 13768 (February 15, 1984)*

Any post-effective amendment filed under paragraph (b) of Rule 485 must include, on the signature page, the appropriate certification of the registrant and, if counsel prepared or reviewed the post-effective amendment, counsel's representation that the post-effective amendment does not contain disclosure that would make it ineligible to become effective under that paragraph. The facing page should be marked to indicate that the filing is made under paragraph (b). (See paragraph (e) of Rule 485.) Of course, the registrant remains responsible for determining whether any changes to its registration statement warrant a post-effective amendment to be filed under paragraph (a) or (b) of Rule 485.

Materials intended to be filed must be sent directly to the Commission and must not be sent to members of the staff. (Courtesy copies of filed materials may be sent to staff members.)

If financial statement requirements are satisfied by incorporating by reference the Annual Report to Shareholders, a copy of the Annual Report should be included in each copy of the filing.

B. Undertakings

In the initial Form N-1A registration statement, the registrant is required by Item 32 to undertake to file, within four to six months from the effective date of the registration statement, a post-effective amendment using financial statements which need not be certified.

Registration statements and post-effective amendments filed for the purpose of adding a series should include an undertaking to call a meeting of public shareholders within the first year of commencement of operations (not the effective date) to provide, where appropriate, for:

1. election of directors (trustees);
2. approval of the investment advisory contract;
3. ratification of the selection of independent public accountants; and
4. approval of any Rule 12b-1 plan.

Registrants not required to hold annual shareholder meetings should undertake, if requested to do so by the holders of at least 10% of the registrant's outstanding shares, to call a meeting of shareholders for the purpose of voting upon the question of removal of a trustee or trustees and to assist in communications with other shareholders as required by Section 16(c).

C. Effective Date and Request for Acceleration

Registrants are encouraged to adopt and implement internal control procedures which will provide for the timely delivery of post-effective amendments to the Commission so that amendments become effective automatically and the issuance of orders is avoided. The appropriate use by registrants of the automatic acceleration provision of Rule 485 has enabled the staff to focus its resources in areas other than the time consuming and less productive tasks of processing orders to declare amendments effective.

In accordance with Rule 461 of Regulation C under the 1933 Act, requests for acceleration of the effective date of a registration statement must be made in writing by both registrant and the principal underwriter.

D. Rule 24f-2 Requirements

SEC filing fees paid under Section 6(b) of the 1933 Act were raised from 1/50th of 1% to 1/40th of 1% of the aggregate offering amount effective at 8:00 a.m. on November 22, 1989. The filing fee is to be calculated using the new rate for any Rule 24f-2 Notice filed on or after November 22, 1989, regardless of when the shares were sold during the year.

When preparing the 24f-2 Notice, carefully review the method of fee calculation described in paragraph (c) of Rule 24f-2. Note that only if the 24f-2 Notice is filed (i.e., received by the Commission) within two months (not 60 days) after the close of the registrant's fiscal year may the fee offset based on redemptions and repurchases ("netting") be used. For example, if the 24f-2 Notice for an investment company with a fiscal year ended December 31 is received by the Commission after February 28, redemptions cannot be netted against sales in calculating the fee.[2] We encourage both timely filing and use of a delivery means that provides a record of transmittal and receipt. Late filing and the consequent loss of the ability to use netting can be very costly.

All 24f-2 Notices must include an opinion of counsel stating whether the securities being registered were legally issued, fully paid, and non-assessable. Initial registration statements filed with the Commission must also include, as an exhibit, an opinion of counsel as to the legality of shares to be registered (See Item 24(b)(10) of Form N-1A.)

If a registrant proposes to cease operations, the registrant must file both a post-effective amendment terminating the declaration and a final 24f-2 Notice prior to its cessation of operations.

E. Exhibits to Registration Statements

Registrants filing amendments to registration statements must list all exhibits, and letter or number them for convenient reference. See Item 24 Form N-1A. Where the exhibits are incorporated by reference, the list of exhibits must include both the incorporation by reference and a description of the location of any incorporated material.

II. Disclosure Comments

A. Investment Objective

The prospectus discussion of a registrant's objective should be sufficiently clear and precise to allow for a reasonable evaluation of the registrant's performance relative to the objective.

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[2]*See Rule 0-2 under the Investment Company Act of 1940 for the applicability of the filing requirements to dates which fall on a Saturday, Sunday or holiday.*

B. Risk Disclosure

Guide 21[3] offers guidelines as to specific disclosure to be made in response to Item 4 of Form N-1A with regard to the principal speculative or risk factors associated with an investment in the registrant. This disclosure shall appear under the caption "Risk Factors" rather than "Special Considerations".

A registrant which invests or intends to invest all or a significant portion of its assets in high yielding bonds or "junk bonds" must provide in its prospectus and SAI a complete discussion of the risk factors inherent in such investments. Please refer to our October 3, 1989 letter to investment company registrants for a full discussion of the Division's views on appropriate disclosure of the risks associated with investing in junk bonds.

C. Valuation and Liquidity

Registrants often value debt securities by reference to other securities which are considered by the board of directors to be comparable in rating, interest rate, due date, etc. (often called matrix pricing) or use pricing services for valuation of these securities. Registrants are reminded that matrix pricing should not ignore a reliable market quotation for an actively traded security.

An open-end investment company should limit its investments in securities which are not readily marketable to no more than ten percent of the company's net assets. The staff considers municipal lease securities to be illiquid because of the inefficiency and thinness of the market in which they are traded. Registration statement disclosure should clearly and completely discuss the company's policy of investing in illiquid securities (see Guides 11, 12, and 13 to Form N-1A) and its valuation practices including an indication of the degree of reliance on a pricing service. (See Guide 28 to Form N-1A.)

D. Account Transfers

There should be a description in the prospectus of the procedures for transferring fund shares between broker/dealer street name accounts. Any difference in the procedures for transferring fund shares for shareholders in a dividend reinvestment plan and those receiving dividends in cash should be disclosed. If the shares can be transferred in either or both circumstances, disclose how this can be done, what limitations exist and what costs, if any, may be imposed. If the shares cannot be transferred to another street name account, disclosure of that fact should be made. In addition, if shares cannot be transferred, the registrant should discuss in the prospectus the alternatives available to the investor such as leaving the shares at the original broker/dealer; registering the shares in the investor's own name; or redeeming and incurring any contingent deferred sales load. The registrant should determine and disclose if the lack of selling agreements with other broker/dealers has an impact on the ability of a proprietary fund shareholder to transfer shares already owned to a broker/dealer that does not have a selling agreement with the fund or the ability of such shareholders to purchase additional shares after an account has been transferred.

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[3]*This guideline is also applicable to risk disclosure for closed-end companies and unit investment trusts.*

E. Contingent Offerings

Investment companies which offer securities on a contingency basis, ie., all or a specified number of securities must be sold as a condition to the offering, must comply with the requirements of Rules 10b-9 and 15c2-4 under the Securities Act of 1934. These rules require the deposit of subscribers' funds in a separate bank account, as agent or trustee, and require a prompt refund to subscribers if a specified number of securities are not sold by a specified date. In addition, the rules limit the permissible investments that can be made with funds in the bank account pending transfer to the issuer or refund to subscribers. Investments in money market funds, corporate equity or debt securities, repurchase agreements, bankers acceptances, commercial paper and municipal securities are not permitted.

F. Redemptions

A discussion in the prospectus of an open-end investment company which offers a telephone redemption privilege should provide disclosure that:

1. gives a shareholder the precise information required to implement a redemption;
2. tells a shareholder what to do if he or she is unable to reach the Fund by telephone;
3. advises a shareholder of potential difficulty in implementing a telephone redemption during periods of drastic economic or market changes;
4. clearly and prominently discloses whether the privilege may be terminated or modified, and if so, what notice will be provided to shareholders of such a change; and
5. accurately discloses the amount of any fees associated with the privilege, how and when they are collected, the circumstances under which the fees may be imposed, and the conditions under which they may be waived.

G. Dividend Reinvestment Plan

In the case of dividend reinvestment plans offered by registrants, the fee table (see Item 2) and other portions of the prospectus (see Item 7 of Form N-1A) must make clear any practice of charging a sales load on the reinvestment of dividends. The disclosure should make clear that the term "offering price" includes the sales load. The example in the fee table should be prepared without regard to the sales load applied to reinvested dividends, but the brief narrative following the fee table must state that the example does not reflect the sales load charged on the reinvested dividends and that the amounts would be increased if they were reflected.

H. Prospectus Simplification

Registrants are encouraged to review the registration statement, in its entirety, to identify any specific areas where existing disclosure can be deleted, reduced or redistributed between the prospectus and the Statement of Additional Information. In recent discussions between the Investment Company Institute and the staff, areas of disclosure regarding repurchase arrangements, options and futures transactions and arrangements subject to the Glass Steagall Act restrictions were identified as possible candidates for abbreviated disclosure.

III. Closed-End Funds

A. Discount

The prospectus disclosure pertaining to the possibility that a closed-end fund's shares will trade at a discount from net asset value must be prominently placed. The staff believes that disclosure relating to the secondary market trading discount of shares of a closed-end fund should:

1. be placed in a separate section or paragraph of the prospectus Summary;
2. state unequivocally that shares of closed-end companies frequently trade at a discount from net asset value; and
3. include a brief discussion of the impact and investment risks associated with purchasing fund shares that may trade at a discount in the secondary market.

The Commission has proposed amendments to Form N-2,[4] the registration form used by closed-end funds to register as investment companies under the 1940 Act and to register their securities under the 1933 Act. Registrants may find the discussion in the proposed amendments and staff guidelines and accompanying release helpful in identifying disclosure matters relevant to their offering of securities.

B. 430A

Rule 430A under the Act permits the registrant to file and the staff to declare effective a registration statement which omits from the prospectus certain information with respect to price and/or syndication of the securities being offering to the public by a closed-end investment company. During the review process, the staff will seek to ascertain from registrant's counsel whether the registrant intends to rely on Rule 430A; and if so, what data the registrant proposes to omit from the final pre-effective amendment of the registration statement. Also, if the registrant is relying on Rule 415 under the Act the registrant must furnish the undertaking required by Item 512(a) of Regulation S-K.

IV. Unit Investment Trusts ("UITs")

Estimated Current Return ("ECR"), short-term performance measurement, is the commonly used performance measure in UIT prospectuses. The staff believes that the ECR used alone is misleading and should not be used as the single measure of performance. Accordingly, the staff of the division will no accelerate a UIT filing containing only ECR.

We believe that a more appropriate performance measurement for UITs is an Internal Rate of Return ("IRR"), a long-term measurement based on outflows of cash to unitholders. Another long-term performance measurement, the Wesolowski-Hicks Formula ("WHF"), starts with the yield to maturity of each bond in the portfolio and weights the yield by the maturity and market value of the bond.

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[4] *Investment Company Act Release No. 17091 (July 28, 1989).*

Where the UIT uses the WHF, the number should be identified as an estimate. "Estimated long term return" has been suggested as a good descriptive label. Both numbers (ECR and WHF) can be shown as percentages. ECR should be labelled "estimated current return", not "yield" or "current yield".

The staff will follow the following standards in granting acceleration registration statements of UIT series. If both the higher of ECR or WHF are no more than 25 basis points[5] above the IRR, the prospectus may include both the ECR and WHF and need not include a cash flow statement. If either the ECR or WHF is more than 25 basis points above the IRR, but the ECR is no more than 25 basis points above WHF, the prospectus may include both ECR and WHF, but must also include a cash flow statement. (A cash flow statement, if used, should cover cash flows over the life of the trust, but payments that are the same may be lumped together to shorten the table.) If the ECR is more than 25 basis points above WHF, the ECR may not be used. In that case, the IRR may be used alone or the WHF may be used together with either a cash flow table or the IRR.

Given the nature of the calculations and the usual makeup of a portfolio, ECR should be a higher number than WHF. If ECR is lower than the long term number calculated as above, the long term number should be presented; use of ECR is optional.

The prospectus, in every case, must describe any numbers used, including how they were calculated and must contain an explanation of any differences between the two, where two are used. Registrants, in all cases, should prepare a statement of cash flows. The cash flows should use either the first call or maturity date depending on the market price. If yield to maturity for each security held by the UIT is not shown as a part of the prospectus disclosure, registrant should be prepared to submit supplementally a list of these yields as well as the cash flow tables and the calculations of the WHF. It is not acceptable for a prospectus to show no percentage numbers at all and to contain dollar amounts that sales personnel could readily use to calculate estimated current return.

We trust that this letter will assist you in preparing your forthcoming filings. Of course, it is not intended to replace the comment process. Any questions about specific investment company filings should be directed to the staff member(s) responsible for reviewing the documents.

Sincerely,

Carolyn B. Lewis
Assistant Director

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[5]*This 25 basis point difference applies to trust with dollar weighted average portfolio maturities of not more than 15 years ("15 years trusts"). Trusts with dollar weighted average portfolio maturities over 15 years ("over 15 year trusts") may use a 40 basis point difference for each of the tests discussed here.*

January 3, 1991

Dear Registrant:

This letter is intended to assist investment company registrants in preparing disclosure filings in 1991. It covers disclosure developments occurring since January 1990 when the first in this series of "generic comment letters" was issued. These comments represent the views of the Division of Investment Management and not necessarily those of the Securities and Exchange Commission (the "commission"). They are intended only to assist registrants in preparing disclosure documents and are not to be considered of precedential value in any court or other official action.

I. Procedural Comments

A. Prospectus Delivery Requirements

Investment companies, like other issuers, are required by the Securities Act of 1933 (the "1933 Act") to deliver to each investor a current prospectus, which must precede or accompany confirmation of a sale.

Mutual funds ordinarily send a prospectus with confirmation of an investor's initial purchase, but many, rather than send updated prospectuses to individual shareholders who make additional purchases, send copies of the new prospectus to all shareholders each time it is updated. The staff believes that this practice satisfies the prospectus delivery requirements of the federal securities laws.

The staff ordinarily does not express a view on whether a fund following this practice must send to shareholders prospectuses that are supplemented ("stickered") during the year in addition to the annually updated prospectuses. Funds and their counsel should consider the nature and materiality of the new disclosure in determining whether to send stickered prospectuses to shareholders.

B. Newspaper/Magazine Prospectuses and Sales Literature

Recently, some registrants have had their fund prospectuses printed, together with supplemental sales material and purchase applications, in newspapers and magazines of general circulation. However, it is the staff's view that registrants may not rely on this method of prospectus publication to satisfy the requirement that sales literature be preceded or accompanied by a prospectus (other than for the sales literature inserted in the publication with the prospectus). This method of prospectus publication does not provide sufficient assurance that the subscriber or reader has received a prospectus, since he or she may consider the prospectus ordinary advertising material or may not even notice it. For more detailed information about the staff's view on these practices, registrants should refer to the letter on this subject from Kathryn B. McGrath, Director, Division of Investment Management to William C. Lloyd, Esq., Office of the Commissioner of Securities, State of Wisconsin (June 7, 1990).

C. Undertakings

A registrant filing an initial Form N-1A registration statement or a post-effective amendment adding a new series must undertake to file, within four to six months of the effective date of the filing, a post-effective amendment containing reasonably current financial statements which need not be certified. (See Item 32 of Form N-1A.)

A registrant should also undertake to hold a meeting of its public shareholders so that certain matters may be considered. For initial registration statements, the undertaking should provide for a shareholders' meeting to vote on the election of directors (trustees); ratification of the selection of independent public accountants; approval of the investment advisory or similar contracts; and the approval of any plans adopted under rule 12b-1. For post-effective amendments filed to add a new series, the undertaking should provide for a meeting of shareholders of a new series to vote on the advisory or similar contracts and any rule 12-1 plans.

The staff has reviewed its policy on how much time can elapse before the meeting is held, heretofore one year from the date of effectiveness of the registration statement or the commencement of operations, whichever is later. The staff is changing this time period to sixteen months from the date of effectiveness. In most cases, this will provide additional time and permit registrants to deliver with the proxy statement an annual report containing audited financial statements as required by rule 14a-3 under the 1934 Act.

D. Incorporation by Reference

If a registrant complies with the requirement to include financial statements by incorporating by reference the annual report to shareholders, a copy of the annual report should be included in each copy of the filing submitted to the Commission. EDGAR filings are excluded from this requirement, if the annual report has been filed electronically.

The initial post-effective amendment filed to comply with the undertaking required by Item 32(b) of Form N-1A should include a per share table at least as current as the most current balance sheet accompanied by an updated consent of the independent public accountant. (See Instruction 1 to Item 3 of Form N-1A.) Registrants may incorporate by reference the per share data from another document at the appropriate location in the first five pages of the prospectus. Copies of the incorporated materials should be affixed to the document when it is filed (except for EDGAR filings). However, copies of the incorporated materials do not have to accompany a prospectus delivered to investors provided that the incorporated materials have been previously delivered to persons receiving the prospectus and a statement is included in the prospectus at the place of incorporation that the incorporated material will be furnished again without charge upon request. (See General Instruction E.3 to Form N-1A.)

E. Rule 24f-2 Requirement

If a registrant proposes to cease operations, the registrant must file both a post-effective amendment terminating its rule 24f-2 declaration and a final 24f-2 notice prior to its cessation of

operations. In the case of a reorganization, the date of consummation of the transaction will be deemed the fiscal year end of the acquired fund. Accordingly, the acquired fund will have to file a 24f-2 notice within two months of that date in order to use the netting provisions in calculating the filing fee due for shares sold.

F. Adviser's Balance Sheet

By its terms, rule 20a-2(a)(9) under the 1940 Act requires registrants to include in proxy statements a certified balance sheet of the investment adviser (unless the adviser is a bank) as of the end of the adviser's last fiscal year. The staff has taken the position that the certified balance sheet should be as of the end of the adviser's fiscal year most recently ended prior to the meeting date. However, the staff will not object if the registrant, as an alternative, includes all of the following items in its proxy statement:

1. An audited balance sheet of the adviser as of a date not more than sixteen months prior to the meeting date;
2. An unaudited balance sheet of the adviser no less current than nine months from the date of the adviser's audited balance sheet included in the proxy statement;
3. A representation by the adviser that, since the date of the unaudited balance sheet, there has been no material adverse change in the financial condition of the adviser; and
4. A statement that proxies solicited for the shareholders' meeting will not be voted for the approval of proposals presented unless in the judgment of the board of directors of the investment company there has been no material adverse change in the financial condition of the adviser between the date of the unaudited balance sheet and the adviser's most recent fiscal year ending prior to the meeting date.

See Dreyfus Connecticut Municipal Money Market Fund and Michigan Money Market Fund, pub. avail. Dec. 5, 1990.

II. Substantive Comments

A. Name of Registrant

1. Use of "Guaranteed" or "Insured"

In a recent letter, the staff advised registrants of the Commission's serious concern over the use of terms such as "guaranteed" or "insured" in the names of investment companies investing in U.S. government securities. Typically, but not necessarily, the names of these funds will also include a reference to the government, such as "United States" or "U.S. Government." The use of terms such as "guaranteed" or "insured" in the name of a government fund may mislead investors into believing that the value of fund shares is guaranteed or insured by the United States Government. Government funds and series having such terms in their names should take immediate action to remove them. The staff will not accelerate the effective date of a registration

statement for a government fund that has one of these terms in its name. Furthermore, investment company advertisements should not imply that the company's shares are guaranteed or insured by the United States Government. (See Letter to Registrants from Gene A. Gohlke, Acting Director, Division of Investment Management, and William R. McLucas, Director, Division of Enforcement (Oct. 25, 1990).)

2. Country, International, and Global Funds

A registrant which includes the name of a country in its name should have an investment policy requiring it to invest at least 65 percent of the value of its total assets in that particular country under normal market conditions.

A registrant which includes the terms "international" or "global" in its name should have an investment policy which requires that, under normal market conditions, at least 65 percent of the value of its total assets be invested in a way that reflects an international (multi-national) or global (worldwide) character of the portfolio. The staff has suggested that a global fund should have a policy requiring investment in at least three different countries and that an international fund should have a policy requiring investment in at least three different countries outside the United States. The staff would consider words such as "world" or "atlas" used in a fund name to be equivalent to "global."

3. Series Companies

When a series is added to a registration statement, the name of that series and its investment objective and policies should not be inconsistent with those implied by the registrant's name. For example, if the registrant's name implies that it will invest at least 80 percent of its assets in municipal obligations, the name and investment policies of each series should be consistent with that name.

B. Concentration and Diversification Policies Regarding Foreign Government Securities

Securities issued by a foreign government, its agencies and instrumentalities ("foreign government securities") are not considered "government securities" as defined in the 1940 Act. For diversified companies, these securities should be included as "other securities" for purposes of Section 5(b)(1). In identifying an "issuer" of a foreign government security for purposes of Section 5(b)(1), the staff applies the criteria for identifying the issuer discussed in Investment Company Act Release No. 9785 (May 31, 1977) relating to municipal securities.

In addition, foreign government securities may not be excluded from a registrant's concentration policy. A registrant may not reserve freedom of action to concentrate in securities issued by a foreign government without clearly indicating when and under what specific conditions any changes between concentration and non-concentration will be made.

C. Junk Bond Risks

A registrant that invests or intends to invest all or a portion of its assets in high-yielding securities ("junk bonds") should prepare disclosure in accordance with guidelines issued by the Division. (See Letters from Carolyn B. Lewis to Investment Company Registrants (Oct. 3, 1989) and the Investment Company Institute (Feb. 23, 1990); see also Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Release Nos. 33-6835, 34-26831, IC-16961 (May 18, 1989) ("MD&A Releases").)

With respect to advertising, registrants should refer to the letter recently sent by the Division to all investment companies regarding recent market developments and junk bond fund yields. (See Letter to Registrants from Gene A. Gohlke, Acting Director, Division of Investment Management (Oct. 16, 1990).)

D. Money Market Funds

Money market funds relying on rule 2a-7 may purchase only those portfolio instruments which meet the quality and maturity requirements of the rule. To satisfy the quality standards imposed by the rule, each portfolio instrument must be denominated in United States dollars and must also be an instrument which (1) the fund's board of directors has determined presents minimal credit risks to the fund, and (2) is rated "high quality"[6] by a major rating service or, if the security is unrated, is determined by the board to be of comparable quality. In a letter dated May 8, 1990, regarding credit analysis of portfolio securities, the Division reminded money market fund boards of directors of their responsibility for the quality of portfolio instruments. The Commission has stated that a board of directors may delegate the daily function of determining quality to the investment adviser provided that the board retains sufficient oversight.[7]

In July, the Commission proposed amendments to rule 2a-7 to (a) tighten certain of the rule's risk-limiting conditions, and (b) prohibit an investment company that does not meet these conditions from holding itself out as a money market fund or its equivalent. The staff soon will be making a recommendation to the Commission concerning final action on the proposed rule amendments.

E. Organization Expenses

If a registrant capitalizes its organization expenses, it should account for them in a separate footnote to the financial statements filed as a part of the registration statement. Organization expenses generally are amortized over the period of benefit, but not for more than sixty months from the commencement of operations. The staff will expect registrants to use the straight-line method unless the registrant demonstrates that another systematic and rational method is more appropriate. If any of the original shares are redeemed by their holders prior to the end of the amortization period, the redemption proceeds should be reduced by the pro rata share of the

[6]*The term "high quality" means that the instrument, if rated, must have been given one of the two top ratings by a major rating service. See Investment Company Act Release No. 13380 (July 11, 1983).*

[7]Id. *at note 5.*

unamortized expenses as of the date of redemption. The pro rata share by which the proceeds are reduced is derived by dividing the number of original shares redeemed by the total number of original shares outstanding at the time of redemption. Reimbursement of the registrant for the amount of the pro rata share should not be used in lieu of reduction of redemption proceeds.

In the event of a liquidation or dissolution not involving a transfer of assets, amortization of organization expenses should cease no later than the date as of which liquidation or dissolution is probable. The remaining unamortized organization expenses should reduce the redemption proceeds for initial shareholders as described above.

Organization expenses of target companies in mergers and other similar transactions involving the transfer of assets ordinarily should not be a part of the assets transferred. Rather, amortized organization expenses should reduce redemption proceeds of the initial shares of the target fund. Amortization of these expenses should not continue past the date of merger or other similar transaction.

F. Rule 144A

An open-end investment company should not invest more than ten percent of its net assets in illiquid securities.[8] Rule 144A securities are restricted securities that ordinarily would be subject to the ten percent limitation. However, the Commission, in adopting rule 144A, allowed the boards of directors of funds the flexibility to determine, in appropriate circumstances, that specific rule 144A securities are liquid and not subject to the ten percent limitation. (See Securities Act Release No. 33-6862 (Apr. 23, 1990).)

Funds that intend to invest in rule 144A securities and treat them as liquid when the directors believe it is appropriate to do so should include additional risk disclosure concerning rule 144A securities. This disclosure should include a discussion of the nature of rule 144A securities, the role of fund boards of directors in determining whether or not such securities are liquid for purposes of the ten percent illiquid asset limitation, and the factors that the board will take into account in determining whether a rule 144A security is liquid (e.g., trading actively, availability of reliable price information, and other relevant information). The disclosure should also state that investing in rule 144A securities could have the effect of increasing the level of fund illiquidity to the extent that qualified institutional buyers become, for a time, uninterested in purchasing these securities.

G. Redemption Charges

If a charge is imposed for the transfer of redemption proceeds by wire, a footnote to the fee table should identify the charge. If an account close-out fee (a type of redemption fee) is imposed, it must be listed as a shareholder transaction expense in the fee table.

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[8] *Investment Company Act Release No. 5847 (Oct. 21, 1969). Current interpretive guidance provided by the Commission relating to the financial reporting of restricted securities can be found in Section 404.04 of the Codification of Financial Reporting Policies.*

III. Other Matters

A. Repurchases of Shares by Closed-end Companies

A closed-end company contemplating share repurchases in the secondary market or through tender offers should disclose:

1. That there is not assurance the board of directors will decide to undertake tender offers or, if undertaken, that tender offers will reduce market discount;
2. That the market price of the fund's shares is based on, among other things, supply, demand, investment performance, and yield;
3. How often the board of directors will consider tender offers;
4. That tender offers will decrease total assets of the fund and therefore have the likely effect of increasing the fund's expense ratio;
5. That interest on any borrowings made to finance tender offers will increase fund expenses;
6. Any objective standards that the board of directors will consider that would result in not proceeding with the offer (e.g., loss of Subchapter M Status, unavailability of cash to finance the offer except though borrowings that would exceed statutory or policy limits).

A closed-end company conducting a tender offer for its own shares must comply with the requirements of the 1934 Act as well as the 1940 Act. It should make certain that no record dates are specified so that all shareholders may participate in the offer until the close of the offer period. The price should be set at net asset value as of the close of business on the date the offer ends. Any service fees imposed in connection with the offer should not be deducted from the consideration paid. Procedures also must be established to allow shareholders to ascertain the current net asset value per share throughout the offering period. If borrowings are made to finance tender offers, the company must comply with the 1940 Act asset coverage requirements and its borrowing policy.

Before undertaking any tender offer, the company should contact both the Office of Trading Practices of the Division of Market Regulation and the Office of Tender Offers of the Division of Corporation Finance concerning compliance with Section 13(e)(4) of the 1934 Act.

B. Substitution of Portfolio Securities by Unit Investment Trusts

In some cases, a trust indenture may permit the sponsor of a unit investment trust to direct the trustee to dispose of portfolio securities and substitute new securities. A trust is not permitted to sell securities and reinvest the proceeds in substitute securities solely on the basis of a decline in value of a portfolio security caused by general market or industry conditions. A decline in price may be used as grounds for selling a particular portfolio security and reinvesting the proceeds in substitute securities only when the price decline is a direct result of serious adverse credit

factors affecting the issuer of that security which, in the opinion of the sponsor, would make the retention of the security detrimental to the trust of its unitholders.

We hope this letter will assist you in preparing filings in 1991. Of course, it is not intended to replace the comment process. Any questions about specific investment company filings should be directed to the staff member responsible for reviewing the documents.

Sincerely,

Carolyn B. Lewis
Assistant Director

January 17, 1992

Dear Registrant:

The Division of Investment Management has prepared this letter to assist investment company registrants in preparing disclosure filings in 1992. It covers disclosure developments since January 3, 1991 when the last "generic comment letter" was issued. These comments represent the views of the staff of the Division of Investment Management and are not necessarily those of the Securities and Exchange Commission (the "Commission"). They are intended to assist registrants in preparing disclosure documents and are not considered to be of precedential value in any court or other official forum.

I. Filing Requirements

A. Filing Fee Increase

Effective October 29, 1991, fees paid under Section 6(b) of the Securities Act of 1933 (the "1933 Act") increased to 1/32 of 1% of the maximum aggregate price at which the securities being registered will be offered. All investment company registrants filing after October 28, 1991 under Rules 24e-2, 24f-1 and 24f-2 under the Investment Company Act of 1940 (the "1940 Act") must pay fees based on the new rate.

B. Rule 24f-2 Requirements

Occasionally, registrants have missed deadlines for registering shares and calculating fees under Rule 24f-2. Registrants are reminded that the fee offset from the "netting" of redemptions can only be used if the 24f-2 Notice is received by the Commission within two months (not 60 days) after the close of the registrant's fiscal year. For example, the 24f-2 Notice for an investment company with a fiscal year-end of December 31 must be received by the Commission on or before the last day of February for redemptions to be netted against sales in calculating the fee. It is the responsibility of registrants to use a means of delivery that will assure Commission receipt of the filing before the deadline. Registrants should maintain a record of transmittal and receipt.

C. Combined Prospectuses

Registrants may use prospectuses that combine disclosure relating to funds that are registered separately under the 1940 Act. However, because the funds are registered separately, each fund must file with the Commission a separate registration statement. To assure proper processing of each registration statement, the facing page should contain, over the caption "Exact Name of Registrant", the name of the fund to which the filing number relates. (This paragraph does not apply to filings which may be made under Rule 429 of the 1933 Act where there is only one 1940 Act registrant.)

Registrants using combined prospectuses should include a statement that there is a possibility that one fund might become liable for any misstatement, inaccuracy, or incomplete disclosure in the prospectus concerning the other fund.

D. Form N-14 and Rule 488

Registrants filing registration statements on Form N-14 to register securities to be used in mergers, consolidations, and other business combination transactions may elect to use Rule 488 under the 1933 Act to designate an automatic effective date for the registration statement (thirty to fifty days after filing). However, Rule 488 also provides for the suspension of the effective date by the Commission if it appears to the Commission that the registration statement may be incomplete or inaccurate in any material respect. Thus, a registrant that makes a Rule 488 filing that is incomplete (e.g., required financial statements or exhibits are missing) or that requires material revision to the disclosure will need to file a pre-effective amendment prior to the automatic effective date or the effective date of the filing will be suspended by the Commission. An amendment filed under Rule 488 is deemed to begin a new automatic effective day period.

The necessity to file a pre-effective amendment under Rule 488 to delay the effective date of the registration statement results in an inefficient us of time and resources by both the registrant and the Commission staff. Accordingly, registrants are advised to make sure that Form N-14 registration statements are complete and accurate before making a filing under Rule 488. In cases where required items are not available at the time of initial filing or where extensive disclosure revisions are anticipated, registrants should consider filing Form N-14 under Rule 473 of the 1933 Act, rather than under Rule 488.

E. Omission of Adviser's Balance Sheet

Absent special circumstances, the investment adviser's balance sheet may be omitted from proxy statements under rule 20a-2(a)(9) under the 1940 Act if the adviser's gross revenue from all services performed for registered investment companies is less than 20% of the adviser's gross revenues. However, the adviser's balance sheet cannot be omitted from the proxy statement if the advisory agreement is being voted on by shareholders for the first time.

F. Proxy Comments

Under Investment company Act Release No. 13768 (February 15, 1984), registrants may print and mail proxies without first receiving any notice or comments from the staff if the preliminary proxy statement has been on file with the Commission for ten calendar days. Thus, if a registrant has not heard from the staff by the close of business on the tenth calendar day, the registrant is free to mail its proxies. If the staff intends to comment on the preliminary proxy, the staff will, before the end of the tenth day, either provide comments or alert the registrant that comments will be given.

II. Disclosure Comments

A. Index Funds

For purposes of Section 35(d) of the 1940 Act, an investment company or series that includes the work "index" in its name should be substantially invested in the securities of the underlying index. The fund or series also should have a policy of weighing its portfolio so as to approximate the relative composition of the securities contained in the index. The prospectus for

such an index fund or series should disclose: (a) the standard used to track accuracy with the index (e.g., what correlation coefficient is used); (b) how tracking accuracy will be monitored; and (c) what steps will be taken if tracking accuracy is not maintained.

B. Money Market Funds

If a registrant holds itself out as a money market fund, Item 1(a)(vi) of Form N-1A requires the outside cover page of the prospectus to contain a prominent statement that (A) an investment in the fund is neither insured nor guaranteed by the U.S. Government and (B) there can be no assurance that the fund will be able to maintain a stable net asset value of $1.00 per share (or, if other than $1.00, the applicable net asset value). The two disclaimers required by Item 1(a)(vi) should appear together in the order specified by the Item. The statement will be prominent if it appears in some typographically distinctive manner (e.g., boldface, italics, red letters, etc.).

C. Third Party Fees

Certain investment company shares are offered exclusively through banks and other financial institutions each of which provides a variety of services at varying fees to customers. While these services may nor may not be fund-related, the fees associated with them must be paid by customers of the financial institution in order to purchase fund shares. In these circumstances, registrants should add a footnote to the fee table to apprise investors that such fees exist. Registrants that do not already include this disclosure in their prospectuses should add it in the next updating amendment.

In circumstances where there is only one institution levying the additional fee (e.g., where shares are offered through a cash management account), or where the fund is designed to be offered primarily by a fund affiliate which charges an additional fee, the fee may have to be included as an item in the fee table.

D. Exculpatory Language Concerning Telephone Transactions

Some fund prospectuses and application forms contain disclaimers that the registrant, shareholder servicing agent, or transfer agent will not be liable for following instructions for telephone exchange or redemption transactions that prove to be fraudulent and will not be responsible for verifying the authenticity of instructions. The Division of Market Regulation, which administers the provisions of the Securities Exchange Act of 1934 relating to transfer agents, and the Division of Investment Management have questioned whether this type of disclaimer is permitted under applicable law.

Until the issue is resolved, the following disclosure should be added to prospectuses of funds that provide for such disclaimers:

(a) a clear description of the registrant's policy with respect to exculpation from liability in the event of a fraudulent telephone exchange or redemption transaction;

(b) a statement that the investor, as a result of this policy, will bear the risk of loss; and,

(c) a statement that the staff of the Securities and Exchange Commission is currently considering the propriety of such a policy.

E. Investment Policies and Rule 144A

In adopting Rule 144A under the 1933 Act, the Commission stated that the determination by an open-end investment company of the liquidity of securities eligible for resale under Rule 144A is a question of fact for the board of directors to determine, based upon the trading markets for the specific security. See Securities Act Release No. 6862 (April 23, 1990).

Some funds have fundamental policies prohibiting them from investing in restricted securities or securities subject to legal or contractual restrictions on resale. A security eligible for resale under Rule 144A falls within one of these categories. Therefore, a fund or series having such a policy must change the policy before investing in Rule 144A securities. If the policy is a fundamental policy, the change must be submitted to shareholders for approval. If the policy is non-fundamental, the board of directors may approve the change in policy. Once the policy is changed, the prospectus should be revised to disclose the fund's policy of investing in Rule 144A securities and the board of directors' duty to determine the liquidity of securities.

The board of directors is not required specifically to approve and review each Rule 144A security selected by the investment adviser for the fund's portfolio. The board is responsible for developing and establishing guidelines and procedures for determining the liquidity of Rule 144A securities and monitoring the investment adviser's implementation of the guidelines and procedures.

F. Segregated Accounts

To comply with 1940 Act requirements concerning senior securities, a fund engaging in certain transactions involving options, futures, short sales, reverse repurchase agreements, and forward contracts on foreign currencies may "cover" its positions by establishing a segregated account. See Investment Company Act Release No. 10666 (April 18, 1979) and Dreyfus Strategic Investing and Dreyfus Strategic Income, SEC No-Action Letter (pub. avail. June 22, 1987). Release No. 10666 requires that these segregated accounts be established and maintained with the fund's custodian and that they contain only liquid assets, such as cash, U.S. Government securities, or other liquid high grade debt obligations. Equity securities cannot be used in segregated accounts. A fund should disclose in its statement of additional information the kinds of assets that will be placed in a segregated account and the fact that the segregated account will be maintained with the fund's custodian.

III. Recent Revisions of Staff Positions

A. Section 12(d) and CMOs

During the last year the staff modified its position on whether issuers of collateralized mortgage obligations (CMOs) that have received exemptive orders under Section 6(c) are subject to

the investment limitations of Section 12(d)(1) of the 1940 Act. In The Blackstone Income Trust Inc., SEC No-Action Letter (pub. avail. February 8, 1991), the staff stated it would not recommend enforcement action if a registered investment company acquires securities issued by "Exempted Issuers" without treating the securities as being subject to the limits on the acquisition and ownership of investment company securities in Section 12(d)(1)(A). "Exempted Issuers" are unmanaged fixed-asset issuers that invest primarily in mortgage-backed securities, do not issue redeemable securities as defined in Section 2(a)(32) of the 1940 Act, operate under general exemptive orders exempting them from "all provisions of the Act," and are not registered or regulated under the 1940 Act as investment companies.

B. Municipal Lease Obligations

In a letter to the Investment Company Institute dated June 21, 1991 the staff modified its position on whether municipal lease securities are illiquid. The letter states that an open-end investment company may determine to treat municipal lease obligations as liquid under guidelines established by the board of directors. Determinations concerning the liquidity and appropriate valuation of a municipal lease obligation should be made based upon all relevant factors, such as the frequency of trades and quotes for the obligation, the number of dealers willing to purchase or sell the security and the number of potential buyers, the willingness of dealers to undertake to make a market in the securities, and the nature of the marketplace trades. The letter sets forth additional factors unique to municipal lease obligations that should be considered.

C. Liquidity of IOs and POs

Recently, the staff modified its position on the liquidity of interest-only and principal-only fixed mortgage-backed securities ("IOs" and "POs") issued by the United States Government or its agencies and instrumentalities. Previously the staff took the position that open-end investment companies should count these securities in the ten percent limit on illiquid securities.

In light of the evolution of the relevant markets, the staff now takes the position that the determination of whether a particular government-issued IO or PO backed by fixed-rate mortgages is liquid may be made under guidelines and standards established by the board of directors. Such a security may be deemed liquid if it can be disposed of promptly in the ordinary course of business at a value reasonably close to that used in the calculation of the net asset value per share.

We trust that this letter will assist you in preparing filings in 1992. Of course, it is not intended to replace the disclosure comment process. Any questions about specific company filings should be directed to the staff member responsible for reviewing that company's documents.

Sincerely,

Carolyn B. Lewis
Assistant Director

February 22, 1993

Dear Registrant:

The Division of Investment Management has prepared this letter to assist investment company registrants in preparing disclosure filings in 1993. These comments represent the views of the staff of the Division of Investment Management and are not necessarily those of the Securities and Exchange Commission (the "Commission") and should not be considered of precedential value in any court or other official forum. The comments in this letter apply to filings made on Forms N-1A, N-2, and S-6, unless otherwise indicated.

This letter covers disclosure development since January 17, 1992 when the last "generic comment letter" was issued. The prior generic comment letters dated January 11, 1990, January 3, 1991, and January 17, 1992 are now publicly available and may be obtained for a fee by calling the Public Reference Branch at (202) 272-7450.

I. Filing Procedures

A. Information Provided in Transmittal Letters

We request that registrants include the following information in transmittal letters accompanying filings:

(i) for all filings: the Investment Company Act of 1940 file number assigned to the registered investment company making the filing (this will be a number with an 811-, 813-, or 814- prefix) and the Securities Act of 1933 File number (a number with a 2- or 33- prefix);

(ii) for filings introducing or adding new series: the number of new series included in the filing and the name of each;

(iii) for UIT pricing amendments filed under Rule 487: the number and name of each series included;

(iv) for open-end management investment companies: which of the new series are money market funds, and of those, which are taxable and non-taxable.

Provision of this information is voluntary. We appreciate that many registrants currently provide some of this information in transmittal letters. Providing this information on a standard basis will assist the staff significantly in reviewing filings and keeping track of investment company and series registrants.

B. Deficient Filings

Registrants should ensure that all requirements of applicable statutes, rules, forms, guides and other staff and Commission positions are met when filing initial registration statements

(including pre-effective amendments) and post-effective amendments. The staff responds to deficient filings on a case-by-case basis. In cases where a registration statement, pre-effective amendment, or post-effective amendment is so poorly prepared or otherwise presents serious problems, the staff will defer its review of the filing and request that the registrant withdraw or amend the filing.

II. Disclosure Comments

A. "Country" Funds

The generic comment letter dated January 3, 1991 stated that a registrant that includes the name of a country in its name should have an investment policy requiring it to invest at least 65 percent of the value of its total assets in that particular country under normal market conditions. The question naturally arises as to the manner of determining the domicile or nationality of specific issuers. The staff has permitted registrants to include as assets that qualify under this 65 percent test the securities of issuers:

(1) which are organized under the laws of that country;

(2) for which the principal securities trading market is in that country; or

(3) which derive a significant proportion (at least 50 percent) of their revenues or profits from goods produced or sold, investments made, or services performed in the eponymous country or which have at least 50 percent of their assets situated in that country.

The staff will consider other criteria offered by registrants to determine the domicile or nationality of an issuer.

B. Rights Offering of Closed-End Funds

In recent years a number of closed-end funds have made rights offerings priced below net asset value to their existing shareholders. For purposes of Section 23(b)(1) of the Investment Company Act, a transferable rights offering made by a closed-end investment company at a price below current net asset value is deemed to be "in connection with a offering to the holders of one or more classes of its capital stock" if it meets three guidelines:

(i) the offering fully protects shareholders' preemptive rights and does not discriminate among shareholders (except for the possible de minimis effect of not offering fractional rights);

(ii) management uses its best efforts to ensure a adequate trading market in the rights for use by shareholders who do not exercise such rights; and,

(iii) the ratio of the offering does not exceed one new share for each three rights held.

See Association of Publicly Traded Investment Funds (pub. avail. August 2, 1985) and Pilgrim Regional Bank Shares, Inc. (pub. avail. December 11, 1991).

The cover page of the prospectus of a rights offering should state that the offering may substantially dilute the aggregate net asset value of the shares owned by shareholders who do not fully exercise their rights and that these shareholders should expect, upon completion of the offering, to own a smaller proportional interest in the company than before the offering.

The prospectus of any rights offering should provide an example showing the extent of the dilutive effect when the subscription price is below the net asset value on the pricing date.

C. Use of Directed-Brokerage Arrangements to Pay Fund Expenses

Several funds have entered into agreements with brokers whereby brokers pay designated fund expenses if brokerage commissions generated by the funds reach specified levels. Because brokerage commissions are not reflected in fund expenses, certain expenses may not be fully set forth in the fund's fee table, per share table, and financial statements and may thus appear lower than they actually are. The staff is examining the need to change Regulation S-Z so that the fee tables, per share tables, and financial statements accurately reflect the effect of directed-brokerage arrangements on fund expenses. A fund should disclose clearly in the footnotes to its fee table, per share table, and financial statements its participation in directed-brokerage arrangements and the effect these arrangements may have on the level of brokerage commissions paid by the fund. To the extent practicable, the fund shall also quantify the effect of directed-brokerage arrangements on fund expenses.

In addition, registrants should be aware that the staff believes that the receipt by an adviser of any direct or indirect economic benefit from a directed-brokerage arrangement, e.g., a reduction in expenses required to be reimbursed by the adviser, would almost certainly violate Section 17(e)(1) of the Investment Company Act.

D. Fee Table

Some registrants are incorrectly calculating the "Example" portion of the fee table in Item 2 of Form N-1A. The proper method was described in a document entitled "Questions and Answers Regarding Fee Table" distributed by the Division at the SEC Advertising Rule and Fee Table Workshop held in Washington, D.C. on March 7, 1988. This document is available for a fee from the Public Reference Branch. A copy of an illustration of the correct method of calculation provided to investment companies at that time is attached as an appendix to this letter.

E. Amendments to the NASD's Rules of Fair Practice

In 1992, the Commission approved amendments to the National Association of Securities Dealers' (NASD's) Rules of Fair Practice (Securities Exchange Act Release No. 30897, July 7, 1992), that impose limits on mutual fund sales charges, including asset-based sales charges (i.e.,

Rule 12b-1 fees) and contingent deferred sales charges. The amendments also prohibit any fund with a front-end, deferred, or asset-based sales charge to be referred to as "no loan", except that a fund with neither a front-end load nor a deferred sales charge and a Rule 12b-1 fee that does not exceed .25 percent of average annual net assets may use the term "no load". In addition, any fund that imposes an asset-based sales charge must disclose, adjacent to the fee table in the prospectus, that long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charges permitted by the NASD. The amendments will become effective on July 7, 1993.

The staff believes that post-effective amendments filed to add disclosure to comply with the amendments to the NASD's Rules of Fair Practice, and which otherwise qualify to be filed under paragraph (b) of Rule 485, may be filed under that paragraph. A registrant that changes its fee structure to conform with the amendments, however, should do so by filing a post-effective amendment under Rule 485(a).

F. Comparisons by Non-Money Market Funds

Comparisons of the performance of non-money market funds with that of money market funds and other investments (for example, certificates of deposit) should clearly distinguish between the risks of the investments compared. For example, wherever an income fund represents in its registration statement that it may realize higher yields than a money market fund it should also state that, unlike money market funds, it does not seek to maintain a stable net asset value and may not be able to return dollar-for-dollar the money invested. For comparisons to certificates of deposit, the prospectus should disclose that the investment in fund shares is not insured by the Federal Deposit Insurance Corporation.

G. Municipal Lease Obligations

In a letter to the Investment Company Institute dated June 21, 1991 the staff modified its position on whether municipal lease obligations are per se illiquid and stated than an open-end investment company may treat these obligations a liquid under guidelines established by the board of directors. The letter set forth the staff's view that a fund investing more than five percent of its net assets in municipal lease obligations must disclose in its prospectus the factors considered by its board of directors in determining the liquidity and proper valuation of these obligations. Upon further experience, the staff has concluded that registrants may disclose such factors in the Statement of Additional Information rather than the prospectus.

Of course, registrants that invest, or intend to invest, more than 5 percent of their net assets in municipal lease securities should discuss the risks inherent in such investments in the prospectus. See Item 4(b)(ii) of Form N-1A and Guide 3 thereto. In such a case, the possibility that a municipality will not appropriate funds for lease payments should be specified as a risk peculiar to municipal lease obligations. Where a fund proposes to purchase unrated municipal leases, the fund should state in the prospectus that the fund's board will be responsible for determining the credit quality of such leases, on an ongoing basis, including an assessment of the likelihood that the lease will not be cancelled.

H. Hub and Spoke Funds

An increasing number of funds are electing to use a "hub and spoke" structure for portfolio management and distribution. In these arrangements (also known as "master-feeder" or "core-feeder" funds), a hub holds and manages the investment portfolio while one or more spokes offers shares to the public and invests all of its assets in the "hub" fund. The registration statement for the spoke should include all information required by Form N-1A as if the distribution function of the spoke and the management function of the hub were contained in a single fund. In addition, the prospectus should described any unique features of these arrangements. In particular, the staff looks for the following disclosure regarding these arrangements:

(a) A general description of the hub and spoke structure on the cover page of the prospectus and how it differs from a traditional mutual fund. For example, the disclosure should explain that the spoke fund intends to achieve its investment objective by investing exclusively in another investment company rather than in a portfolio of securities, and that its investment experience will correspond directly with the investment experience of the hub.

(b) Information regarding the hub fund, including:

(i) its investment objectives and policies;

(ii) its management and administration including its investment adviser, administrator, custodian and any other persons providing services to the hub fund; and

(iii) its financial statements, including its balance sheet, statement of operations, statement of changes in net assets, and schedule of investments.

(c) A statement that other mutual funds may invest in the hub fund and that their expenses and, correspondingly, their yields/returns may differ from those of the spoke fund. The prospectus should also include a telephone number for information regarding the availability of other spoke funds.

(d) A unified fee table disclosing all fees of both funds. The brief narrative following the fee table should explain that the table summaries both hub and spoke expenses and should refer to the text of the prospectus for a detailed description of these expenses.

(e) A discussion of the factors considered by the directors of the spoke fund including:

(i) whether the directors/trustees of the spoke fund believe that it will achieve any economies of scale by investing in the hub fund; and

(ii) whether the aggregate of the fees assessed at the hub and spoke levels will be more or less than if the spoke invested directly in the securities held by the hub.

(f) A discussion of the pass-through voting procedures followed by the spoke fund when the hub fund requests a vote of its security holders (i.e., the spoke funds).

(g) The consequences in the event a spoke fund is required to redeem its shares of the hub because its shareholders do not approve a change in the spoke's investment objectives parallel to changes approved for the hub by a majority of shareholders of all spoke funds. The spoke's inability to find a substitute hub or equivalent investment management could have a significant impact upon its shareholders' investments.

The spoke fund, the hub fund, and the directors and principal officers of both funds should sign the registration statement under the Securities Act of 1933. The facing page of the registration statement should state that the hub fund has executed the registration statement.

If a traditional open-end fund elects to convert to a hub and spoke arrangement, the conversion will not constitute a change in the fund's fundamental policy if: (1) the fund had reserved in its prospectus the right to undertake this conversion in the future; and, (2) it does not have a fundamental policy that is otherwise inconsistent with investing in the securities of a hub fund. The fund may look through to the hub's investments to determine consistency with its fundamental policies of diversification and concentration.

I. Options and Futures

In the generic comment letter dated January 11, 1990, registrants were encouraged to abbreviate their prospectus disclosure concerning options and futures transactions in the interest of prospectus simplification. This change should not be interpreted as encouraging the elimination of pertinent risk disclosure from the prospectus.

The amount of the registrant's net assets that are at risk for purposes of determining whether "more than five percent of net assets are at risk" is not limited to the initial amount of the registrant's assets that are invested in a particular practice, for example, the purchase price of an option. The amount of net assets at risk is determined by reference to the potential liability or loss that may be incurred by the registrant in connection with a particular practice. See Instructions to Item 8.4 of Form N-2, Investment Company Act Release No. 19115 (November 20, 1992), effective January 1, 1993, 57 F.R. 56826. Examples of the risks that should be considered include, but are not necessarily limited to, the following:

(1) Options and futures may fail as hedging techniques in cases where the price movements of the securities underlying the options and futures do not follow the price movements of the portfolio securities subject to the hedge.

(2) The loss from investing in futures transactions is potentially unlimited.

(3) Gains and losses on investments in options and futures depend on the portfolio manager's ability to predict correctly the direction of stock prices, interest rates, and other economic factors.

(4) The fund will likely be unable to control losses by closing its position where a liquid secondary market does not exist.

J. Bank Affiliated ("Private Label") Funds

Certain investment company shares are offered exclusively by or through a banking institution. For such offerings, prominent disclosure should be made on the cover page of the prospectus that the shares are not deposits or obligations of, or endorsed or guaranteed by, the bank nor are they federally insured by the Federal Deposit Insurance Corporation or any other agency. The disclosure will be considered prominent if it appears in some typographically distinctive manner (e.g., boldface, italics, red letters, etc.).

K. Experts

A company that provides general information about issuers, including investment companies, to the public and whose services are not procured by a particular fund to assign the fund a rating is not considered by the staff to be an "expert" under Section 7 of the 1933 Act. Accordingly, filings that refer to rankings provided by a company such as Morningstar, Inc. do not have to be accompanied by a written consent from the company.

When a ranking is used in the prospectus, Statement of Additional Information, or an advertisement, it should be accompanied by a statement that past performance is no guarantee of future results as well as a simple, brief explanation of the manner in which the ranking is calculated. The fund should disclose whether the ranking takes into account sales loads and other fees and charges. A ranking from whatever source should be current.

III. Recent Staff Positions

A. Undertakings

In a letter to the Investment Company Institute dated November 6, 1992, the staff announced that funds will no longer be asked to include in their registration statements undertakings to hold a shareholders' meeting to elect a board of directors and to approve the fund's investment advisory contract and Rule 12b-1 plan, if any, or to ratify the board of directors' selection of independent public accountants.

If a fund has made no sales to the public (i.e., its only sales are to initial shareholders) it can file a post-effective amendment to withdraw the undertaking. The Division has stated that it considers any attempt by a fund to delete its obligation to hold a shareholders' meeting ineffective as to current shareholders if it has made the undertaking and sold its shares to the public. However, a fund may determine, relying on the opinion of counsel and considering its particular circumstances, that its undertaking is not material or that its shareholders did not rely upon the undertaking. On that basis, the fund may decide to forego conducting the meeting and delete the undertaking by post-effective amendment. See the letter to William M. Tartikoff, General Counsel, The Calvert Group (pub. avail. January 7, 1993).

B. Illiquid Investments by Non-Money Market Funds

In March 1992, the Commission revised the Guidelines to Form N-1A to increase the amount of illiquid securities that funds (other than money market funds relying on rule 2a-7) may hold from ten percent to fifteen percent.[9]

The staff will not object if a fund files a post-effective amendment to its registration statement under rule 485(b) to reflect that it has revised its investment policies to raise its illiquidity ceiling in accordance with the new guidelines, provided the amendment otherwise qualifies for filing under paragraph (b).

IV. Regulation and Compliance

A. SAI Delivery Requirements

The Commission and state regulatory authorities continue to receive complaints from investors who have had difficulty in obtaining copies of the Statement of Additional Information from investment companies. Registrants are reminded that, under Item 1(a)(iii) of Form N-1A, a Statement of Additional Information must be made available upon request and without charge. Standards for prompt and expeditious delivery are set forth in Forms N-2 and N-14.[10] Open-end investment companies are implicitly held to the standards of prompt delivery that are explicitly required by Forms N-2 and N-14. Complaints about repeated delays in delivering Statements of Additional Information will be referred by the staff to the Division of Enforcement for appropriate action.

B. Use of Performance Data In Rule 482 Advertisements

Discussions in a fund's advertisement about the performance of any entity related to the fund such as its adviser (i.e., other funds or private accounts managed by the adviser) is not consistent with the provisions of Rule 482 under the 1933 Act, even though the information appears in the fund's registration statement, prospectus, Statement of Additional Information, or accompanying sales literature. See footnote 31, Investment Company Act Release No. 16245 (February 2, 1988).

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[9]*Investment Company Act Release No. 18612 (March 12, 1992). The revision does not apply to money market funds relying on rule 2a-7. See Letter to Matthew P. Fink, President, the Investment Company Institute dated December 9, 1992.*

[10]*General Instruction H of Form N-2 requires closed-end investment companies to send the Statement of Additional Information by first class mail or other means to ensure equally prompt delivery within two business days of receipt of a request. General Instruction F of Form N-14 provides that the Statement of Additional Information with respect to securities so registered be sent within one business day of receipt of a request and must be sent by first class mail or other means designed to ensure equally prompt delivery.*

The performance of related funds and private accounts may only be used in a prospectus or Statement of Additional Information or accompanying sales literature in the case where the fund itself does not have any performance history. See Growth Stock Outlook Trust, Inc. (pub. avail. April 15, 1986) for the conditions required in such cases.

C. "Gun Jumping"

Registrants, investment adviser, underwriters, and their respective directors, officers, employees, agents, and affiliates should exercise caution when discussing pending registration statements with representatives of the news media. The discussion of a new fund in interviews, in press conferences, or in speeches which are then reprinted, excerpted, quoted, or used in articles or broadcasts before the effective date of the fund's registration statement may constitute a "prospectus" under Section 2(10) of the 1933 Act that does not meet the requirements of Section 10 of the Act and thereby violates Section 5(b)(1). Such a violation is commonly referred to as "gun jumping". In such a case, acceleration of the effectiveness of the registration statement may be delayed and a "cooling off" period with a re-circulation of any preliminary prospectus may be required.

V. Money Market Funds

A. Investments in Illiquid Securities

In a letter dated December 9, 1992 to the Investment Company Institute, the staff expressed its conclusion that the Commission did not intend to include money market funds among those funds that may invest up to fifteen percent of their net assets in illiquid securities.[11]

B. Investments in Derivative Instruments

In a letter to the Investment Company Institute dated December 6, 1991, the staff expressed its concern about money market funds investing in highly volatile instruments known as "inverse floaters". The letter stated that an investment in inverse floaters amounts to a leveraging of a fund's portfolio which is a form of portfolio management that is highly inappropriate for a fund attempting to maintain a stable net asset value. The letter also stated that, although the face maturity of an inverse floater may be less than 397 days, such an investment will expose the money market fund to a degree of interest rate risk and volatility more characteristic of a long-term instrument.

Other instruments, such as ricochet floating rate notes and capped floaters, have emerged recently that combine short-term maturities with the higher interest rates (and volatility) of longer-term instruments. Capped floaters are floating rate instruments that become fixed income instruments after a preset interest cap has been reached. Ricochet floating rate notes are floating rate instruments that decline inversely when a benchmark rate (such as LIBOR) rises beyond a preset cap. Such instruments are just as inappropriate for money market funds as inverse floaters. Those purchasing these instruments for money market funds may be relying on a paragraph

[11] *See note 1,* supra.

(d)(1) of Rule 2a-7. That paragraph, and the Rule as a whole, limit the permissible portfolio instruments of a money market fund to instruments that have a low level of volatility to provide a greater assurance that the money market fund will continue to maintain a stable price per share that fairly reflects the current net asset value per share. See Investment Company Act Release No. 13380 (July 8, 1983). Any other interpretation would call into question the Commission's authority to exempt these portfolios from the mark-to-market accounting otherwise required by the Investment Company Act.

C. Investments in Other Money Market Funds

On occasion, registrants have raised questions about the circumstances under which a money market fund (the "fund") can invest in other money market funds under Rule 2a-7. The following guidelines are provided to assist registrants in the formulation of policies with respect to such investments.

a. The fund may treat shares of other money market funds as First Tier Securities, regardless of whether those money market funds themselves limit their investments to First Tier Securities. Nevertheless, the fund is required by Rule 2a-7(c)(3) to perform a minimal credit analysis when purchasing shares of another money market fund.

b. The fund does not have to "look through" the shares of the fund to the underlying instruments to determine compliance with the diversification or Second Tier Security limitations.

c. The fund should treat shares of other money market funds as having a rolling maturity of seven days, unless the fund has contractual arrangements with the money market fund for more rapid receipt of the pools of the redemption.

Of course, money market funds investing in other money market funds are subject to the limitations on such investments imposed by Section 12(d) of the Investment Company Act.

D. Diversification

Section 8 of the Investment Company Act requires a fund to recite the classification and subclassification, as defined in Sections 4 and 5 of the Act, within which the fund will operate. If it is a management company, it must recite whether it is closed-end or open-end and whether it is diversified or non-diversified, as defined by Section 5, of the Act. The diversification requirements of Section 5(b) are less restrictive than the diversification requirements under Rule 2a-7. The staff will allow a money market fund, otherwise in compliance with Rule 2a-7, to make its compliance with the rule an operating policy rather than a fundamental policy of the fund. Because such an operating policy is more restrictive than the fundamental policy, the prospectus of the fund should explain that (i) the fund will operate in accordance with the fund's operating policy which complies with Rule 2a-7, and (ii) the fundamental policy would give the fund the ability to invest, with respect to twenty five percent of the fund's assets, more than five percent of its assets in any one issuer only in the event that Rule 2a-7 is amended in the future.

VI. Financial Statements of Series Companies

Registered management investment companies are required to update financial statements in accordance with Rule 3-18 of Regulation S-X. Series company registrants are reminded that this requirement applies where series are added to prospectuses and/or Statements of Additional Information which already include data of other series. For example, if a prospectus or Statement of Additional Information adds information about a new series, the financial information for the existing series will be required to meet the updating requirement in such prospectus or Statement of Additional Information. This requirement also applies to registrants using prospectuses that combine disclosure relating to funds that are registered separately under the Investment Company Act.

VII. New Proxy Rules

The Shareholders Communications Improvement Act of 1990 (the "SCIA") amended the Securities Exchange Act of 1934 primarily to ensure that shareholder communications of investment companies registered under the Investment Company Act are delivered to shareholders whose shares are held in nominee name. The SCIA amended (a) Section 14(b)(1) of the 1934 Act to require brokers and banks holding shares in nominee name to transmit proxy materials and information statements to beneficial owners of securities of investment company issuers, and (b) Section 14(c) of the 1934 Act to require investment companies to furnish an information statement to shareholders where proxies are not solicited in connection with an annual or other meeting.

The final rules implementing the SCIA amendments were adopted in January, 1992, for Shareholder meetings held, or corporate action taken by consent or authorization, on or after March 31, 1992, with a record date on or after February 10, 1992. See Investment Company Act Release No. 18467 January 6, 1992).

In Exchange Act Release No. 31326 (October 16, 1992), the Commission amended the proxy rules in order to reduce regulatory impediments to communication among shareholders and to the effective use of shareholder rights. Among the significant provisions in those amendments, the following should be noted:

a. Item 21 of Schedule 14A now requires a description of the treatment and effect of abstentions and broker non-votes under applicable state law and the issuer's charter and by-law provisions.

b. Effective November 23, 1992, preliminary, proxy materials or information statements filed with the Commission are available for public inspection upon filing.

c. Amendments to Rules 14a-4(a) and (b)(1) require that the form of proxy provide for a separate vote on each matter presented rather than identifying groups of matters, as previously permitted. Separate voting on matters is intended to allow shareholders to express their views on each matter although the effectiveness of any proposal may be conditioned on the adoption of one or more other matters.

VIII. Investment Trusts

In a letter dated April 8, 1992 to sponsors of unit investment trusts, the Division of Market Regulation and this Division stated that, in the current interest rate climate, the promotion of unit investment trusts ("UITs") in the secondary market on the basis of "estimated current return" ("ECR") alone does not give investors full and fair information.

Brokers and others selling secondary market UITs to investors must make sure that investors are given full and fair information about the potential returns of UITs with high ECRs. Any quotation of a UIT's ECR should be accompanied by a quotation of the UIT's long-term yield or internal rate of return, if the ECR varies materially from the long-term return of the trust. This disclosure should be made in any prospectus, sales literature, and advertisements for shares of UITs offered in the secondary market, and in oral communications with potential investors. Secondary market prospectuses that only contain ECRs should be stickered to include the additional information.

However, "junk bond" UITs that advertise long-term yields should do so only in the context of an explanation of the limitations of the long-term figure. Junk bond UITs typically trade at a discount, reflecting the market's assessment that a portion of the portfolio is likely to default prior to maturity. The long-term return calculation assumes that the bonds in the portfolio will mature on schedule.

* * *

We hope that this letter will assist you in preparing filings in 1993. Of course, it is not intended to replace the disclosure comment process. You should direct any questions about specific company filings to the staff member responsible for reviewing that company's documents.

Sincerely,

Carolyn B. Lewis
Assistant Director

APPENDIX

FEE TABLE EXAMPLE

Fund A **4.5% sales load**
1.2% total fund operating expenses
1.0% redemption fee

Year	Amount Invested –	Sales Load =	Beginning Value +	(5%-1.2%)=	Ending Value	Avg Value x 1.2%=	Annual Expenses	Aggregate Expenses	Redemption Fee	Amounts Listed in Table
(1)	$1,000–	45=	955.00	36.29	991.29	973.15	11.68	56.68	9.91	$ 67
(2)			991.29	37.67	1028.96	1010.12	12.12	68.80		
(3)			1028.96	39.10	1068.06	1048.51	12.58	81.38	10.68	$ 92
(4)			1068.06	40.59	1108.65	1088.35	13.06	94.44		
(5)			1108.65	42.13	1150.78	1129.71	13.56	108.00	11.51	$120

February 25, 1994

Dear Registrant:

The Division of Investment Management has prepared this letter to assist investment company registrants in preparing disclosure filings in 1994. These comments represent the views of the staff of the Division of Investment Management and are not necessarily those of the Securities and Exchange Commission (the "Commission") and should not be considered of precedential value in any court or other official forum. The comments in this letter apply to filings made on Forms N-1A, N-2, N-14, and S-6 unless otherwise indicated.

This letter covers disclosure and procedural developments since February 22, 1993 when the staff issued its last "generic comment letter."

I. Filing Procedures

A. EDGAR Implementation

Mandated electronic filing on the Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") System began for some investment company registrants on April 26, 1993. See Rulemaking for EDGAR System—Investment Companies and Institutional Investment Managers, Investment Company Act Release No. 19284 ("Release No. 19284") [58 FR 14848 (Mar. 18, 1993)]. Under the current schedule, all investment company registrants must begin filing under EDGAR within the next two years. Registrants should consult the phase-in schedule for EDGAR filers published in Release No. 19284 and the phase-in and electronic filing rules found in Regulation S-T (17 CFR Part 232).

Registrants that file under EDGAR must file electronically: (1) all registration statements under the Securities Act of 1933 ("the 1933 Act") and the Investment Company Act of 1940 ("the 1940 Act"); (2) all proxy materials required to be filed with the Commission; (3) reports, including reports on Form N-SAR, required to be filed with the Commission under Section 30 of the 1940 Act; and (4) all other reports, forms, and schedules required to be filed by or with respect to investment companies under the Securities Exchange Act of 1934 ("the 1934 Act"). See Rule 101 of Regulation S-T.

For one year after a registrant's mandated phase-in date, or until expressly notified otherwise by the Commission, any registrant making filings on EDGAR must furnish the Commission with paper copies of its filings. The paper copies may be either traditional paper copies or computer print-outs of EDGAR filings (with all confidential information in the header omitted). The paper copies must include the legend required by Rule 902(g) of Regulation S-T and should be sent to OFICS Filer Support, SEC Operations Center, 6432 General Green Way, Alexandria, Virginia 22312-2413, and be received no later than six business days after the filing.

Questions regarding the EDGAR phase-in may be directed to Tony Vertuno, Division of Investment Management, at (202) 272-7710. Questions regarding the EDGAR rules may be directed to Ruth Sanders, Division of Investment Management, at (202) 272-7714 or to Mr. Vertuno.

B. Filing Fee Increase

The Commission's appropriation for the 1994 fiscal year was signed into law on October 28, 1993. It changed the filing fee rate imposed by Section 6(b) of the 1933 Act to 1/29th of one percent from the previous rate of 1/32nd of one percent. This change was effective as of 9:00 a.m. on October 28, 1993. The Commission's formula used to calculate the new fee rate is based on a factor of 0.00034483, effective as of that date.

All investment company registrants, including those paying fees pursuant to Rule 24f-1 or 24f-2 under the 1940 Act, are affected by this change. The Commission interprets this legislation to require investment companies to calculate the fees payable according to the rate specified in Section 6(b) of the Securities Act of 1933 in effect on the date of the payment of the fees.

C. Calculation of Automatic Effectiveness under Rules 485 and 488.

Rule 485 provides for the automatic effectiveness of certain post-effective amendments on the "sixtieth day after the filing thereof" or on a later data designated by the registrant not later than "eighty days after the date on which the amendment is filed." Similarly, Rule 488 provides for automatic effectiveness of a registration statement filed on Form N-14 on the "thirtieth day after the date on which it is filed" or on a later date designated by the registrant not later than "fifty days after the date on which the registration statement is filed." The staff has observed some inconsistency in the manner of calculating the range of available dates for automatic effectiveness.

It is the staff's position that the first day after filing is the day following the day of filing, not the day of filing. Thus, for a post-effective amendment filed on November 1, sixty days after filing is December 31 (not December 30), and eighty days after the date of filing is January 20 (not January 19).

Similarly, for a Form N-14 filed on November 1, thirty days after filing is December 1 (not November 30) and fifty days after filing is December 21 (not December 20).

For any filings made after the date of this letter, registrants should not expect an automatic effective date earlier than that which is calculated in accordance with the position stated in this letter.

D. Information Provided in Transmittal Letter

The staff reminds registrants of its request made in the February 22, 1993 generic comment letter for certain information to facilitate the review of filings (viz., the 1940 Act and 1933 Act

file numbers, the number and name of new series, which of the new series are money market funds, and of those, which are taxable and non-taxable). In addition to the information set forth in that letter, we request that the cover letter state if (1) the filing concerns a master/feeder arrangement, (2) the registrant or any series will be marketed through banks, savings and loan associations, or credit unions, and/or (3) the registrant's operations raise novel or complex issues of law or policy.

E. Calculation of Rule 24f-2 Fees

(1) Series

The staff has not objected to an open-end management investment company aggregating sales and redemptions of all its series (sharing the same registration statement under the 1933 Act) for the purpose of calculating the filing fee owed the Commission under Rule 24f-2(b) under the 1940 Act. Registrants are reminded, however, that, in choosing to aggregate, they are responsible for ensuring that the method of allocating the fee liability among the series is fair and equitable.

(2) Business Combinations

Business combinations of registered companies are viewed by the staff as two simultaneous transactions. the acquiring fund sells its shares to the target fund for securities and other assets of the target fund (in-kind). Contemporaneously, the target fund redeems its shares, in-kind, from its shareholders. Thus, the shares sold by the acquiring fund should be included in its calculation of Rule 24f-2 fees for the fiscal year during which the combination occurs.

The share redemptions by the target fund are available to offset the share sales during the target fund's fiscal year ending with or after the business combination. For series companies using the aggregation method of calculating Rule 24f-2 fees, any excess net redemptions from the target series' combination with and into another fund may be included in the aggregation for that fiscal year. Of course, the net effect of a combination of two series in the same fund may not be material; however, the appropriate calculations should be made for verification.

(3) Minimum Fee

The filing fee accompanying the Rule 24f-2 Notice should be calculated according to the provisions of Rule 24f-2(c), even if such amount is less than $100. The $100 minimum prescribed by Section 6(b) under the 1933 Act is not applied to fees payable under Rule 24f-2(c).

F. Transmittals by Fax

Registrants and their counsel are requested to limit their fax transmittals to matters requiring urgent consideration by the staff. Notice should be given to the member of the staff that is to receive the fax prior to transmission. In general, any transmission over nine pages should only be sent to the Commission's principal fax number, (202) 272-7050.

II. Disclosure Comments

A. Prospectus Simplification

The staff strongly encourages registrants to take the initiative regularly to review, simplify and improve fund prospectuses. A registrant that wishes to change the format or content of its existing prospectus in an effort to make the prospectus more readable and usable by investors may submit a draft of a prototype prospectus for review by the staff. To facilitate the staff review of draft filings made for the purpose of improving prospectus disclosure, we request that any other changes to the prospectus be minimal. After our review is completed, the registrant can request selective review of future filings that it or its counsel represents are based upon the model. Registrants should limit draft filings to no more than one draft prospectus per month for each fund complex so that the disclosure staff is not burdened by an excessive number of draft filings. In reviewing specific disclosure or a specific presentation that is not required by rule or the form, the staff will use the standard or whether the prospectus is materially false or misleading. Where appropriate, the staff will accelerate the effective date of post-effective amendments filed for the purpose of improving prospectus disclosure.

B. Mutual Funds Sold by Financial Institutions

In a letter dated May 13, 1993 from Barbara J. Green, Deputy Director, Division of Investment Management, to investment company registrants, the staff set forth disclosure designed to help investors in bank-advised or bank-sold mutual funds to understand that their investments, unlike bank deposits, are not guaranteed or insured by any governmental agency. Letter reproduced at [Current] Fed. Sec. L. Rep. (CCH) 76,683, at 77,934.

Any mutual fund sold by or through banks, but not sharing a common or similar name with the bank, may add the disclosure contemplated by the staff's letter at the time of the fund's next post-effective amendment which may be filed under Rule 485(b) provided the amendment meets all other conditions for filing under paragraph (b). Funds may also implement the disclosure changes sooner than the next update through the use of the "sticker" process under Rule 497. Funds that share a common or similar name with a federally insured institution should add the prominent disclosure to their cover page immediately, if they have not already done so.

Furthermore, for the same reasons given in the May 13, 1993 letter, the staff believes that funds that are sold by or through federally insured institutions other than banks (such as credit unions), or share a common or similar name with such institutions, should prominently display analogous disclosure on the cover pages of their prospectuses.

C. Fee Table

Under the Rules of Fair Practice of the National Association of Securities Dealers (NASD). service fees of up to 25 basis points may be paid by an investment company and are not subject to the sales charge cap provided for in the Rules.

Service fees deducted from assets pursuant to a Rule 12b-1 Plan may not be placed on a separate line of the fee table but must be included under the line captioned "12b-1 fees." In such cases, registrants may, if they wish, place a parenthetical note after the line caption "Rule 12b-1 fees" to indicate inclusion of service fees under that caption. The brief narrative following the fee table should provide a cross-reference to the section of the prospectus that describes the Rule 12b-1 Plan. The section should disclose separately the percent of 12b-1 fees and the percentage of service fees which are and which are not 12b-1 fees.

Service fees not deducted pursuant to a Rule 12b-1 Plan should be included under "Other Expenses" and, as provided in the instructions to the fee table, may be shown separately. See Instructions 10(a) and (b) of Item 2 of Form N-1A.

D. Defining Small, Medium, and Large Capitalization Companies

Consistent with Guide 1 to Form N-1A, a registrant that includes a term such as "small, mid, or large capitalization" in its name should have an investment policy requiring it to invest at least 65 percent of the value of its total assets in the particular category under normal market conditions. While there are no precise definitions for the terms "small, mid, and large capitalization," there are indices that classify publicly offered companies according to their market capitalization. The staff believes that any fund that uses "small, mid or large capitalization" in its name must include a definition of the term in its prospectus.

The staff further believes that registrants, in developing such a definition, should consider all pertinent references, including, for example, industry indices, classifications used by mutual fund rating organizations and definitions used in financial publications. Definitions and disclosure inconsistent with common usage, including definitions relying solely on an average capitalization, will be considered inappropriate by the staff. Funds may rely on a "cap" or "ceiling" in defining the particular category. In addition, use of a percentage cutoff may be appropriate, e.g., "small cap" companies defined as those which fall in the lowest 15% of market capitalization of publicly traded companies listed in the United States.

E. Temporary Defensive Position

Many investment companies adopt "temporary defensive position" investment policies to be followed when significant adverse market, economic, political, or other circumstances require immediate action to avoid losses.[12] Such a policy permits a fund to deviate temporarily from fundamental and non-fundamental investment policies (e.g., any policy required by Guide 1 to Form N-1A and the concentration policy) without a shareholder vote or without prior or contemporaneous notification to shareholders during exigent situations. A fund may resort to a temporary defensive position only under abnormal market or economic situations and, while in such a temporary defensive position, invest in securities that the fund and its investment adviser believe appropriate under such circumstances.

[12]*It may not be appropriate, however, for certain funds to adopt such a policy, e.g., funds that endeavor to track an index.*

Consistent with the foregoing, if a fund has a temporary defensive position policy, its prospectus should state, succinctly, (1) that it has adopted such a policy, (2) the kinds of securities that may be used, and (3) the extent (e.g., up to 100 percent of its assets) to which the fund may deviate from its normal investment policies while maintaining a temporary defensive position. The staff believes that the phrase "temporary defensive position," (particularly the word "defensive") suggests that, in assuming such a position, a fund will invest in securities less risky than those in which the fund normally invests. If securities in which a fund may invest when taking a defensive posture are not less risky than those in which the fund typically invests, the fund must include disclosure of that fact and any applicable risk disclosure. See Guide 3 to Form N-1A.

F. Derivatives

More and more funds are investing in derivative instruments, which may include, for example, financial futures contracts, forward foreign currency contracts, mortgage-backed and asset-backed securities, options, inverse floaters and interest rate swaps. The staff is currently conducting a comprehensive review of funds uses of, and disclosures regarding, derivative instruments. The staff anticipates that, upon completion of its review, it may undertake various rulemaking initiatives.

In the course of its review, the staff has found, in many cases, fund disclosures regarding derivative instruments to be lengthy and highly technical in nature. We strongly encourage registrants to review their existing disclosure concerning derivative instruments to identify areas of such disclosure that can be deleted, reduced or modified to enhance investor understanding about pertinent risks.

In this regard, if more than 5% of a fund's net assets are at risk from its involvement in derivative instruments and derivative based transactions, its prospectus should (1) identify the types of derivative-based transactions in which it will engage; (2) briefly describe the characteristics of such transactions or instruments; (3) state the purpose for which the fund will use derivatives; and (4) identify the risks of derivative instruments and derivative-based transactions. See Items 4(b) and 4(c) of Form N-1A, Guide 3 thereto and Item 8 of Form N-2.

G. Fund Performance and Portfolio Managers

The Commission has adopted amendments to Forms N-1A and N-14 and Rule 34b-1 under the 1940 Act to require, among other things, the disclosure of the performance of open-end management investment companies in their prospectuses and annual reports. Disclosure of Mutual Fund Performance and Portfolio Managers, Investment Company, Act Release No. 19382 ("Release No. 19382") [58 FR 19050 (April 12, 1993)]. The amendments require a fund to include in its prospectus, or alternatively in its annual report, a narrative discussion of the factors, strategies, and techniques that materially affected the fund's performance during its most recently completed fiscal year, as well as a line graph comparing its performance to that of a broad-bases securities index. The amendments also revise the content and format of the condensed financial information contained in the prospectus and require disclosure about portfolio managers.

The effective dates of the amendments have been staggered to coincide with the annual updating of registration statements and the distribution of annual reports to shareholders. Registrants should consult Release No. 19382 for the effective dates of the amendments.

In Frank Russell Investment Management Company (pub. avail. August, 30, 1993), the staff has provided guidance as to performance disclosure appropriate for a fund that holds itself out as being managed by a "manager of managers" (i.e., managed by more than one sub-adviser, under the supervision of the advisor). The staff has also provided guidance on how funds with multiple classes of shares should present the line graph comparison of their performance to that of an appropriate broad-based securities index.

III. Recent Staff Positions

A. Definition of "Bond"

The staff has traditionally taken the position that, in the case of a fund that uses the term "bond" in its name, at least 65 percent of its total assets should be invested in instruments that include the word "bond" or "debenture." Upon further consideration, the staff has come to the conclusion that a fund using the term "bond" in its name satisfies the requirements of Section 35(d) of the 1940 Act and Guide 1 to Form N-1A if it invests at least 65 percent of its total assets in debt instruments. The prospectus of such a fund should describe what the fund considers to be a "bond" for purposes of its investment policy.

B. Disclaimers of Liability for Losses Resulting from Unauthorized Telephone Transactions

In the 1992 generic comment letter, the Division of Investment Management advised investment company registrants that the Divisions of Market Regulation and Investment Management were reviewing the practice of some investment companies to disclaim liability for following instructions for telephone exchange or redemption transactions that prove to be fraudulent.

In a recent letter to the Investment Company Institute, the Division stated its position that it is misleading for a fund to attempt to disclaim all liability for losses resulting from unauthorized or fraudulent telephone transactions regardless of the precautions the fund takes to avoid such losses. See Letter to Matthew P. Fink, President, Investment Company Institute from Max Berueffy, Senior Special Counsel, Division of Investment Management (April 19, 1993). In our view, such disclaimers do not accurately state the obligation of a fund, or its servicing or transfer agents, to exercise due care to determine that instructions communicated by telephone are genuine and thus avoid fraudulent transfers.

The letter stated that a fund permitting investments to engage in transactions by telephone may advise investors that it will not be liable for following instructions communicated by telephone that it reasonably believes to be genuine. The letter also states that, whether or not it

includes such a statement, a fund should include the following information in its prospectus or in any other document describing transactions initiated by telephone:

1. A statement whether the privilege to initiate transactions by telephone will be made available to shareholders automatically or whether the shareholder must first elect the privilege.

2. A statement to the effect that the fund will employ reasonable procedures to confirm that instructions communicated by telephone are genuine, and that if it does not, it may be liable for any losses due to unauthorized or fraudulent instructions.

3. A description of the procedures the fund follows for transactions initiated by telephone.

Certain questions have arisen regarding this position. First, the letter indicates that a fund may state that it "will not be liable for following instructions communicated by telephone that it reasonably believes to be genuine" if the fund includes the three other statements specified in the letter. One of these statements is that the fund may be liable for any losses due to unauthorized or fraudulent instructions if it fails to follow reasonable procedures. A fund need not include both the negative statement (when the fund will not be liable) as well as the positive (when the fund will be liable). One or the other is sufficient.

Second, some funds have expressed concern that describing the procedures they use to confirm the identity of shareholders over the telephone will make it easier for impostors to defeat those procedures. Therefore, funds may describe, in the Statement of Additional Information, the general types of procedures (e.g., a password or other form of personal identification) they will employ, rather than the specific requirements (e.g., the shareholder's social security number).

C. Redemption Fee

In Flag Investors Fund, Inc. (pub. avail. October 1, 1984) the staff stated that it would not recommend enforcement action if a redemption fee was imposed without first obtaining an exemptive order from the Commission permitting its imposition, provided (1) the maximum charge imposed upon redemptions was limited to 2%; and (2) the sum of any distribution, sales, and redemption charges did not exceed 8.5% of the purchase price.

Because of proposed Rule 6c-10 which would codify the standards that the Commission has developed in issuing exemptive orders concerning the use of contingent deferred sales charges on fund shares, the Division has withdrawn the no-action letter issued to Flag Investors Fund, Inc., Funds may rely on the 1984 no-action letter for all shares sold prior to March 22, 1994, even if the shares are redeemed after that date. See Flag Investors Fund, Inc. (pub. avail. September 22, 1993).

D. Use of Demand Features by Non-Money Market Funds to Shorten Maturities

The question has been raised as to whether a fund may shorten the maturity of a municipal obligation by the use of standby commitments to which such obligation is subject. The staff has concluded that Guide 28 to Form N-1A does not preclude investment companies, including mu-

nicipal bond funds, from following the procedures described in paragraph (d) of Rule 2a-7 under the 1940 Act to determine the maturity of portfolio securities of the types set forth in that paragraph. An investment company that follows the procedures described in sub-paragraphs (d)(3) and (4) of Rule 2a-7 to shorten the maturity of a variable or floating rate instrument subject to a demand feature may do so only if the fund's investment adviser determines that there is no more than a minimal risk that the demand feature would not be honored. In the case of a demand feature the exercise of which is contingent on the continued credit quality of the underlying security or other conditions, this would include a determination that there is minimal risk of the downgrading of credit quality or of the occurrence of such conditions. If applicable, a fund should disclose in its prospectus that under certain circumstances it will invest in nominally long-term securities that have many of the features of shorter-term securities and the maturities of these securities will be deemed to be earlier than their ultimate maturity dates by virtue of an existing demand feature.

E. Capped Floating and Variable Rate Instruments

In Morgan, Keegan & Co. (pub. avail. July 24, 1992), the staff noted that a money market fund may not use the maturity shortening provisions of Rule 2a-7 for a floating rate or variable rate instrument subject to an interest rate cap. Thus, except as noted below, money market funds should measure the maturities of short-term capped floaters (those with final maturities of 397 day or less) by reference to their final maturities not their interest readjustment dates. However, money market funds can invest in capped floating or variable rate demand notes or other instruments the maturity of which is determined by reference to a demand feature under paragraph (d)(3) or (4) of Rule 2a-7. (See also letter to Investment Company Institute dated June 25, 1993.)

In a letter dated June 16, 1993 to the Investment Company Institute, the Division made an exception, in an environment of low interest rates, from its interpretation of Rule 2a-7 for variable or floating rate instruments issued by the United States Government and its agencies the interest rates of which are capped at a rate in excess of 20 percent to comply with certain state usury laws. The maturities of these instruments may be determined on the basis of their interest rate readjustment dates.

IV. Regulation and Compliance

A. Mergers and Reorganizations

The staff has encountered a number of instances where the boards of directors of affiliated funds involved in mergers have failed to make the findings required by Rule 17a-8 under the 1940 Act. Rule 17a-8 provides that a merger involving investment companies that may be affiliated solely because they have a common investment adviser, common directors, and/or common officers is exempt from the provisions of Section 17(a) of the 1940 Act if the directors for each company, including a majority of the independent directors, determine:

> (a) that participation in the transaction is in the best interests of that investment company; and

(b) that the interest of exising shareholders of that investment company will not be diluted as a result of its effecting the transaction.

Registrants are further reminded that the Rule also requires that such findings, and the basis upon which the findings were made, be recorded in sufficient detail in the minute books of the investment companies concerned.

Registrants no longer engaged in the investment company business, or no longer having any assets, after a reorganization, consolidation, merger, or asset sale should file a Form N-8F. Registrants are reminded that they continue to be subject to the 1940 Act, including the reporting requirements of Section 30, until the order is granted.

When a business combination such as a reorganization or merger results in a single successor company, all companies except the survivor should file a Form N-8F as soon as possible after consummation of the transaction. See Commonwealth Funds (pub. avail. June 14, 1989).

B. Liquidation of Funds

The staff has considered the question of whether a shareholder vote is required under Section 13(a)(4) of the 1940 Act in the dissolution of an investment company. The staff believes that the 1940 Act does not require shareholder approval of dissolution and complete liquidation of an investment company.

C. Use of Testimonials in Advertising

In a letter dated October 19, 1993, to the National Association of Securities Dealers from C. Gladwyn Goins, Associate Director, Division of Investment Management, the staff expressed its position with respect to the use of testimonials in mutual fund advertising material. As suggested by that letter, the staff believes that statements by any person about his or her experience with a particular fund must be made in a manner that is not likely to cause a prospective or current investor to draw any unwarranted inferences about the performance or success of the fund.

V. Financial Statements

Item 32(b) of Form N-1A requires an undertaking to file a post-effective amendment within four to six months from the effective date of the registration statement. The purpose of the undertaking is to provide financial statements of the registrant reflecting an initial period of operations. Most funds that initiate operations on, or shortly after, the effective date of the initial registration statement have little problem complying with this requirement. The staff has provided limited relief from the undertaking, however, in two types of cases.

The first type of case in which relief has been provided is one in which a fund defers initiation of its operations for a significant period of time and, for that reason, has little or no operations to report at the end of the 4 to 6 months period. In such a case, the staff has agreed that the date to begin measuring the 4 to 6 months period should be the actual date shares are sold to the public or operations otherwise begin, rather than the effective date of the registration statement.

The second type of case arises when the end of the 4 to 6 month period is near the date of the financial statements to be used in the next semi-annual (or annual) report. In such a case, the staff has permitted an extension of the 4 to 6 month period so long as (1) the filing would not occur more than 60 days after the end of the 4 to 6 month period and (2) the filing date of the post-effective amendment containing the financial statements, whether audited or unaudited, would be within 30 days of the date of the latest balance sheet.

If the latest financial statements are not audited, they must be supplemented by the audited financial information, if any, contained in the registration statement that was declared effective. In all cases in which audited financial statements are included in the post-effective amendment, the filing must include a currently dated consent from the auditors to the use of the report in the post-effective amendment.

VI. Unit Investment Trusts

A. Cash Flow Statements

The staff of the Division will no longer verify the accuracy of the computation of the estimated current return and the internal rate of return of unit investment trusts. Therefore, registrants need no longer submit a cash flow statement in connection with the registration statements of unit investment trust ("UIT") series. However, registrants should keep cash flow statements available for examination by the inspection staff of the Commission.

B. Form N-SAR

Until further notice, UITs that are phased-in to mandatory electronic filing on the EDGAR system should continue to submit their Form N-SAR filings in paper because the Commission's software for preparing Form N-SAR has not yet been provided to filers.

We hope that this letter will assist you in preparing filings in 1994. Of course, it is not intended to replace the disclosure comment process. You should direct any questions about specific company filings to the staff member responsible for reviewing that company's documents.

Sincerely,

Carolyn B. Lewis
Assistant Director

February 3, 1995

Dear Registrant:

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

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

I. FILING PROCEDURES

A. Post-Effective Amendments Under Rules 485 and 486

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

The amendments to Rule 495:

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

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

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

4. enable the Division to permit certain types of posteffective amendments not otherwise eligible to be filed under Rule 495(b) to become effective immediately upon filing. See new subparagraph (b)(1)(ix) of Rule 485. Acting under this authority, the staff of the Division has

permitted the automatic effectiveness of a post-effective amendment to a registration statement filed by one fund in a fund complex when the amendment reflects substantially identical revisions to those contained in a post-effective amendment of another fund in the complex previously reviewed. Requests pursuant to this new provision should be addressed in writing to the Assistant Director, Office of Disclosure and Review. Insurance company investment contract registrants should send their requests to the Assistant Director, Office of Insurance Products; and

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

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

B. Amendments to Proxy Rules

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

- **Reorganization of Rules:** The revised proxy rules consolidate the fund-specific disclosure requirements of the Commission's proxy rules into a new Item 22 in Schedule 14A under the 1934 Act, which sets forth general proxy statement requirements. The other items in Schedule 14A, unless they specifically state otherwise, continue to apply to funds.
- **Summary Table:** When a proxy statement solicits votes on different proposals from shareholders of more than one fund, a portfolio of a series fund, or a class of a multiple class fund, the new rules require a table at the beginning of the proxy statement that summarizes each proposal and indicates which shareholders are being requested to approve each proposal.
- **Fee Table:** The new rules require a fee table in proxy statements that contain proposals that would result, directly or indirectly, in increased fees or expenses. The fee table must compare the proposed fees and expenses to those currently in effect.
- **Election of Directors:** The revised rules continue to require basic information concerning directors and nominees, such as business background and relationships with certain affiliates of the fund. This information is now required for the past five years. Proxy requirements for the election of directors no longer include detailed information about the fund's investment advisor (including the investment advisor's balance sheet), the advisory agreement, or the fund's brokerage arrangements.

- **Management Compensation:** The amended rules require a table setting forth the amount of compensation a director received, pension or retirement benefits accrued by the fund, for each director, and estimated annual retirement benefits for each director. The compensation table also must disclose the aggregate remuneration received by a director from all funds in the same fund complex. "Fund complex" is defined broadly for these purposes as two or more funds that hold themselves out to investors as related companies or that have a common investment advisor.

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

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

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

To make the disclosure of compensation uniform, the new rules also amended fund registration statement forms to require the same compensation table as in Item 22. This information should be reflected in the first post-effective amendment filed on or after January 23, 1995 and may be filed under Rule 495(b) if it is otherwise eligible for such a filing. New registration statements should include the table with amounts estimated for the fiscal year, but using actual fund complex information if it is available.

- **Investment Advisory Contract and Distribution Plans:** The amended rules retain most of the disclosure requirements concerning shareholder approval of investment advisory contracts and impose similar requirements for distribution plans. The rules, however, no longer require the inclusion of an investment advisor's balance sheet or extensive discussion of brokerage arrangements. There is a new requirement for a discussion of the material factors considered by the board of directors in recommending the advisory contract for shareholder approval, including a discussion of soft dollar arrangements that benefit the investment advisor.
- **Annual Reports:** In connection with the proxy rules revisions, the Commission eliminated for funds the requirement in Rule 14a3(b) under the 1934 Act that an annual report accompany or precede a proxy statement. Item 22 requires that the proxy statement state that the fund's most recent annual and semi-annual report are available upon request.

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

Section 24(e)(I) of the 1940 Act provides that registration statements under the 1933 Act relating to certain investment companies may be amended after their effective dates to increase

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

Registrants are reminded that Rule 24e-2 permits the preservation of net redemption credits only if a post-effective amendment containing the information required by Rule 24e-2(b) is filed in the year immediately following the fiscal year in which the net redemptions occur.

D. EDGAR Implementation

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

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

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

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

Registrants are also reminded that all correspondence (including cover letters and requests for acceleration) related to electronic filings must also be submitted electronically. See Rule

101(a) of Regulation S-T. Electronically submitted cover letters should include the information requested in Comment I.A of the February 22, 1993, and Comment I.D of the February 25, 1994, generic comment letters.

Investment company registrants are required to furnish a Financial Data Schedule as an exhibit to certain filings that are submitted electronically, namely registration statements on Forms S-6, N-1, N-1A, N-2, N-3, N-4, and N-5; Form N-SAR; and certain proxy materials (as specified in Item 22(a)(4) of Schedule 14A). However, there are circumstances under which this requirement would not be applicable. For example, an initial filing of Form S-6 typically does not include financial statements; they are furnished in pre-effective amendments. Therefore, the instructions to Form S-6 provide that a Financial Data Schedule is required when any amendment to that form is filed electronically. In addition, the staff has taken the position that a Financial Data Schedule need not be submitted with the filing of a registration statement or amendment on Forms S-6, N-1, N-1A, N-2, N-3, N-4, or N-5 containing no financial information or containing only information concerning initial capitalization. Of course, a registration statement containing financial information incorporated by reference from another source, such as the annual report to shareholders, would require as an exhibit a Financial Data Schedule. For the specific requirements for Financial Data Schedules, see Rule 483(e) of Regulation C.

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

E. Filings Under Rule 497

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

II. DISCLOSURE COMMENTS

A. Disclosure Regarding Management's Discussion of Fund Performance

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

B. Fund Names and Guide 1

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

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

C. Updated Risk Disclosure

A fund's prospectus disclosure must adequately inform investors as to the risk factors peculiar to the fund (e.g., investment strategies, assumptions, practices or techniques) or its portfolio of securities. See, for example, Item 4 of Form N-1A and Guide 21 thereto and Item 8 of Form N-2. Over time, with changes in the marketplace or in the fund's portfolio or investment strategy or practices, the significance of some risk factors may change, or new ones may be introduced. Registrants cannot rely on the Commission to identify these changing areas of risk significance and new areas of risk disclosure. Registrants are reminded that they have a duty, on an ongoing basis, to analyze fund risk and review prospectus risk disclosure, and to update prospectus disclosure when appropriate.

III. Recent Staff Positions

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

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

B. Advertising Past Performance Following a Reorganization

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

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

In Hyperion Capital Management, Inc. (pub. avail. August 1, 1994) the staff granted no-action assurance if, for the purposes of determining compliance with Section 5(b)(1) of the 1940 Act, a fund treats each underlying pool of assets backing certain privately issued mortgage-backed and asset-backed securities, rather than the sponsor or depositor of the pool, as a separate issuer provided that (1) in the event of the sponsor's bankruptcy, the sponsor's creditors would have no recourse against the pool, and (2) the holder of the asset-backed or mortgage-backed security would look to the pool for payment.

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

D. Rule 12b-1 Carry-Forwards

Under the NASD's Rules of Fair Practice, mutual funds calculate a "remaining amount", i.e., the appropriate maximum aggregate sales charge minus the amount of sales charges paid or accrued, including asset-based sales charges, front-end and deferred sales charges, plus the permitted interest. See NASD Notice to Members 93-12, Questions and Answers About New

NASD Rules Governing Investment Company Sales Charges—Article III, Sections 26(b) and (d) of the Rules of Fair Practice (February 1993). The staff will not raise objections under Section 17(d) of the 1940 Act or the rules thereunder if a Rule 12b-1 plan allows for the transfer of a portion of a mutual fund's "remaining amount" in the event of an exchange between series of the same mutual fund or between affiliated mutual funds (or a combination thereof), under the following conditions: (1) the arrangement is conducted in accordance with Section 26(d)(2)(D) of the NASD's Rules of Fair Practice, as described more fully in NASD Notice to Members 93-12; and (2) the carry-forward arrangement is implemented in accordance with Rule 12b-1 requirements. Specifically, Section 26(d)(2)(D) permits mutual funds to increase their "remaining amount" by treating the shares received through an exchange as new gross sales, provided the amount of the increase is deducted from the "remaining amount" of the mutual fund out of which the shares are exchanged.

E. Money Market Funds

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

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

F. Bundling of Proxy Proposals

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

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

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

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

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

* * *

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

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

Sincerely,

Carolyn B. Lewis
Assistant Director

February 15, 1996

Dear Registrant:

This letter is intended to assist investment company registrants in preparing disclosure filings. These comments represent the views of the staff of the Division of Investment Management and are not necessarily those of the Securities and Exchange Commission. The comments in this letter apply to filings made with the Division, including filings on Forms N-1A, N-2, N-14 and S-6.

This letter covers disclosure and procedural developments since February 3, 1995 when the staff issued its last letter to registrants. Accounting-related matters of interest to registrants and their independent public accountants can be found in a letter dated November 2, 1995 from Lawrence A. Friend, Chief Accountant of the Division, addressed to Chief Financial Officers. General guidance to variable annuity, variable life, and other insurance company investment contract registrants can be found in a letter dated November 3, 1995 from Brenda D. Sneed, Assistant Director, Office of Insurance Products.

I. Prospectus Improvement

In past letters to registrants, the staff has urged registrants to improve fund prospectuses by making disclosure more concise, direct, and understandable. Some have responded by producing prospectuses that are significantly more user-friendly and readable. We continue to encourage registrants to review their prospectuses with the goal of eliminating unnecessary legal terms, jargon, and verbose disclosure. In this regard, the staff directs registrants' attention to General Instruction G to Form N-1A and General Instruction for Part A: The Prospectus of Form N-2. The information in the prospectus should be clear, concise, and understandable; avoid the use of technical or legal terms, complex language, or excessive detail.

The staff has assisted, and will continue to assist, registrants who take the initiative to review, rewrite, and improve fund prospectuses. Registrants are encouraged to submit drafts of revised prototype prospectuses for review by the staff prior to filing.

II. Disclosure Comments

A. Multiple Class Funds

The Commission has adopted Rule 18f-3 under the Investment Company Act of 1940 (the "1940 Act") which permits open-end investment companies to issue multiple classes of voting stock representing interests in the same portfolio. See Investment Company Act Release No. 20915 (February 23, 1995). In connection with Rule 18f-3, the Commission adopted amendments to Form N-1A designed to improve disclosure for multiple class funds. The staff has observed, however, that the disclosure of mutual funds offering multiple classes in the same prospectus is, in some cases, needlessly long and complex, making the differences between classes difficult to understand. Registrants are encouraged to simplify the description of multiple class arrangements.

In addition, Item 24(b) of Form N-1A requires copies of any plan entered into by the registrant under Rule 18f-3, including any implementing agreement and plan amendments, to be filed as exhibits to the registration statement. A post-effective amendment for the purpose of filing exhibits and agreements pertaining to the Rule 18f-3 plan may be filed under Rule 485(b) under the Securities Act of 1933 (the "1933 Act").[13]

B. Registration Statements Filed on Form N-14

Item 16(12) of Form N-14 requires registrants filing registration statements on Form N-14 to file as an exhibit to the registration statement, or incorporate by reference, an opinion of counsel or a copy of an Internal Revenue Service ("IRS") ruling supporting the tax matters discussed in the registration statement. Opinions or rulings may be filed either in the original filing or at effectiveness of the registration statement.

The staff recognizes, however, that the closing of a reorganization usually is contingent on the registrant receiving the tax opinion or IRS ruling; therefore, the closing of the transaction itself is satisfactory evidence that the tax opinion or ruling was obtained. In such a circumstance, the staff will not object if a registrant files the tax opinion or IRS ruling after the reorganization, if the registrant includes an undertaking in the registration statement to file, by post-effective amendment, an opinion of counsel or a copy of an IRS ruling supporting the tax consequences of the proposed reorganization within a reasonable time after receipt of such opinion or ruling. Such post-effective amendment may be filed under Rule 485(b) under the 1933 Act.

C. Closed-End Funds' Tender Offers

Closed-end funds often trade at a discount from net asset value. Some closed-end funds disclose in their prospectuses that, in order to minimize or eliminate the discount, they will offer to purchase their shares through tender offers or propose to shareholders at a later date conversions to open-end status.

Fund boards typically have the discretion to decide whether funds should purchase their shares or propose conversions, and the decisions generally are based on circumstances existing at the time the decisions are made. Nevertheless, some prospectuses highlight the corporate actions to be taken but tend to minimize their conditional nature. For example, a number of prospectus summaries state the funds' intention to conduct tender offers or propose conversions without mentioning any conditions or qualifying circumstances. Often, language appearing much later in the prospectuses qualifies these commitments and states that they may be subject to a variety of conditions.

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[13] *When the Commission adopted amendments to Rule 485 in 1994, it delegated authority to the Division to determine appropriate uses of Rule 485(b) in contexts other than those specifically enumerated in the rule. This comment and Comment II.B dealing with Form N-14 filings authorize registrants to file post-effective amendments under Rule 485(b) in accordance with that authority. See Investment Company Act Release No. 20486 (Aug. 17, 1994). Registrants availing themselves of this procedure should ensure that their post-effective amendments otherwise meet the conditions for filing under Rule 485(b).*

In describing the commitments to conduct tender offers or propose conversions, registrants need to convey the possibility that the corporate actions may not occur. Discussions of conditions or qualifying circumstances should not be lengthy or overly technical. Funds should also review any advertising or sales literature referring to commitments to determine if they may be misleading to potential investors.

III. Proxies

A. Proxy Disclosure Requirements

The staff has responded to a number of interpretive questions and reviewed proxy statements filed under the revised disclosure requirements for fund proxy statements ("the revised rules"), which became effective in January, 1995. Generally, the quality of disclosure under the new rules has been good and substantially improves disclosure that would have been required under the old rules. We believe, however, that the following disclosure issues require clarification.

1. Material Factors Discussion

Items 22(c)(11) (approval of investment advisory contract) and 22(d)(4) (approval of Rule 12b-1 plan) of Schedule 14A require a discussion of the material factors on which the board of directors has based its decisions to recommend an investment advisory contract or Rule 12b-1 plan for shareholder approval. While the revised rules do not dictate the form or content of the material factors discussion, the instructions to the Items state that a mere list of the factors considered by the board of directors is not sufficient disclosure. The staff has given, and will continue to give, comments on material factors discussions that do not include a clear, concise explanation of the bases for the directors' recommendation to shareholders (whether for a new contract or the renewal of an existing contract). The discussion should include the material factors underlying the recommendation, the relative importance or weight of each factor, and how each factor relates to the board's recommendation. The discussion also is required to reference, if appropriate, whether there are soft dollar arrangements that benefit the investment adviser. Registrants should avoid generalized discussions of brokerage arrangements that do not directly address the specific soft dollar arrangements that benefit their investment advisers.

2. Compensation Disclosure

Item 22(b)(6) in Schedule 14A requires proxy statements to include a table disclosing the amount of compensation paid to fund directors by a fund and, if applicable, the fund complex. The same compensation disclosure is required in registration statements. The staff's review of proxy statements (and registration statements) filed under the revised rules indicates that:

- In some cases, variation from the prescribed format may be necessary to present the information in an understandable manner. Funds may present information in a different tabular format if it will make the compensation information clearer. For example, a fund may vary the format of the compensation table to accommodate a proxy statement

that solicits votes from shareholders of more than one fund. However, all compensation information must be provided in the table (or the footnotes to the table) in the section of the proxy statement discussing the election of directors.

• No entry is required in the compensation table if a director did not receive compensation for service as a director during the most recent fiscal period. In addition, if there is no reportable information for a particular required category (for example, pension or retirement benefits accrued), funds may omit that column from the compensation table.

B. Electronic Proxy Voting

Rule 14a-4(B)(1) of the proxy rules requires registrants to provide to shareholders, in the form of proxy, a means of conferring authority to vote on specific matters. The staff has not objected to proxy solicitation material containing a supplemental method for shareholders to vote electronically by using a telephonic or other electronic voting system, if specifically permitted by applicable state law. In these cases, the registrant:

a) adopted a reasonable means of verifying the authenticity of proxies transmitted by telephone or otherwise (such as including a personal identification number on the proxy card);

b) provided the shareholder an opportunity to validate an electronic vote to ensure that the vote was received correctly;

c) determined that the supplemental electronic voting procedures provided for in the proxy are permissible under applicable state law; and

d) retained voting records, including the date of receipt of voting instructions and the name of the recipient.

C. Voting Results

Registrants are reminded that the results of a vote of shareholders must be furnished in the next annual or semi-annual shareholder report following a shareholder meeting or other shareholder vote. See Rule 30d-1(b) under the 1940 Act.

IV. Filing Procedures

A. EDGAR Implementation and Filing Procedures

Investment company registrants must file electronically via EDGAR (i) all registration statements, including amendments, under the 1933 Act and/or the 1940 Act; (ii) all proxy materials required to be filed with the Commission (except those for which confidential treatment is requested); (iii) all reports, including reports on Form N-SAR and annual and semi-annual reports to shareholders required to be filed with the Commission under Section 30 of the 1940 Act; and (iv) all other reports, forms, and schedules required to be filed by or with respect to

investment companies under the Securities Exchange Act of 1934 (except Form 13F)[14]. All correspondence related to electronic filings also must be submitted electronically.

1. Financial Data Schedules

Registrants are required to furnish Financial Data Schedules as exhibits to electronic filings, including registration statements on Forms S-6, N-1, N-1A, N-2, N-3, N-4, and N-5; Form N-SAR; and certain proxy materials (as specified in Item 22(a)(4) of Schedule 14A).[15] The specific EDGAR tagging requirements for investment company Financial Data Schedules are set forth in Appendix E of the EDGAR Filer Manual.[16] Appendix E should be read in conjunction with specific investment company form requirements and Rule 483(e) under the 1933 Act which set forth the requirements for the schedules.

2. Paper Copies

Registrants are reminded that Rule 902(g) of Regulation S-T requires electronic filers to provide a paper copy of their first electronic filing. This paper copy is not an official filing, and the legend required by Rule 902(g) should be placed on the cover page to indicate that fact. No signatures are required. A computer printout of an EDGAR filing is acceptable, but the confidential access codes must be removed or blanked out. The copy should be received by the Commission no later than six business days after the electronic filing and may be mailed to the address set forth in Rule 902(g).

3. Cover Letters

Where appropriate, cover letters relating to a filing should be included as part of the electronic submission of the relevant filing. Cover letters provide information helpful to the review of the filing, including requests for selective review.[17] Cover letters always should include a typed letterhead, since letters that are "EDGARized" will not include the letterhead printed on firm or company stationery. Also, if they are not included in the letterhead, the name, address, and telephone number of the registrant's contact person(s) should be provided in the text of the letter. See Comment I.A. of the February 22, 1993 Letter to Registrants for other types of information that may be appropriately included in cover letters.

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[14] *See Rules 101, 902, and 903 of Regulation S-T (17 CFR Part 232.101, 902 and 903) and Release 4.40 of the EDGAR Filer Manual (December 1995) and the Appendix thereto (the "EDGAR Filer Manual").*

[15] *For circumstances under which this requirement would not be applicable, see Comment I.D. of the Letter to Registrants dated February 3, 1995.*

[16] *See, in particular, pages E-2 and E-3 ("Filings Processed by the Division of Investment Management; Investment Company Forms") and pages E-43 through E-48 ("Investment Companies, Article 6 of Regulation S-X"). The EDGAR document header tag for a document containing a Financial Data Schedule will always begin with the characters "EX-27" regardless of the item number of this exhibit within the relevant registration statement. See pages C-8 and C-9 of Appendix C of the EDGAR Filer Manual.*

[17] *Registrants should note that cover letters submitted under document type "COVER" and correspondence submitted under submission and/or document type "CORRESP" are treated as non-public and are not disseminated. See the EDGAR Filer Manual, Section E, paragraph 4.12 ("Non-Public and Confidential Information").*

4. Extending Effectiveness of Rule 485(a) Filings

Registrants filing post-effective amendments under Rule 485(b) under the 1933 Act to extend the effective date of a post-effective amendment filed pursuant to Rule 485(a) should (i) submit such filings under EDGAR submission type "485BPOS," "485B24E," or "485B24F," as appropriate; and (ii) following acceptance of the submission, notify the staff by correspondence ("CORRESP" submission) of the Rule 495(b) filing. These procedures will be superseded when new EDGAR submission types designed specifically for this purpose become available.

5. Avoiding Common Problems

Registrants can avoid many common problems associated with the process of making electronic filings with the Commission by (i) including the correct "CIK" number when making check or wire payment of filing fees through Mellon Bank, in accordance with Rule 3a of the Commission's Informal and Other Procedures, and (ii) establishing and using a CompuServe mailbox to receive and carefully review Commission notices of filing acceptance or suspension. These notices provide information about the type of filing (live, test, or confirming copy), the date and time of receipt, error messages for suspended filings, and the official filing dates assigned to accepted live filings.

6. Facing Sheets

Registrants are reminded to check the appropriate box(es) on the facing sheet of amendments filed under Rule 485 and to make sure that all submission and document header tags corresponding to those boxes are prepared correctly.

7. EDGAR Contacts

Apart from questions in the specific areas enumerated below, registrants generally should direct their EDGAR questions to their regular processing branches or reviewers, who will provide the answers or, in appropriate cases, refer them to the EDGAR Branch. Registrants new to the EDGAR filing process, however, should direct their questions to the EDGAR Branch at 202-942-0591. In addition, questions concerning Regulation S-T and related EDGAR rules provisions may be directed to either Anthony A. Vertuno at 202-942-0591 or Ruth A. Sanders at 202-942-0633.

Financial Data Schedules	Anthony Evangelista Asst. Chief Accountant	202-942-0636
Rule 24f-2 Notices	Carolyn Miller Senior Financial Analyst	202-942-0510
Form N-SAR	N-SAR Inquiry Line	202-942-0513

B. Registering Additional Shares under Rule 24f-2

The Commission recently amended Rule 24f-2 under the 1940 Act to provide that a Rule 24f-2 Notice is deemed timely filed if the fund establishes that it transmitted the notice to a third party company or governmental entity that guaranteed delivery no later than the filing deadline.[18] By providing a means for funds to ensure that they are not penalized for the failure of a third party to timely file their Rule 24f-2 Notices, the Commission expected the amendments to eliminate the need for funds to seek exemptions from the requirements of Rule 24f-2.

Registrants are reminded that they must use new Form 24F-2 for filing Rule 24f-2 Notices for periods ending on or after October 10, 1995. Also, as provided in amended Rule 24f-2 and new Form 24F-2, registrants calculating the registration fee due by deducting the amount of shares redeemed during the fiscal year from the amount of shares sold during the period must include shares issued in connection with dividend reinvestment plans when determining the amount of shares sold and redeemed.

C. De-Registering Funds

The staff has noted a number of cases in which funds that have transferred all of their assets in a reorganization subsequently failed to de-register. A registrant whose assets have been transferred to another fund and which ceases operations as an investment company must file an application pursuant to Section 8(f) and Rule 8f-1 for an order declaring that the company has ceased to be an investment company. Applications should be filed on Form N-8F within a reasonable time after the reorganization. Registrants also are reminded to provide, by establishing a reserve account or otherwise, for the payment of costs of the Form N-8F application proceedings and for the preparation and filing of a final N-SAR on behalf of a fund that has ceased operations.

* * *

This letter is intended to assist registrants in preparing filings in 1996; it is not intended to replace the disclosure comment process. You should direct any questions about specific company filings to the staff member responsible for reviewing that company's documents.

Sincerely,

Carolyn B. Lewis
Assistant Director

Barry D. Miller
Assistant Director

[18] *Investment Company Act Release No. 21332 (Sept. 1, 1995).*

November 1, 1994

Dear Chief Financial Officer:

The accounting staff of the Division of Investment Management has prepared this letter to assist investment company registrants and their independent public accountants in addressing certain accounting-related matters. These comments represent the views of the staff of the Division of Investment Management and are not necessarily those of the Securities and Exchange Commission (the "Commission"). The comments addressed in this letter apply to filings made by registered investment companies, including reports to shareholders. This letter should be read in conjunction with similar letters issued by the Division's Office of Disclosure and Review and Office of Insurance Products.

Accounting For Certain Transactions with Affiliates

Increasingly during the past year, affiliates[19] have compensated funds for losses on certain of their investment holdings. The contributions generally take one of two forms—a direct contribution by the affiliate to the fund to offset the effect of a realized loss on a portfolio investment ("direct contribution") or the purchase by the affiliate of securities from the fund at prices in excess of the securities' current market value ("affiliated purchase"). In both cases, the accounting for the loss on the investment and the resulting payment should be reflected in a fund's financial statements as a realized loss and a corresponding contribution to capital.

Cash (or other assets) received from an affiliate as a direct contribution should be reflected by the fund in its financial statements in the statement of changes in net assets immediately after the capital share transactions section and in the financial highlights table immediately following the "distributions" section. Notes to the financial statements and financial highlights table should describe these contributions. In addition, footnotes to the total return disclosure in the table should quantify the effect of the capital contribution in a manner similar to disclosure for the effect of voluntary waivers of fees and expenses.[20]

Affiliated purchases at a price in excess of the current market value[21] do not reduce the loss that would otherwise have occurred if the investment had been sold to an unaffiliated person. The amount by which the payment exceeds the current market value of the investments purchased is considered a contribution to capital, and the accounting should be the same as that for direct contributions.

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[19] *The term "affiliate" as used in this context is as defined by the Commission's Regulations S-X Item 6-02(a) (17 CFR §210.6-02(a)). This comment does not address situations involving non-affiliates. The accounting for such non-affiliated transactions should be reviewed on a case-by-case basis.*

[20] *In addition to the general guidance in Statement of Financial Accounting Standards No. 57, Related Party Disclosure, specific requirements are set forth in Paragraph 5.29 of the Audit and Accounting Guide, Audits of Investment Companies, AICPA, 1993.*

[21] *Unless facts indicate otherwise, the staff views purchases of fund investments by affiliates under the circumstances described in this letter as being at a price in excess of market value. This letter is not intended to express any views on the implications of any transactions described under section 17 of the Investment Company Act of 1940.*

Funds should consider the non-financial statement disclosure implications surrounding the contribution and the related accounting treatment, including the Management's Discussion of Fund Performance required by Item 5A of Form N-1A. The narrative disclosure should be consistent with the related financial statement disclosure referred to above.

Valuation of Certain Portfolio Investments

In recent years, investment companies have made increasing use of certain instruments that, under some market conditions, may require valuation by the companies' boards of directors. The Commission's Accounting Series Releases (ASRs) 113 and 118 provide guidance in the valuation, accounting and auditing of these investments. This guidance requires clearly defined policies and procedures to be established by an investment company's board of directors and any deviation from these policies and procedures to be disclosed in the financial statements or notes thereto. These policies and procedures should encompass all appropriate factors relevant to the valuation of investments for which market quotations are not readily available.

In determining whether market quotations are readily available, Section 404.03.b.iii of the Codification of Financial Reporting Policies reiterates the guidance in ASR 118, which states that "quotations for a security should be obtained from more than one broker-dealer… If the validity of the quotations appears to be questionable, or if the number of quotations indicates that there is a thin market in the security, further consideration should be given to whether market quotations are readily available." Where it is determined that market quotations are readily available, the certifying accountant should independently verify all the quotations used by the company at the balance sheet date. With respect to valuation of non-exchange-traded investments by a certifying accountant, independent verification should be interpreted as reliance on quotations received from a source independent of the source used by the client.

The guidance in ASRs 113 and 118 also applies to investments for which there are few market makers or broker-dealers[22] providing market quotations. The staff believes, where there are few market makers or broker-dealers providing market quotations (as in the case of structured notes), the independent verification guidance set forth above requires the independent public accountant to seek verification from a market maker or broker-dealer providing a market quotation, the independent public accountant should employ alternative valuation procedures that provide an accurate and reasonable valuation.

Audited Balance Sheet for New Series

Although the staff has interpreted Section 14(a)(2) of the Investment Company Act of 1940 (the "Act") generally to permit a new series of a fund to make a public offering of securities without having at least $100,000 of networth, a fund registering a new series may sell one or more shares of the series to a single shareholder, usually affiliated with the fund. In such cases, regardless of the amount invested by the initial shareholder or shareholders prior to the

[22]*The terms "market maker" and "broker-dealer" as used in this context have the same meaning as those in ASRs 113 and 118.*

effectiveness of the registration, an audited balance sheet is required in the registration statement in accordance with Item 25, Schedule A of the Securities Act of 1933. This requirement also applies to those companies distributing insurance products which are allowed an exemption under Rules6e-2(b)(6), 6e(T)(b)(6) and 14a-2 under the Act which, despite the exemption, decide to seed the insurance products' company with initial capital.

Securities With Zero Value

Schedule 12-12 of Regulation S-X contemplates the listing of each security a fund owns in the schedule of investments. A fund that owns securities considered to be worthless should continue to list those securities in its schedule of investments indicating a zero value. Only after the fund has classified the security as a worthless security for federal income tax purposes should any security be removed from the listing. Omitting securities from the schedule prior to the determination of worthlessness for tax purposes may be misleading to investors interested in evaluating the fund's investments.

* * *

This letter contains information of importance to the company's independent public accountant; therefore, we encourage these items to be discussed with them. Any questions on the contents of this letter or related matters can be addressed to me, Anthony S. Evangelista or James F. Volk, Assistant Chief Accountants, at (202) 942-0590.

Very truly yours,

Lawrence A. Friend
Chief Accountant

November 2, 1995

Dear Chief Financial Officer:

The accounting staff of the Division of Investment Management (the "Division") has prepared this letter to respond to questions raised by investment company registrants and their independent public accountants with regard to certain accounting-related matters. These comments represent the views of the staff of the Division and are not necessarily those of the Securities and Exchange Commission (the "Commission"). The comments addressed in this letter apply to filings made by registered investment companies, including reports to shareholders. This letter should be read in conjunction with similar letters previously and subsequently issued by the Division's accounting staff, Office of Disclosure and Review and Office of Insurance Products.

Transactions With Affiliates in a Master/Feeder Structure

In a letter addressed to Chief Financial Officers dated November 1, 1994 (the "November 1 Letter"), the Division expressed the position that funds that are compensated by affiliates for losses on certain of their investment holdings should account for such transactions as contributions to capital. The staff has subsequently become aware of instances when the master fund in a "master/feeder" structure received a capital contribution, but the effect of the transaction was not disclosed at the feeder level. Although a feeder fund includes the financial statements of its master fund in its annual and semi-annual reports to shareholders, the feeder fund's financial statements should also reflect these capital contributions.

If the master fund is organized as a partnership, generally accepted accounting principles ("GAAP") require the financial statements of the feeder to reflect its pro rata portion of every master fund transaction. Income received by the master fund partnership is considered to be received, pro rata, by the feeder fund contemporaneously with the receipt by the master fund. The distribution policy of the master fund does not dictate the feeder fund's accounting for income. The feeder fund's financial statements should contain the same presentation and disclosure suggested by the November 1 Letter with respect to the feeder fund's pro rata benefit received from the master fund's receipt of a capital contribution.

If the master fund is organized as a corporation, classification of the master fund's income in the feeder fund's financial statements depends upon the distribution policies of the master fund. Until it is distributed, income received by the master fund is recorded by a feeder fund as unrealized appreciation. When distributions are made by the master fund, it must differentiate distributions from capital gains and other sources from distributions of net investment income. The master fund's determination of the source of its distributions dictates the accounting by the feeder. A capital contribution to a master fund corporation will not be automatically recorded by a feeder fund as such. Rather, as noted above, the feeder fund will account for it as it would any other increase in the master fund's overall net asset value. Notes to the feeder fund's financial statements should refer to the circumstances surrounding the capital contribution received

by the master fund either specifically or by cross-reference to the corresponding note to the financial statements of the master fund and should indicate the feeder fund's benefit received.

Accounting For Organization and Other Deferred Costs

In a letter dated May 9, 1995, the Division stated that the Investment Company Act of 1940 (the "1940 Act") does not prohibit unit investment trusts ("UITs") from bearing certain organizational and offering expenses.[23] Since then, the Division has received a number of questions regarding the accounting for such expenses and the appropriate period of amortization.

In accordance with GAAP, costs qualifying as organization expenses should be amortized over the period of benefit, not to exceed sixty months. Organization expenses generally consist of expenses incurred to establish a company and legally equip it to engage in business.[24] Such costs may be deferred and amortized by all registered investment companies. For accounting purposes, offering costs, including the costs of registering securities with the Commission and the states, do not qualify as organization costs and, accordingly, require different accounting treatment. Offering costs are distinguishable from organization expenses because they represent costs associated with the sale of a fund's securities. Open-end funds may defer charging offering costs to expense for a period not to exceed one year. Closed-end funds and UITs should charge offering costs to paid-in-capital. In accordance with industry practice, closed-end funds and UITs may capitalize offering costs until the offering period commences. For closed-end funds, the costs should then be charged to paid-in-capital immediately. For UITs, such costs should be charged to paid-in capital no later than the close of the period during which units of the trust are first sold to the public, which generally does not exceed thirty days.

Since many UITs have predetermined termination dates, organization expenses should be amortized over the shorter of the life of the trust or sixty months from the date of commencement of operations. UITs with trust indentures that contain provisions for mandatory termination of the trust if assets fall below a specified level should accelerate the amortization of any remaining organization costs when it appears probable that the trust will terminate before the sixty month or shorter period has elapsed. In such instances, the reduction of the amortization period should be considered a change in accounting estimate in accordance with Accounting Principles Board Opinion No. 20—Accounting Changes ("APB 20").[25]

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[23] *Letter to Pierre de St. Phalle, Re: Unit Investment Trust Organizational Expenses, publicly available May 9, 1995. Specifically, the letter addresses whether a UIT can "bear the cost of preparing its registration statement, trust indenture and other documents, registering its securities with the Commission and the states, and the initial audit of the trust." Although these expenses were referred to in the letter as "organizational" expenses, the letter was not intended to address the accounting treatment of these types of expenses.*

[24] *See paragraph 8.09 of the Audit and Accounting Guide—Audits of Investment Companies, issued by the American Institute of Certified Public Accountants, with conforming changes as of May 1, 1994.*

[25] *Issued by the American Institute of Certified Public Accountants, July 1971.*

Financial Statements of Depositors Required by Forms N-8B-2 and S-6

In many cases, the financial statements of the depositor may not be critical to evaluating and understanding a UIT offering. As a result, the staff has not objected if, under certain circumstances, a registrant omits the depositor financial statements required by Item 59 of Form N-8B-2 and Instruction 1(c) (as to the prospectus) of Form S-6.

Registrants have requested clarification of the circumstances under which the financial statements of the depositor may be omitted from Form N-8B-2 and Form S-6. In addition, registrants that include financial statements have asked whether they are required to be audited.

Registrants using Forms N-8B-2 or S-6 generally may omit depositor financial statements unless the depositor meets any of the following conditions:

- The depositor has liabilities pursuant to Section 27 of the 1940 Act (associated with a periodic payment plan). Periodic payment plan certificates and some insurance products are subject to refund requirements under Section 27. The depositor's financial statements are important in determining the ability of the depositor to refund the required amounts.
- The depositor is considered the issuer of the securities whose reserves will be relied upon to ensure payments. Insurance companies issuing variable products charge fees for mortality and expense risks which, in part, are credited to reserves required by state insurance statutes. The financial statements reflect the size of the reserves available to cover these and other risks.
- The depositor has a legal obligation to maintain a secondary market for the securities. To prevent trusts from diminishing in size during a specified period, some depositors agree to maintain a secondary market for the orderly transfer of ownership of trust units.[26] The ability of the depositor to continue to maintain that market is reflected in its financial statements.
- The depositor must continuously function as the issuer because of the nature of the offering. For example, equity ownership units in some trusts have been sold with the ability to split the units into separate financial instruments. The separate instruments are separately traded and have differing market values attributable to their unique economic characteristics based on their differing demands on the assets of the issuer. Trading of the separate instruments usually requires the depositor's continuation in business. In addition, the depositor must remain continuously involved when additional equity ownership units are issued or the separate instruments are reconstituted for the purpose of a redemption.

If the depositor meets any of the above conditions so that financial statements are required, the following procedures should be noted:

Form N-8B-2, the 1940 Act registration form used by UITs that are currently issuing securities, requires audited financial statements of the depositor. The financial statements must

[26]*More often, the depositor agrees only to attempt to maintain such a market but makes no legal commitment. This is not considered a legal obligation to maintain a secondary market.*

include a balance sheet, statement of income (profit and loss) and a statement of surplus for the depositor's most recently completed fiscal year[27] as of the date of filing.

Form S-6 is used to register under the Securities Act of 1933 securities of UITs registered on Form N-8B-2 and also requires financial statements of the depositor. The form requires the financial statements to contain a balance sheet as of a date within ninety days of the date of the filing. This requirement is modified by Rule 3-01(a) of S-X [17 CFR §210.3-01(a)] which permits the balance sheet to be as of a date within 135 days of the date of filing. The Commission, therefore, will accept balance sheets as of a date within 135 days of the date of filing. If the balance sheet is unaudited, an audited balance sheet as of a date within one year of the date of the filing must also be provided. The financial statements must also include an income (profit and loss) statement for the most recently completed fiscal year and for any subsequent period up through the date of the latest balance sheet provided. The income statements must be audited through the date of the latest audited balance sheet.[28]

When financial statements are required in accordance with the policy set forth above, the Office of the Chief Accountant of the Division will still consider informal written requests for omission or substitution of financial statements pursuant to Rule 3-13 of S-X [17 CFR §210.3-13].

Financial Statement Presentation of Fee Waivers

There have been varying interpretations of the requirement to disclose fee waivers in a fund's statement of operations. The varying interpretations may result from current discrepancies between the Audit and Accounting Guide—*Audits of Investment Companies*[29] (which is considered to encompass GAAP) and Rule 6-07 of S-X.[30] Although the audit guide states that voluntary waivers need to be disclosed, it does not require voluntary waivers to be stated separately in the statement of operations. Rule 6-07.2 of S-X requires fee reductions or reimbursements by any entity **to be shown separately** in the statement of operations as a negative amount or as a reduction of total expenses. The rule makes no distinction between voluntary and involuntary waivers and requires a note to the financial statements to include the amounts and a brief description of such arrangements. When there is an apparent conflict, registrants should follow the requirements of S-X in filings with the Commission.

Compliance with Rule 18f-3

Rule 18f-3 [17 CFR §270.18f-3]—*Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares; Disclosure by Multiple Class and Master-Feeder Funds; Class Voting on Distribution Plans* was adopted on February 23, 1995.[31] The rule, among

[27] *The financial statements of the depositor are required to be prepared in accordance with Regulation S-X ("S-X"). Rule 3-02 of S-X [17 CFR §210.3-02] requires a statement of cash flows to be filed as part of the financial statements.*

[28] Id. *The statement of cash flows must also be audited through the date of the latest audited balance sheet.*

[29] *Issued by the American Institute of Certified Public Accountants, with conforming changes as of May 1, 1994.*

[30] *17 CRF §210.6-07.*

[31] *Investment Company Act Release No. 20915 (February 23, 1995) [60 FR 11876 (March 2, 1995)].*

other things, prescribes how income and expenses must be allocated among classes. The allocation methods selected by the fund, however, must be applied consistently from period to period. Paragraphs (c)(2) of the rule allows income, realized and unrealized capital gains and losses, and expenses not otherwise allocated to a particular class to be allocated on a settled share basis (as defined in the rule) for companies operating under Rule 2a-7 of the 1940 Act and for companies declaring distributions of net investment income daily, provided those companies maintain the same net asset value per share for each class.

Some registrants have interpreted the rule to require funds electing to use the settled share method to apply consistently such method to all components of operations (including realized and unrealized gains and losses). We believe use of the same method to allocate all components of operations may result in a divergence of net asset value among classes when certain levels of subscriptions are received by a fund. The staff, therefore, will not object if funds relying on Rule 18f-3 consistently use a dual allocation method where such method would reduce the likelihood of net asset values diverging among classes. The dual allocation method would permit the use of the relative net assets method for allocating realized and unrealized gains and losses and the settled share method for allocating investment income and expenses.

Pro Forma Financial Information for Business Combinations

Form N-14, the registration statement used to register securities to be issued in a business combination, requires pro forma financial statements to be included if the transaction meets the criteria set forth in Item 14(a)(2) of the form. Recently, the Division did not object to the exclusion of certain financial information by registrants when the registration statements filed on Form N-14 solicited approval of the shareholders of two or more funds for proposals whereby the funds to be acquired (the "target funds") were to be combined with and into another fund (the "acquiring fund").[32]

The transactions typically are structured so the combination will include any and all funds that obtain shareholder approval; however, approval by every target fund is not necessary for the merger to take place. As a result, multiple pro forma presentation alternatives are required, depending on the number of target funds.

Article 11 of S-X governs the form and content of pro forma financial statements. Rule 11-02(b)(8) of S-X [17 CFR §210.11-02(b)(8)] states "if the transaction is structured in such a manner that significantly different results may occur, additional pro forma presentations shall be made which give effect to the range of possible results." A strict interpretation of this requirement would produce full pro forma financial statements for each possible combination.

[32]*E.g., Jaffray Funds, Inc., Form N-14 (File No. 33-58849). The pro forma combined schedule of total returns and expense ratios provided in this filing contained information for four years prior to the period covered by the pro forma combining financial statements, which exceeded the current requirements to provide the information for the two prior years, as noted below.*

The staff believes that including full pro forma financial statements for each potential combination could be burdensome to the registrant and confusing to shareholders. In situations where the acquiring fund will combine with only target funds that receive shareholder approval, the staff will not object if, in lieu of providing pro forma financial statements for all possible combinations of the eventual combined entity, registrants provide the following:

- pro forma combining financial statements reflecting the combination of all funds that are involved in the proposed combinations, prepared in accordance with the requirements of Rule 11-02(b) and (c) of S-X [17 CFR §210.11-02(b) and (c)] based on the assumption that the shareholders of all target funds will approve the transaction; and
- a schedule reflecting pro forma combined expense ratios and total returns for every possible combination involving the target funds and the acquiring fund. The schedule should present the information for all periods covered by the pro forma financial statements referred to above and for each of the two fiscal years prior to the earliest pro forma financial statements presented. Appropriate adjustments should be made where funds have different fiscal years, different dividend payout rates, or other relevant differences in order to provide a consistent presentation based on the actual results of the accounting survivor in each scenario. The expense ratio should be calculated in the manner set forth in Item 2 of Form N-1A, and total return should be calculated in the manner set forth in Item 22 of Form N-1A. In addition, a headnote to the schedule should explain the reason for presentation of the abbreviated pro forma information and briefly describe, if relevant, any assumptions that were made to conform the information of the various target funds to that of the acquiring fund.

Correction of Errors

Certain funds are not immediately recording the correction of errors in their books and records. In cases where the correction would have an immediate effect on net asset value, some funds have capitalized the loss and amortized it over some arbitrary period. APB 20 prescribes the accounting treatment for adjustments resulting from the correction of errors. In pertinent part, APB 20 requires the correction of errors to be recorded when identified. The staff believes that immediate recognition of the entire amount of the error should be reflected in the statement of operations and, if appropriate, the footnotes, regardless of the effect on net asset value. Capitalization and subsequent amortization of error amounts are not acceptable under GAAP.

* * *

This letter contains information of importance to the company's independent public accountant; therefore, we encourage these items to be discussed with them. Any questions on the contents of this letter or related matters can be addressed to Anthony S. Evangelista, James F. Volk, Assistant Chief Accountants, or me at (202) 942-0590.

Very truly yours,

Lawrence A. Friend
Chief Accountant

SEC GENERIC COMMENT LETTER FOR INVESTMENT COMPANY CFOs

November 1, 1996

Dear Chief Financial Officer:

The accounting staff of the Division of Investment Management (the "Division") has prepared this letter to assist investment company registrants and their independent public accountants in addressing certain accounting-related matters. These comments represent the views of the staff of the Division and are not necessarily those of the Securities end Exchange Commission (the "Commission"). The comments addressed in this letter apply to filings, including reports to shareholders, made by registered investment companies. This letter should be read in conjunction with similar letters previously issued by the Division's Chief Accountant as well as letters issued by the Division's Office of Insurance Products and Office of Disclosure and Review.

Undertaking to File Financial Statements

Item 32(b) of Form N-1 A requires a registrant to undertake to file a post-effective amendment within the four to six month period after the effective date of its registration. The purpose of the undertaking is to provide financial statements of the registrant reflecting an initial period of operations that is considered representative of the operations of the new registrant.[33]

Recently, the Division addressed the need for this undertaking in the case of a merger of an operating investment company into a non-operating registrant, that is, a "shell" entity. The operating investment company was to be the accounting survivor; therefore, its financial statements became those of the continuing new registrant. We agreed that the registration statement containing the financial statements of the operating company need not include the four to six month period undertaking pursuant to Item 32(b). This position was based on our view that the financial statements of the new registrant were those of the pre-merger operating investment company and were considered representative of the operations of the new registrant. In other merger situations, when the operating investment company is a relatively new registrant (i.e. having fewer than four to six months of operations), undertaking to file financial statements within four to six months following the merger is not necessary if the financial statements included in the initial registration statement of the new registrant are considered representative of its operations.

Accounting for Foreign Corporate Actions

In recent years the number of investment companies investing in foreign securities has increased dramatically.[34] In many cases, information relating to corporate actions (e.g., dividends,

[33]*The Division has previously provided limited relief from this requirement. See Letter to Registrants from Carolyn B. Lewis dated February 25, 1994, Item V, "Financial Statements" (limited relief granted when the initiation of operations is deferred and the end of the four to sixth month period is near the date of the end of the annual or semi-annual period).*

[34]*The number of registered investment companies with international portfolios has more than doubled over the past four years. Investment Company Institute, "Trends in Mutual Fund Activity," Table 6A, July, 1996.*

stock splits, rights offerings, interest payments) by foreign issuers is difficult for investment companies or their agents to obtain and verify on a timely basis. Generally accepted accounting principles ("GAAP") require an investment company to record corporate actions affecting portfolio securities on the dates when they become effective[35] (e.g., ex-dividend date, payment date) in order for the investment company's net asset value to be correctly stated.

The Division understands that some investment companies do not record foreign corporate actions until they receive formal modification from a third party such as the investment company's custodian or other service provider and are able to verify that the corporate action has occurred. Generally, it is not appropriate under applicable accounting rules for an investment company to delay the recording of foreign corporate actions if the investment company knew or, in the exercise of reasonable diligence, should have known that the corporate action had occurred. Delayed recording of foreign corporate actions may be appropriate, however, if the investment company, exercising reasonable diligence, did not know that the corporate action had occurred.[36] In this event, the investment company should record such action promptly after receipt of the information. Reasonable diligence would generally require an investment company to adopt appropriate procedures to obtain timely notification and verification of the effective date of the foreign corporate action.[37]

Financial Highlights in Multi-Class Reorganizations

In the past, we have addressed the issue of determining which investment company in a business combination is deemed the survivor and which historical financial highlights are used by the new surviving investment company.[38] Several registrants have inquired about accounting for a multi-class reorganization in which several investment companies merge into one fund, and contemporaneously, the acquiring fund implements a multi-class structure. Each of the predecessor funds becomes a different class of the acquiring successor fund. Only the successor class (i.e., the existing fund) represents the continuing entity whose operating history is reflected in the historical financial highlights. The financial highlights of the other predecessors (classes) are not carried forward, and each new class generates an operating history on a post-reorganization basis.[39]

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[35]*Financial Accounting Standards Board Statement of Concepts No. 5, "Recognition and Measurement in Financial Statements of Business Enterprises," December, 1984.*

[36]*In addition, an investment company may have conflicting information about the date of a corporate action which it is unable to confirm with reasonable diligence.*

[37]*In some cases, failure to record a foreign corporate action on a timely basis will cause an investment company later to adjust its financial statements. Accounting for a correction of a material error is discussed in the Division's letter to Chief Financial Officers dated November 2, 1995, in which we concluded that immediate recognition of the entire amount of any error should be reflected in the statement of operations and, if appropriate, the footnotes, regardless of the effect on net asset value.*

[38]*North American Security Trust (pub. avail. August 5, 1994) ("NAST Letter").*

[39]*Operating history contained in the financial highlights is different from historical performance which may contain information prior to reorganization. (See, e.g., NAST Letter, IDS Financial Corp. (pub. avail. December 19, 1994.))*

Accounting for Liquidation Expenses

Several investment company registrants have inquired as to the proper treatment of expenses in connection with a liquidation. In some cases, the estimation of expenses and the approval of the plan of liquidation may not occur at the same time. We believe that it is prudent to record the liquidation expenses promptly to ensure that investors who remain shareholders of the liquidating company do not pay a disproportionate share of the liquidation expenses. GAAP require liabilities to be recorded when it is probable that a liability has been incurred and the amount can be estimated.[40] We believe the liquidation expenses should be reflected on the books and records of the registrant as soon as determinable under GAAP.[41]

Accounting Treatment for Indirect Expenses

The Division recently reviewed a filing of a closed-end investment company organized as a term trust (the "Trust") that raised issues regarding the accounting treatment for indirect expenses. The Trust's assets consisted of government securities and a forward purchase contract between the Trust and an independent third party (the "seller") who owned common stock of an unaffiliated company. The forward purchase contract provided that each of the Trust's unitholders would receive a certain number of shares of common stock of the unaffiliated company at the expiration of the Trust. The seller agreed to pay all underwriting, organizational and ongoing operational expenses of the Trust either directly or indirectly through the underwriter.

In the initial registration filing, the Trust included a table pursuant to Item 3 of the Form N-2 (Fee Table and Synopsis) that presented its total annual expenses as zero because the seller had agreed to pay these Trust expenses. We concluded that the presentation of zero expenses was not appropriate because the cost of the forward purchase contract included these expenses. Further, we concluded that the Trust should record these costs as an expense or prepaid asset with a corresponding reduction to the cost of the contract purchased. The prepaid asset is to be reduced ratably over the life of the Trust by a charge to Trust expenses. Under the circumstances, these charges, whether paid directly or indirectly by the Trust, were included as part of the Trust's total annual expenses in the table required by Item 3 of Form N-2.

Average Commission Rate Considerations

In July 1995, the Commission revised certain line items in the financial highlights table in Forms N-IA, N-2 and N-3, including the "average commission rate paid" (the "ACRP").[42] Since that time, the Division responded to a number of questions regarding an ACRP that includes both domestic and foreign commission rates. According to registrants, blending both commission

[40] *Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," March 1975, Par. 8.*

[41] *See Letter to Registrants from Carolyn B. Lewis and Barry D. Miller dated February 15, 1996, Item IV.C., "De-Registering Funds" (reminding registrants to File Form N-8F to notify the Commission that the investment company has ceased operations).*

[42] *Investment Company Act Rel. No. IC-21221 (July 28, 1995).*

rates presents a concern because of the significant difference between the dollar amount of commissions paid for domestic securities and the dollar amount (after translation) of commissions paid for foreign securities.

In adopting revisions to the financial highlights table, the Commission considered the effects of requiring a blended commission and indicated that such a rate is appropriate. In particular, the Commission stated that "disclosure of average commission rates [in a blended manner] can improve investors' ability to evaluate and compare investment company brokerage costs… and that a comparison of average commission rates among investment companies will be a useful bench-mark for investors…. [43] An average commission rate should be based on actual commissions paid, translated into U.S. dollar equivalents, as required by the instruction to the financial highlights table.[44] The registrant may, at its option, add an explanatory note to the financial highlights table with respect to the components of the ACRP including domestic, foreign or country-specific average commission rates.

Dating of Financial Statements

The Division has addressed questions regarding the proper dating of financial statements when the reporting period ends on a non-business day.[45] When the reporting period ends on a weekend, the investment company has the option to choose either the calendar day or the last business day as the date of the balance sheet. If the investment company chooses to use the last business day, the financial statements should reflect that date and include the appropriate accruals to that date. If the investment company chooses to define the fiscal period based on the calendar date, the financial statement should reflect the calendar date and include the appropriate accruals to the calendar.

This letter contains information of importance to the company's independent public accountants; therefore, we encourage you to discuss these items with them. Any questions about the contents of this letter or related matters can be addressed to John S. Capone or Paul T. Kraft, Assistant Chief Accountants, or me, at (202) 942-0590.

Very truly yours,

Lawrence A. Friend
Chief Accountant

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[43] Id., *Item II.E.*

[44] *An instruction to the item provides that the registrant should "[convert commissions paid in foreign currency into U.S. dollars and cents per share using consistently either the prevailing exchange rate on the date of the transaction or average exchange rate over such period as related transactions took place."*

[45] *For example, the calendar end may be a Sunday, but the last business day would be the preceding Friday.*

SEC GENERIC COMMENT LETTER FOR INVESTMENT COMPANY CFOs

November 7, 1997

Dear Chief Financial Officer:

The accounting staff of the Division of Investment Management (the "Division") has prepared this letter to assist investment company registrants and their independent public accountants in dealing with certain accounting-related matters. These comments represent the views of the staff of the Division and are not necessarily those of the Securities and Exchange Commission (the "Commission"). The comments described below apply to filings including reports to shareholders, made by registered investment companies. This letter should be read together with earlier letters issued by the Division's Chief Accountant and letters issued by the Division's Office of Insurance Products and Office of Disclosure and Review.

Foreign Pricing Considerations

In its letter dated November 1, 1996[46], the staff discussed certain accounting-related matters involving a fund's ability to obtain and verify foreign corporate actions. In particular, the staff focused on the situation in which management of a fund uses reasonable diligence to attempt to obtain timely notification and verification of the effective date of foreign corporate actions but delayed the recording of the foreign corporate actions until third party confirmation. Such a procedure is commonly referred to as reflecting a "reasonable diligence standard."

Since the letter's issuance, registrants have asked whether a reasonable diligence standard could extend to the pricing of foreign securities. Although the staff recognizes that accounting for both corporate actions and pricing of securities is often intertwined, we do not believe the same standard applies. As noted in a previous letter[47], the Commission's Accounting Series Releases 113 and 118 are the accounting standards that govern the valuation and accounting for investments.[48]

Fund of Funds Considerations

In recent years, the number of fund of funds arrangements,[49] in which one fund ("top tier fund") invests its assets in shares of another fund ("underlying fund") rather than directly in

[46]*See Letter to Chief Financial Officers from Lawrence A. Friend, dated November 1, 1996. "Accounting for Foreign Corporate Actions."*

[47]*See Letter to Chief Financial Officers from Lawrence A. Friend, dated November 1, 1994. "Valuation of Certain Portfolio Investments."*

[48]*Accounting Series Release 113, (October 21, 1969); Accounting Series Release 118, (December 23, 1970). These releases have been codified in Sections 404.04 and 404.03, respectively, in the Codification of Financial Reporting Policies.*

[49]*Fund of funds arrangements are subject to the provisions of Section 12 of the Investment Company Act of 1940.*

securities, has increased. In some of these arrangements, the top tier fund has invested a significant amount of its investments in an underlying fund. The degree of investment raises financial reporting concerns for these top tier funds. Top tier funds, like all other funds, report each investment separately on their financial statements.[50] When a top tier fund has a significant amount of its portfolio invested in a single underlying fund or owns a controlling interest in an underlying fund, registrants should consider providing additional financial information to shareholders.

For example, if the top tier fund has a significant portion of its portfolio invested in an underlying fund, the top tier fund should consider accompanying its financial statements with those of the underlying fund. Additionally, if a top tier fund owns a controlling interest in all underlying fund, current accounting literature may require consolidating the financial statements of an underlying fund and the top tier fund.[51]

Designation of Segregated Assets

Certain trading practices undertaken by registrants may involve the issuance of senior securities subject to the prohibitions and asset coverage requirements of Section 18 of the Investment Company Act of 1940.[52] In 1979, the Commission issued a General Statement of Policy[53] indicating the staff's view that certain instruments held by a fund would not be deemed subject to Section 18 if the fund's obligation, with respect to any such instrument, was "covered" by assets established and maintained by the fund in a segregated account.

Release 10666 further stated that the board of directors of a fund that is engaged in the specified trading practices should review the fund's portfolio and custodial accounts to determine if the fund has created or should create any segregated accounts *with the company's custodian*. Although Release 10666 includes a section on valuation and accounting, it does not discuss internal accounting control and reporting issues related to the segregated accounts.

Typically, investment companies have designated securities to be segregated on the records of their custodians. The staff has been asked by registrants whether it would be consistent to segregate accounts on the fund's records. The staff has indicated that it would not object if assets segregated under Section 18 were designated solely on the fund's records and not designated on the fund's custodian's records.[54]

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[50]See *Regulation S-X. Articles 6-04, 6-10 and 12-12. [17 CRF 210.6-04, 6-10, and 12-12].*

[51]*Statement of Financial Accounting Standards No. 94 "Consolidation of All Majority-Owned Subsidiaries." Financial Accounting Standards Board. (October, 1987) ("SFAS 94"). SFAS 94 requires consolidation of all majority-owned subsidiaries unless control is temporary or does not rest with the majority owner. Control is defined as ownership of over 50% of the outstanding voting shares of another company. While a fund of funds arrangement differs from an operating company envisioned by the current accounting literature, SFAS 94 suggests that consolidation may be appropriate.*

[52]*15 U.S.C. 80a-18.*

[53]*Investment Company Act Release No. 10666, April 18, 1979 ("Release 10666").*

[54]*To the extent that a fund designates segregated assets solely on its records, the fund may need to implement additional procedures and controls to ensure that segregation is undertaken in accordance with the interpretation outlined in Release 10666.*

Accounting for Securities Lending Transactions

In a typical fund securities lending transaction, the fund lends its securities to a borrower which pledges cash or securities as collateral for the securities on loan. Generally Accepted Accounting Principles ("GAAP") for securities lending transactions are governed by Statement of Financial Accounting, Standards No. 125 ("SFAS 125").[55] SFAS 125 focuses on "effective control"[56] as a key component for determining the accounting treatment for securities on loan and the corresponding collateral exchanged between the lending fund and borrower.

When a lending fund receives securities as collateral and does not have effective control over the securities, it should not record the securities as its asset. Conversely, when a fund receives securities as collateral and has effective control over the securities, it should record the securities as its asset with a corresponding liability for repayment. When a fund receives cash as collateral, it is deemed to have effective control of the collateral and should record the cash as its asset with a corresponding liability for repayment.[57]

We have noted inconsistent accounting by some funds that automatically reinvest cash collateral in securities. These funds are "looking through" to the securities purchased with the cash collateral and treating the securities received as collateral without effective control. Therefore, the funds do not record them as assets. The staff believes, consistent with SFAS 125, that a fund has effective control over cash collateral and also has effective control over any securities purchased with the cash collateral. As a result, a fund should record these securities as its asset and a corresponding liability for repayment, in the amount of the cash collateral received, in its financial statements.[58]

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[55] *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," Financial Accounting Standards Board. (June, 1996) ("SFAS 125"). SFAS 125 was amended by Statement on Financial Accounting Standards No. 127.* "Deferral of the Effective Date of Certain Provision of FASB Statement Number 125," *Financial Accounting Standards Board. (December, 1996) ("SFAS 127") by deferring the effective date of certain relevant portion of SFAS 125, including the paragraphs dealing with securities lending, to December 31, 1997. For the purpose of this letter, the reference to SFAS 125 encompasses SFAS 125, as amended by SFAS 127.*

[56] *See SFAS 125. Par. 9 (defines the three conditions under which the transferor has surrendered control over transferred assets, all of which must be met: (1) the transferred asset has been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy, (2) each transferee may use the transferred assets, and (3) the transferor does not have an agreement that maintains effective control over the transferred asset.)*

See SFAS 125. Par. 27 (defines effective control as an agreement that has all of the following features: "(a) the assets to be repurchased or redeemed are the same or substantially the same as those transferred: (b) the transferor is able to repurchase or redeem them on substantially the agreed terms, even in the event of default by the transferee: (c) the agreement is to repurchase or redeem them before maturity at a fixed or determinable price; and (d) the agreement is entered concurrently with the transfer.")

[57] *See SFAS 125. Par. 161 " … all cash collateral should be recorded as an asset by the secured party, together with a liability for the obligation to return it to the transferor, whose asset is a receivable."*

Further, the lending fund remains liable for returning the amount of cash collateral, and incurs the risk of loss from any securities purchased with the cash collateral.

[58] *The Staff noted in Norwest Bank Minnesota N.A., SEC No-Action Letter (pub. avail. May 25, 1995) that cash collateral should be invested in accordance with the fund's investment policies. Because the fund invests the cash collateral in securities consistent with its policies, the fund exercises control over the cash collateral and the securities purchased with that cash. As fund assets, the securities purchased with the cash collateral are subject to the fund's usual valuation procedures.*

Closed-End Fund Expense Ratios

In reviewing the financial statements of closed-end funds, we have noted inconsistencies in how they have calculated their expense ratios[59] when they incurred interest expense on debt securities or paid dividends on preferred shares.

Interest Expense

Item 4 of Form N-2, Financial Highlights, requires expense ratios to include all expenses of the fund. The instructions to Form N-2 make no exception for any expense item; all expenses, including interest expense, should be included in the fund's calculation of its expense ratio.[60]

We have been asked by registrants and their independent accountants whether more than one expense ratio may be shown as a part of the financial highlights table. For example, some funds believe a more meaningful ratio would be based on expenses that do not include interest ("net expenses"). The staff has not objected to a second ratio that excludes interest in certain circumstances.[61] In all cases, the expense ratio that includes interest expense ("gross expenses") should be shown in the body of the financial highlights. The staff would not object if both the net and gross expense ratios are shown in the body of the financial highlights table or if the expense ratio, without the interest expense, is reflected in a footnote to the financial highlights table. Both ratios should be clearly identified with appropriate disclosure about the differences.

Dividend Payments

GAAP defines preferred stock to be a component of equity and not debt, even though it has characteristics of both.[62] Accordingly, dividend payments to preferred stockholders are not considered to be an expense of the fund and, in the staff's view, should not be included as expenses in the financial statements.[63] Instruction 15 to Item 4 of Form N-2 requires a fund to "indicate in a note that the expense ratio and net investment income ratio do not reflect the effect of dividend payments to preferred shareholders." Also, Instruction 9 to Item 3, *Fee Table and Synopsis*, states that other expenses includes all expenses that will be reflected as expenses in the registrant's statement of operations. Because GAAP does not permit dividends to be included as expenses in a statement of operations, the staff's position is that dividends would not be included as an expense in either Item 3 or 4 of Form N-2.

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[59] See *Form N-2, Item 4.1, line i.*

[60] *In proposing Form N-2, the Commission stated that "interest payments on long-term debt, which may be part of the capitalization of a closed-end fund, would be included among the annual shareholder expenses." (Release No. 1C-17091, July 28, 1989, footnote 38).*

[61] *This position reflects an application of a general principle stated in the instructions to Form N-2. General Instructions (2) to the form states: "The prospectus or the SAI may contain more information than called for by this form, provided the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of required information."*

[62] See *Accounting Principles Board Opinion Number 10-Omnibus Opinion. American Institute of Certified Public Accountants. (December 1966).*

[63] *Distributions to preferred and common stockholders are required to be shown broad in Form N-2. Item 4.1.*

In view of the reporting differences, the staff takes the position that it would not object to additional ratios reflecting the treatment of the preferred shares. In the staff's view, the additional ratios should not be included on the face of the financial highlights table; rather, they should be included in the footnotes to that table.

Other Disclosures

Instruction 6 to Item 3 of Form N-2 prescribes "other expenses [to] be stated as a percentage of net asset value attributable to common shares." Although this instruction is to Item 3 and is not repeated as an instruction to Item 4, the staff believes the concept should be consistently applied in both tables. Expense ratios should be presented as a percentage of the net asset value attributable to common shares only.[64] The staff would not object to the inclusion, in the footnotes to the financial highlights table, of additional ratios that are clearly identified and explained.

The Division acknowledges that its positions stated above with respect to closed-end funds may result in some funds changing their financial statements. To enable those funds sufficient time to complete these changes, the staff would not object if registrants implement these interpretations for all ratios contained in financial statements for fiscal years that begin after November 15, 1997.

Organization Costs Considerations

The staff continues to address questions from registrants and their independent accountants regarding the accounting treatment for organization costs[65] that arise in connection with a merger, liquidation, or dissolution of a fund.[66] The staff has indicated that the remaining amount of organization costs, in such a transaction, are the responsibility of the holder of the original shares and should be netted against redemption proceeds of the original shares.[67] The staff has indicated that it is not appropriate to accelerate the write-off of the remaining organization costs to the date of the merger, liquidation, or dissolution, or to immediately charge to fund expenses the remaining amount of organization costs.

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[64]*Similarly, the ratio of net income to average net assets (Form N-2. Item 4.1 line j.) should also be presented as a percentage of the net asset value attributable to common shares only.*

[65]*This item does not address any possible changes to the accounting for and the reporting on organization costs as contemplated in proposed Statement of Position (SOP) "Reporting on Costs of Start-Up Activities" dated April 22, 1997, issued by the American Institute of Certified Public Accountants.*

[66]*The staff would not object if, in the case of a merger, the organization costs of the acquiring, legal survivor fund are capitalized and amortized. However, remaining organization costs of the target fund should be netted against the redemption proceeds of the original shares.*

[67]See *Letter to Registrants from Carolyn B. Lewis, dated January 3, 1991. Item 11. E. "Organization Expenses."*

This letter contains information of importance to the company's independent public accountants; therefore, we encourage you to discuss these items with them. Address any questions about the contents of this letter or related matters to John S. Capone or Paul T. Kraft, Assistant Chief Accountants, or me, at (202) 942-0590.

Very truly yours,

Lawrence A. Friend
Chief Accountant

SEC GENERIC COMMENT LETTER FOR INVESTMENT COMPANY CFOs

December 30, 1998

To the Chief Financial Officer:

The accounting staff of the Division of Investment Management (the "staff") has prepared this letter to assist investment company registrants and their independent public accountants in addressing certain accounting-related matters. These comments represent the views of the staff of the Division and are not necessarily those of the U.S. Securities and Exchange Commission. The comments addressed in this letter apply to filings, including reports to shareholders, made by registered investment companies.

Average Commission Rate Disclosure

In March 1998, the Commission adopted final amendments to Form N-1A.[68] As part of these amendments, the Commission adopted several changes to the financial highlights table. One change is to eliminate disclosure of the average commission rate from the prospectus of open-end investment companies.[69] Thus, the average commission rate is no longer required to be included in the financial highlights table in either the prospectus or shareholder reports of open-end investment companies.

Although the amendments to Form N-1A are specific to open-end investment companies, several closed-end investment companies have asked whether the average commission rate must be included in their prospectuses and shareholder reports.[70] We believe that the same considerations underlying the elimination of the average commission rate from open-end investment company prospectuses and shareholder reports also apply to closed-end investment companies. As a result, we would not object if closed-end investment companies do not disclose the average commission rate in their prospectuses or shareholder reports.

Organization Costs for Open-End Investment Companies

In April 1998, the Accounting Standards Executive Committee issued Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities" ("SOP 98-5"). SOP 98-5 provides

[68]*Form N-1A is used by open-end investment companies to register under the Investment Company Act of 1940 (the "Act") and to register their shares under the Securities Act of 1933. See Investment Company Act Release No. 23064 (Mar. 13, 1998) (the "Adopting Release").*

[69]*The Adopting Release noted commenters' concern that the average commission rate was technical information with only marginal benefit for typical investors. The Adopting Release stated, "At this time, the Commission believes there continues to be some merit in ensuring that information about the average commission rate paid by funds is publicly available. The Commission believes however, that a fund's prospectus appears not to be the most appropriate document through which to make this information public." 55 FR at 13936.*

[70]See *Item 4 of Form N-2 (Financial Highlights).*

guidance on the financial reporting of start-up costs and organization costs, and in particular requires all start-up costs and organization costs to be expensed as incurred.[71]

The effect of SOP 98-5 on the investment company industry is that investment companies no longer can capitalize organization costs as an asset and ratably reduce this asset by amortization.[72] As a result of SOP 98-5, we believe that organization costs will be treated in one of the following manners: (1) as a direct expense to the investment company, (2) as an expense to the investment company and a simultaneous reimbursement by the sponsor, in accordance with a reimbursement or excess expense plan, or (3) as an expense of the investment company sponsor, if it intends to incur organization costs on behalf of the investment company. When organization costs are charged as expenses of the investment company as in scenarios "(1)" or "(2)", the financial statements of the investment company that are part of its registration statement should include a statement of operations because the investment company has operating activity.[73]

We also remind recently formed registrants that SOP 98-5 permits capitalization of organization costs only if the investment company shares are sold to independent third parties prior to June 30, 1998. If the investment company failed to sell shares to independent third parties prior to June 30, 1998, we believe that organization costs should be immediately written off as an expense and/or reimbursed directly by the investment company sponsor.

Financial Reporting for a Master/Feeder Structure

We continue to receive questions regarding the reporting requirements for complex investment company structures.[74] One such structure is the master/feeder arrangement. Currently, shareholder reports of the feeder contain two sets of financial statements, one for the master and another for the feeder. Section 30 of the Act outlines periodic reporting requirements for registrants. Specifically, Sections 30(e)(1) and (2) require registrants to provide a balance sheet accompanied by a statement of the aggregate value of investments and a list showing the amounts and values of securities owned on the date of the balance sheet.

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[71]*SOP 98-5 applies to all non-governmental entities and is effective for financial statements for fiscal years beginning after December 15, 1998.*

[72]*SOP 98-5 made an exception for entities that report substantially all investments at market value or fair value, issue and redeem shares, units, or ownership interests at net asset value, and have sold their shares, units, or ownership interests to independent third parties before June 30, 1998. For these entities, existing organization costs can continue to be amortized in the normal course of business.*

Further, SOP 98-5 is silent as to offering costs that generally include: (1) legal fees pertaining to the company's shares offered for sale, (2) SEC and state registration fees, (3) underwriting and other similar costs, (4) costs of printing of prospectuses for sale purposes, and (5) initial fees paid to be listed on an exchange. The staff has taken the view that offering costs should be amortized over the shorter of the offering period or one year for open-end investment companies and unit investment trusts and charged to capital for closed-end investment companies at the close of the offering period.

[73]*Consistent with our analysis, a series portfolio that elects to expense the organization costs of the series portfolio is required to prepare a statement of operations and include it as part of the series portfolio's registration statement.*

[74]See *Letter from Lawrence A. Friend, Chief Accountant, Division of Investment Management, Securities and Exchange Commission, to Chief Financial Officer (November 7, 1997)(discussing "Fund of Funds Considerations").*

Questions have arisen as to the proper reporting when the master and feeder have different fiscal year-ends. In such circumstances, we would not object if, at each feeder investment company year-end, the audited shareholder report of the feeder is accompanied by the latest audited shareholder report of the master and by an unaudited balance sheet of the master, and schedule of investments of the master as of the date of the feeder financial statements.[75] We remind registrants that the portfolio turnover rate for the master should be disclosed in the financial highlights table contained in the shareholder report and registration statement of the feeder.[76]

Change in Accountants

We have received numerous questions regarding the procedures that investment companies must follow when there is a change in accountants. Unlike publicly traded operating companies that file Form 8-K when there is an accountant change, investment companies report an accountant change in Item 77K of Form N-SAR. In addition, we remind registrants that there is a reporting requirement for investment companies under N-1A and N-2.[77]

To satisfy the reporting requirement of Forms N-1A and N-2, we suggest that investment companies include a narrative summary in the notes to the financial statements contained in shareholder reports, in management's discussion of the investment company's performance,[78] or as supplemental information contained in the investment company's shareholder report. Investment companies should include this information in the first shareholder report that is issued subsequent to the Board of Directors' approval. The summary disclosure should conform to the requirements of Item 304 of Regulation S-K.[79]

Updating Performance Data in the Bar Chart

Several registrants have asked whether an investment company must update the performance information in the bar chart required in the prospectus of an open-end investment company when a calendar year-end or calendar quarter-end passes after the investment company has filed a post-effective amendment to its registration statement but before the effective date. Item 2(c)(2)(ii) of Form N-lA requires an investment company to provide its total returns for each of

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[75] *For example, if the feeder has a December 31 fiscal year-end and the master has a September 30 fiscal year-end, the audited December 31 feeder financial statements would be accompanied by the audited September 30 master financial statements, and an unaudited master balance sheet and master schedule of investments as of December 31.*

[76] See *Letter from Carolyn B. Lewis, Assistant Director, Division of Investment Management, Securities and Exchange Commission, to Registrants (February 22, 1993) ("The registration statement for the spoke (feeder) should include all information required by Form N-1A as if the distribution function of the spoke (feeder) and the management function of the hub (master) were contained in a single fund.").*

[77] See *Instructions 2(b)(4) and (c)(4) to Item 22 of Form N-1A ("Every annual report to shareholders required under Rule 30d-1 must contain the following: The information concerning changes in and disagreements with accountants and on accounting and financial disclosure required by Item 304 of Regulation S-K,") and Instructions 4(d) and 5(d) to Item 23 of Form N-2.*

[78] See *Item 5 of Form N-1A (Management's Discussion of Fund Performance).*

[79] See *Item 304 of Regulation S-K (Changes in and Disagreements with Accountants on Accounting and Financial Disclosure).*

the last 10 calendar years in a bar chart. The Item also requires an investment company to include year-to-date return information as of the most recent quarter in a footnote to the bar chart, if the investment company's fiscal year-end is other than the calendar year-end. We interpret these requirements to mean that an investment company must disclose return information as of the calendar year-end or calendar quarter-end most recently completed prior to the date the investment company files its post-effective amendment that includes its financial statements.[80]

Directed Brokerage Reporting in Financial Statements

A recent study by the Commission's Office of Compliance Inspections and Examinations reported that many investment companies failed to "gross up" expenses paid for under directed brokerage and certain expense offset arrangements (e.g., compensating balance arrangement).[81] According to the study, some investment companies failed to gross up their expenses because they deemed the amounts not to be material. Rule 6-07 of Regulation S-X requires the grossing up of expenses regardless of materiality.[82] We would not object, however, if an investment company that has grossed-up its expenses in the statement of operations, omits the expense offset line if the rounded amount is zero. Under these circumstances, the investment company should disclose in a footnote the existence of the arrangements and state the total amount of the expenses that were paid under directed brokerage and expense offset arrangements.

Financial Data Schedules

We no longer require financial data schedules from registrants who file on Form N-4 and Form S-6. Form N-4 and Form S-6 have been removed from the Filer Manual Appendix E list of investment company forms requiring an Article 6 financial data schedule.

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This letter contains information of importance to the company's independent public accountants; therefore, we encourage you to discuss these items with them. Address any questions about the contents of this letter or related matters to John S. Capone, Assistant Chief Accountant, or me, at (202) 942-0590.

Kenneth V. Dominques
Chief Accountant

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[80] *For example, if a fund files a post-effective amendment under rule 485(a) on November 30, then files a post-effective amendment including its financial statements under rule 485(b) on the following January 30, the fund must update its bar chart to include return information for the calendar year which ended between its first filing and its second filing.*

[81] See *Office of Compliance Inspections and Examinations, Securities and Exchange Commission, Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds, (Sept. 22, 1998).*

[82] See *Rule 6-07 of Regulation S-X ("Statement of Operations") and Investment Company Act Release No. 21221 (July 21, 1995) [60 FR 38918 (July 28, 1995] (Payment for Investment Company Services with Brokerage Commissions).*

1999 ANNUAL INVESTMENT COMPANY CFO LETTER

December 30, 1999

Dear Chief Financial Officer:

The accounting staff of the Division of Investment Management has prepared this letter to assist investment company registrants and their independent public accountants in addressing certain accounting-related matters. These comments represent the views of the staff of the Division and are not necessarily those of the Securities and Exchange Commission. The comments addressed in this letter apply to filings, including reports to shareholders, made by registered investment companies.

Management's Statement Regarding Compliance

Rules under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 require that an independent accountant conduct an examination of the securities held by a regulated entity. Specifically, Rules 17f-1 and 17f-2 under the Investment Company Act require an independent accountant to conduct an examination when the securities are maintained in the custody of a member of a national securities exchange, or when the investment company itself maintains custody, respectively. Similarly, Rule 206(4)-2 under the Investment Advisers Act requires an examination when the adviser has custody or possession of client funds or securities. In all three instances, an independent accountant issues a report attesting to management's compliance with these rules, and the independent accountant's report is based upon a statement from management of the adviser or the fund that they have complied with the rules.

Our review of filings on Forms N-17f-1, N-17f-2 and ADV-E has revealed that many registrants have not included *Management's Statement Regarding Compliance* in their filings.[83] To be a complete filing, registrants must attach *Management's Statement Regarding Compliance to the Report of Independent Accountants* in filings on Forms N-17f-1, N-17f-2, and ADV-E.

Accounting for Reimbursement of Expense Waivers

During examinations of registrants, we have noted receivables from fund advisers, under expense reimbursement plans, which have been outstanding for periods extending beyond one year. These receivables did not have corresponding valuation reserves reducing the outstanding receivable balance for potentially uncollectible amounts. Consistent with generally accepted accounting principles, fund management should consider the collectibility of any receivable from an adviser, particularly in circumstances where the receivable is not fully paid as frequently as the adviser receives payment for services provided under the advisory agreement.[84] In addition,

[83] *Forms N-17f-1, N-17f-2, and ADV-E are the filings required by Rules 17f-1 and 17f-2 under the Investment Company Act and Rule 206(4)-2 under the Investment Advisers Act, respectively.*

[84] *We believe that if an adviser redeems its shares in a fund, the redemption proceeds should be reduced by any outstanding receivables due from that adviser at the time of the redemption. See Section 17(a)(3) of the Investment Company Act.*

auditors of a fund's financial statements are reminded of the requirement under generally accepted auditing standards to satisfy themselves that receivables from an adviser or third party are properly valued to reflect collectibility concerns.[85]

Financial Highlights and Fee Table Disclosures

We have reviewed a number of financial highlights tables where registrants have incorrectly calculated the ratio of expenses to average net assets ("the expense ratio"). The expense ratio is calculated by dividing total expenses by average net assets.[86] We have noted that a number of registrants are incorrectly reducing total expenses by brokerage offsets, custodial credits and/or other expense reductions.[87] Certain registrants also are excluding interest and dividend expenses, attributable to securities sold short, from total expenses.[88] Registrants are reminded that total expenses may be reduced only by fee waivers or reimbursements.

In our review of prospectuses, we have noted that some registrants are reducing the fee table expense percentages with custodial credits and/or other third-party offset arrangements. We remind registrants that the use of these credits and offsets to reduce fund expense ratios is inconsistent with the requirements of the form.[89]89 Only contractual waivers or reimbursements may be used to reduce expense percentages in the fee table.[90]

Holding Period for Seed Capital Shares

Recently, we have received a number of questions regarding the holding period for shares purchased pursuant to Section 14(a) of the Investment Company Act as part of a fund's initial registration with the Commission. Some registrants and their sponsors appear to believe that the holding period for seed capital shares is related to the period over which a fund amortizes the organization costs. This view appears to have been the result of the staff's position that if any original shares are redeemed during the five-year amortization period, then the redemption proceeds must be reduced by any unamortized organization costs. Registrants and their sponsors apparently interpret this requirement to suggest that there is a five-year holding period for seed

[85] *When receivables from an adviser or third party are outstanding and possibly uncollectible, a number of other issues arise, including whether the adviser or another affiliated person has violated Section 17(a)(3) of the Investment Company Act, and whether the financial condition of the adviser or other service provider should be disclosed in the fund's prospectus.* See, e.g., In the Matter of Vector Index Advisors, Inc., *Investment Company Act Release No. 22055 (July 8, 1996).*

[86] See *Instruction 4 to Item 9 of Form N-1A; Instruction 16 to Item 4 of Form N-2.*

[87] See *Rule 6-07.2(g) of Regulation S-X.*

[88] See *Letter from Lawrence A. Friend, Chief Accountant, Division of Investment Management, to Chief Financial Officers (Nov. 7, 1997) (section concerning closed-end fund expense ratios).*

[89] See *Item 3 of Form N-1A; Item 3 of Form N-2.*

[90] See *Letter from Barry D. Miller, Associate Director, Division of Investment Management, to Craig S. Tyle, Esq., General Counsel, Investment Company Institute (Oct. 2, 1998).*

capital shares. With the implementation of AICPA SOP 98-5,[91] the ability to capitalize and amortize organization costs over a five-year period was eliminated. Consequently, many registrants and sponsors have asked us whether they may redeem seed capital shares shortly after a fund becomes effective.

We remind registrants and their sponsors that the redemption of seed capital shares is subject to the requirements of Section 14(a) of the Investment Company Act. The legality of a sponsor redeeming seed capital shares depends on the facts and circumstances of the redemption and is not based on the accounting for organization costs.[92]

Adviser Accounting for Offering Costs

In September of 1998, the Financial Accounting Standards Board (FASB) staff addressed the proper accounting treatment for the initial offering costs of closed-end funds in Emerging Issues Task Force (EITF) Topic No. D-76.[93] The FASB staff concluded that an adviser could not capitalize the offering costs of closed-end funds because the adviser was not receiving both a continuing distribution fee and a contingent deferred sales charge (CDSC) or early withdrawal charge (characteristics of certain open-end funds previously addressed by the EITF). Under EITF Issue No. 85-24, advisers of open-end funds are permitted to capitalize offering costs if the adviser is compensated for the offering costs through both Rule 12b-1 fees (a continuing distribution fee) and CDSCs.[94]

Certain closed-end funds, such as hybrid or interval funds ("hybrid funds"), objected to the FASB staff's position on the basis that hybrid funds have many of the same features as open-end funds. Hybrid funds continuously offer shares to the public and honor redemption requests at preset dates, usually quarterly or monthly. Each hybrid fund also receives an exemptive order from the Commission that allows it to charge distribution fees and early withdrawal charges, charges that are similar to Rule 12b-1 fees and CDSCs of open-end funds.[95] In an update to Topic No. D-76, the FASB staff concluded that an adviser to a hybrid fund may capitalize initial offering costs if the adviser receives both a distribution fee and early withdrawal charges. We would not object to the capitalization of initial offering costs in these situations provided that the investment company registrant has received an exemptive order permitting both distribution fees and early withdrawal charges.

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[91]See *American Institute of Certified Public Accountants, Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities" (Apr. 3, 1998).*

[92]*Section 14(a) has been interpreted to mean that a new investment company cannot make a public offering of its securities unless the company has a bona fide net worth of $100,000, and that such amount cannot be loaned or redeemed as a temporary accommodation by those persons who make the investment, nor can there be any intention, when the investment is made, to redeem or dispose of such investment.* See, e.g., Automation Shares, Inc., *37 S.E.C. 771 (1957); Champion Fund, Inc. (pub. avail. Mar. 9, 1972 and June 26, 1972).*

[93]See EITF Topic No. D-76, *"Accounting by Advisors for Offering Costs Paid on Behalf of Funds, When the Advisor Does Not Receive Both 12b-1 Fees and Contingent Deferred Sales Charges" (July 23, 1998; Sept. 23-24, 1998).*

[94]See *EITF Issue No. 85-24, "Distribution Fees by Distributors of Mutual Funds That Do Not Have a Front-End Sales Charge" (June 27, 1985 and Feb. 6, 1986).*

[95]See, *e.g., Cypresstree Asset Management Corporation, et al., Investment Company Act Release Nos. 23312 (July 10, 1998) (notice) and 23378 (Aug. 5, 1998) (order).*

Independence Standards Board Recordkeeping Requirements

In January 1999, the Independence Standards Board issued its first standard, *Independence Discussions with Audit Committees*.[96] The standard requires auditors to discuss their independence with either the company's audit committee or board of directors. Auditors must disclose, in writing, all relationships between the auditor and its related entities and the company and its related entities that may impact an auditor's independence. Auditors also must affirm, in writing, that in their judgment they are independent of the company. We remind registrants that this correspondence is subject to inspection during periodic and other reviews.[97]

Issuance of AICPA Audit and Accounting Guide

On September 14, 1999, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants approved the AICPA Audit and Accounting Guide for Investment Companies. The audit guide outlines changes to existing practice that, in certain areas, differs from the requirements of Regulation S-X under the federal securities laws. For example, the audit guide permits the presentation of a condensed schedule of investments containing only a fund's 50 largest holdings. In contrast, Rule 12-12 of Regulation S-X requires all securities held by a fund to be separately listed in the schedule. We remind registrants that notwithstanding the audit guide, the financial statements of registered investment companies must be prepared in accordance with the requirements of Regulation S-X.

Financial Statements Submitted via EDGAR

We would like to remind registrants that all semi-annual and annual reports must be filed with the Commission within 10 days of distribution to shareholders.[98] Semi-annual and annual reports must be submitted electronically via EDGAR under submission type "N-30D" and other interim or periodic reports should be submitted under type "N-30B-2". We also remind registrants that financial statements can be incorporated into a registration statement, post-effective amendment or other document by reference, but only if the requirements of Rule 303 of Regulation S-T have been met. This letter contains information of importance to the company's

[96] *See Independence Standards Board, Independence Standard No. 1, "Independence Discussions with Audit Committees" (January, 1999). This Standard is effective for companies with fiscal years ending after July 15, 1999.*

[97] See *Rule 31a-1(a) under the Investment Company Act. ("Every registered investment company … shall maintain and keep current the accounts, books, and other documents relating to its business which constitute the record forming the basis for financial statements required to be filed pursuant to Section 30 of the Investment Company Act of 1940 and of the auditor's certificates relating thereto"). Under Rule 2-01(b) of Regulation S-X, an auditor is required to be independent. The new Standard requires the independent accountants to confirm in writing that they are in fact independent. This required communication supports the auditor's certificate that they were independent in performing their duties.*

[98] See *Rule 30b2-1 under the Investment Company Act.*

independent public accountants; therefore, we encourage you to discuss these items with them. Address any questions about the contents of this letter or related matters to Brian D. Bullard, Assistant Chief Accountant, or me, at (202) 942-0590.

Very truly yours,

John S. Capone
Chief Accountant

2001 ANNUAL INVESTMENT COMPANY CFO LETTER

February 14, 2001

Dear Chief Financial Officer:

The accounting staff of the Division of Investment Management has prepared this letter to assist investment company registrants and their independent public accountants in addressing certain accounting-related matters. These comments represent the views of the staff of the Division and are not necessarily those of the Securities and Exchange Commission. The comments addressed in this letter apply to filings, including reports to shareholders, made by registered investment companies and investment advisers.

Audit Guide Implementation

On November 21, 2000, the American Institute of Certified Public Accountants revised its Audit and Accounting Guide, Audits of Investment Companies. The revised Guide codifies new accounting standards on several issues, including amortization of premium or discount on bonds, accounting for offering costs, and the accounting for excess expense plans. Registrants and their auditors are reminded that Staff Accounting Bulletin No. 74 requires disclosure of the impact of new accounting standards that have been promulgated, but are not yet effective, in the footnotes to the financial statements.[99] This disclosure should include a brief description of the new standard, a discussion of the methods of adoption allowed by the standard, a discussion of the impact that adoption of the standard is likely to have on the financial statements, and disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard.[100]

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[99]*See Disclosures by Registrant When an Accounting Standard Has Been Issued But Not Yet Adopted, SEC Staff Accounting Bulletin No. 74, 53 Fed. Reg. 110 (1987) (Adding Topic 11-M "Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period" to the Staff Accounting Bulletin Series). SAB 74 states:*

The staff believes that this disclosure guidance applies to all accounting standards which have been issued but not yet adopted by the registrant unless the impact on its financial position and results of operations is not expected to be material. In those instances where a recently issued standard will impact the preparation of, but not materially affect, the financial statements, the registrant is encouraged to disclose that a standard has been issued and that its adoption will not have a material effect on its financial position or results of operations. When adoption of new accounting standards have a material impact on a registrant's financial position and results of operations, disclosure should be made in the footnotes to the company's financial statements.

[100]*Under Item 77L of Form N-SAR, registrants are required to indicate any change in accounting principle that will materially affect the registrant's financial statements filed, or to be filed, for the current fiscal year with the Commission. Item 77L also requires the registrant's accountants to prepare a letter discussing the preferability of the accounting change to accompany this disclosure. We will not, however, require this letter if an accounting change results solely from a standard promulgated by a new Audit and Accounting Guide.*

Senior Securities Table Disclosure

Item 4 of Form N-2 requires the registration statement of closed-end funds to disclose debt coverage information in a senior securities table.[101] This information is required to be audited.[102] Several registrants and their auditors have asked questions about compliance with the audit requirement. In meeting the form's requirements to include financial statements, financial highlights and an audit opinion covering the financial statements and financial highlights, registrants typically incorporate by reference the annual report.[103] The senior securities table information, however, is usually not contained in the annual report because this information is only required in the registration statement. As a result, the audit opinion does not cover the senior securities table information. Registrants, therefore, have asked whether the senior securities table information can be deemed audited because it is derived from information contained in the audited financial statements, even though it is not covered by the auditors' opinion on the financial statements and financial highlights.

We do not believe the requirement that the senior securities table be audited is met merely because the information in the table is derived from audited financial statements. To meet the audit requirement, the independent accountant must express an opinion on the senior securities table itself or on a financial statement or financial highlights that include the senior securities table. Registrants must include, or incorporate by reference, this opinion in the registration statement. One way to meet the senior securities audit requirement is for the registrants to include the senior securities table information with the per share and ratio information in the financial highlights. Since the financial highlights are specifically covered by the audit opinion, the senior securities table information also would be covered. If registrants, however, include the senior securities table information elsewhere in the annual report, the audit opinion must expressly cover the senior securities table. Alternatively, if a registrant includes the senior securities table only in the registration statement, the registrant should file a separate opinion in the registration statement covering the senior securities table information.

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[101] *Item 4.3 of Form N-2, (captioned Senior Securities (hereinafter "Senior Securities Table")) states:*

Furnish the following information as of the end of the last ten fiscal years for each class of senior securities (including bank loans) of Registrant. If consolidated statements were prepared as of any of the dates specified, furnish the information on a consolidated basis: (1) Year; (2) Total Amount Outstanding Exclusive of Treasury Securities; (3) Asset Coverage Per Unit; (4) Involuntary Liquidating Preference Per Unit; and (5) Average Market Value Per Unit (Exclude Bank Loans).

[102] *Item 4.3 instructs registrants preparing the senior securities table to follow Instruction 8 to Item 4.1, which requires the senior securities table to be audited.*

[103] *Item 23 of Form N-2, (captioned Financial Statements), prescribes the contents of annual reports to shareholders required by Section 30(d) of the Investment Company Act of 1940 ("1940 Act"). The annual report must include the financial statements prescribed under Articles 3 and 6 of Regulation S-X (17 C.F.R. §§ 210.3-01 to -20, 210.6-01 to -10 (2000)) and the financial highlights table under Item 4.1 of the Form. Item 23 of Form N-2 does not specifically require the senior securities table to be included in annual reports to shareholders.*

AIMR Performance Verification and Auditor Consents

An increasing number of registrants include certain private account performance information of investment advisers in their registration statements and disclose that this information is presented in accordance with the Association for Investment Management & Research Performance Presentation Standards ("AIMR-PPS"). We have noted that a number of these presentations do not fully comply with the requirements of AIMR-PPS. For example, many presentations do not include the standard compliance statement required by AIMR-PPS.[104] If registrants choose to disclose that performance information is prepared and presented in accordance with AIMR-PPS, then we remind registrants that it may be misleading to not comply with all of the performance and presentation standards required by the AIMR standards.[105] Additionally, when a third party, such as an independent public accountant, is named in a registration statement as having performed a verification in accordance with AIMR-PPS, the written consent of that third party is required to be filed as an exhibit to the registration statement.[106]

Discounting Market Quotations for Large Holdings (Block Discounts)

We recently received a question about whether it is appropriate for a registered investment company to value an unrestricted security at a discount or premium from a readily available market quotation based solely on the size of the investment company's holding. The 1940 Act requires a registered investment company to value securities using market quotations when they are readily available.[107] Therefore, we do not believe it is appropriate to discount or mark-up a readily available market price for an unrestricted security solely because an investment company holds a large quantity of the outstanding shares of an issuer or holds an amount that is a significant portion of the security's average daily trading volume.

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[104]*For current AIMR standards, see Association of Investment Management and Research, AIMR Performance Presentation Standards Handbook (2d Ed. 1996). In addition to a number of other presentation requirements required by AIMR, investment advisers seeking to comply with the AIMR-PPS must include a compliance statement to accompany all performance presentations: "[insert firm name] has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS). AIMR has not been involved with the preparation or review of this report."*

[105]*As part of its inspections program, the Office of Compliance Inspection and Examinations routinely reviews the disclosure and compliance practices of registrants that claim compliance with AIMR-PPS.*

[106]*Section 7 of the 1933 Act states:*

If any accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement. 15 U.S.C. § 77g(a) (2000).

[107]*See 15 U.S.C. § 80a-2(a)(41) (2000) (Section 2(a)(41) of the 1940 Act); 17 C.F.R. § 270.2a-4 (2000) (Rule 2a-4 under the 1940 Act).*

Updating Requirements for Financial Highlights Included in a Registration Statement Subsequent to a Stock Split

Several registrants have asked whether retroactive adjustment to the financial highlights and financial statements is required after an investment company issues a stock split.[108] Staff Accounting Bulletin Topic 4C requires that a change in capital structure be presented retroactively if such change occurs before the release of the financial statements or the effective date of the registration statement, whichever is later.[109] When a stock split occurs after the effective date of the registration statement, some registrants make a supplemental filing pursuant to Rule 497 ("sticker") to provide investors with information about the transaction, including an updated financial highlights table showing the effect of the stock split on a per share basis. Since the supplemental filing under Rule 497 does not update the registration statement, this information does not need to be audited. When a registrant files its annual update or any other post-effective amendment to the registration statement, however, the registrant is required to include an audited retroactively adjusted financial highlights table.

Pro Forma Financial Statements and Filings Pursuant to Rule 488 of the Securities Act of 1933

Typically, management investment companies file a registration statement on Form N-14 when merging investment companies and may elect to file pursuant to Rule 488 under the 1933 Act requesting automatic effectiveness.[110] As a condition to Rule 488, the filing must be materially complete. We have seen a growing number of registration statements filed pursuant to Rule 488 that do not include the required pro forma, audited annual, or unaudited semi-annual financial statements. When an open-end investment company files pursuant to Rule 488 and excludes this information, the staff considers the filing materially incomplete, and will suspend the automatic effectiveness by notifying the registrant in writing.[111]

Financial Highlights and Financial Statements During Reorganizations When Performance is being Carried Over

The staff receives numerous inquiries each year on the financial statements and financial highlights requirement for "shell" investments companies who utilize the historical performance of a predecessor entity subsequent to reorganization. In August, the Division granted no-action relief to Janus Adviser Series, permitting the Adviser Series to use the historical performance information of the predecessor entities (in this case several classes) in their initial registration statement provided that, among other things, Adviser Series represented it would carry forward

[108] *A fund must provide its financial highlights pursuant to either Item 9 of Form N-1A, or Item 4 of Form N-2.*

[109] *See Topic 4-C of the Staff Accounting Bulletin Series ("Change in Capital Structure").*

[110] *Rule 488(a) under the 1933 Act states: "A registration statement filed on Form N-14 by a registered open-end management investment company … shall become effective on the thirtieth day after the date upon which it is filed with the Commission …." 17 C.F.R. § 230.488(a) (2000).*

[111] *Rule 488(b) under the 1933 Act states: "No registration statement shall become effective pursuant to paragraph (a) of this section if, prior to the effective date of the registration statement, it should appear to the Commission that the registration statement may be incomplete or inaccurate in any material respect and the Commission furnishes to the registrant written notice that the effective date is to be suspended." 17 C.F.R. § 230.488(b) (2000).*

the financial statements and financial highlights of the predecessor entities and report their historical financial information as their own.[112] When investment companies reorganize existing funds or classes into new "shell" entities and carry over past performance information, the new "shell" entities should also carryover the prior financial highlights and financial statements.

Auditor Independence Issues

In last year's "Dear CFO Letter," we reminded registrants of the requirements of Independence Standards Board, Independence Standard No. 1, Independence Discussions with Audit Committees (ISB No.1).[113] ISB No.1 requires auditors to discuss, in writing, all relationships between the auditor and its related entities and the company and its related entities that may impact an auditor's independence and affirm, in writing, that in their professional judgment they are independent of the company.[114] During our examination of registrants, we have found several instances where the auditor did not deliver the required written correspondence to the audit committee or board of directors. We remind registrants and auditors for both investment companies and investment advisers that auditors of any financial statements filed with the Commission must comply with the provisions of ISB No.1.[115]

ISB No.1 also requires auditors to discuss their independence with management. In this discussion we encourage the board of directors or their audit committee to consider the Commission's recently adopted rule amendments concerning auditor independence.[116] Those amendments identify certain relationships that render an accountant not independent of an audit client. The relationships addressed include, among others, financial, employment, and business relationships between auditors and audit clients, and relationships between auditors and audit clients where the auditors provide certain non-audit services to their audit clients. As applied to investment companies and investment advisers, we encourage a robust discussion of services provided by auditors to related entities within the mutual fund complex, including affiliated broker/dealers and other funds in the complex and the potential independence issues that may arise.

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[112]*See Janus Adviser Series (pub. avail. Aug. 28, 2000).*

[113]*See Independence Standards Board, Independence Standard No. 1, "Independence Discussions with Audit Committees" (Jan., 1999). ISB No.1 became effective for audits of companies with fiscal years ending after July 15, 1999.*

[114]*See Letter from John S. Capone, Chief Accountant, Division of Investment Management to Chief Financial Officer (pub. avail. Dec. 30, 1999).*

[115]*Audited financial statements filed with the Commission in compliance with forms under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 must follow Regulation S-X, including those filed pursuant to Schedule G of Form ADV. See, e.g., 17 C.F.R. § 210.1-01(a)(4) (2000). Rule 2-01 of Regulation S-X requires an auditor to be independent. 17 C.F.R. § 210.2-01 (2000). For those advisors that are sole proprietors, or who do not have a board of directors, or an audit committee or their equivalents, correspondence should be addressed to the person, or group of persons, who is responsible for selecting and ratifying the independent auditor.*

[116]*See Revisions of the Commission's Auditor Independence Requirements, Securities Act Release No. 7919, 65 Fed. Reg. 76008, (Nov. 21, 2000).*

Ratification of Independent Accountants

The Commission has adopted amendments to the rules under the 1940 Act effective February 15, 2001, which pertain to the role of independent directors of investment companies.[117] Included in the amendments is Rule 32a-4, a new rule that exempts investment companies from the Act's requirement that shareholders vote on the selection of the fund's independent public accountant if the investment company has an audit committee composed wholly of independent directors.[118] While the rule is optional, we encourage investment company registrants to consider adopting an audit committee consisting solely of independent directors.

This letter contains information of importance to your company's independent public accountants; therefore, we encourage you to discuss these items with them. Address any questions about the contents of this letter or related matters to Brian D. Bullard, Kenneth B. Robins, Assistant Chief Accountants, or me, at (202) 942-0590.

Very truly yours,

John S. Capone
Chief Accountant

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[117]*See Role of Independent Directors of Investment Companies, Investment Company Act Release No. IC-24816, 66 Fed Reg. 3,734 (2001).*

[118]*This rule is effective February 15, 2001. See Id. at 3,745. Under the provisions of this rule, a registered management investment company, or a registered face-amount certificate company, is exempt from the provision of section 32(a)(2) of the Act (codified at 15 U.S.C. § 80a-32(a)(2) (2000)) that requires the selection of the company's independent public accountant be submitted for ratification or rejection at the next succeeding annual meeting of shareholders, if: (a) The company's board of directors has established a committee, composed solely of directors who are not interested persons of the company, that has responsibility for overseeing the fund's accounting and auditing processes ("audit committee"); (b) The company's board of directors has adopted a charter for the audit committee setting forth the committee's structure, duties, powers, and methods of operation or set forth such provisions in the fund's charter or bylaws; and (c) The company maintains and preserves permanently in an easily accessible place a copy of the audit committee's charter and any modification to the charter.*

DISCLOSURE AND COMPLIANCE MATTERS FOR INVESTMENT COMPANY REGISTRANTS THAT INVEST IN COMMODITY INTERESTS

The staff of the Division of Investment Management has noted an increase in the use by investment companies that are registered under the Investment Company Act of 1940 ("funds") of derivatives that are commodity interests under the rules of the Commodity Futures Trading Commission ("commodity interests").[1] This Guidance Update summarizes views of the Division regarding certain disclosure and compliance matters relevant to funds that invest in commodity interests. The guidance is intended to assist those funds in preparing disclosure filings and in their consideration of compliance issues. In addition, the Division is continuing its ongoing review of funds' use of derivatives, including commodity interests, and the associated regulatory issues.

In February 2012, the Commodity Futures Trading Commission ("CFTC") revised its requirements for determining which sponsors of funds should be required to register as commodity pool operators ("CPOs").[2] At the same time, the CFTC issued a rule proposal to address concerns that had been raised by commenters regarding the need for harmonization between Securities and Exchange Commission ("SEC") disclosure and reporting requirements applicable to funds and CFTC requirements that would apply to sponsors of funds required to register as CPOs.[3] Since that time, the staff of the Division of Investment Management and the staff of the CFTC have worked together, with a view to harmonizing the requirements of the SEC and CFTC in a manner that would result in the provision of material information to investors in funds that invest in commodity interests without imposing duplicative, inconsistent, and burdensome requirements on funds and their sponsors. It is our intent that the views expressed in this Guidance Update facilitate compliance with SEC and CFTC disclosure and reporting requirements by funds and their sponsors that are subject to regulation by both agencies.

I. Disclosure of Derivatives and Associated Risks

The staff of the Division has previously provided its observations regarding derivatives-related disclosures by funds in registration statements and shareholder reports.[4] We wish to reiterate the views expressed previously and, in particular, to highlight our concern that funds adequately disclose the risks associated with investments in commodity interests.

Form N-1A, the form used by mutual funds 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"), requires a fund to disclose in its prospectus its principal investment strategies, including the type or types of securities in which the fund principally invests or will invest.[5] Further, Form N-1A requires a mutual fund to disclose in its prospectus the principal risks of investing in the fund, including the risks to which the fund's particular portfolio as a

whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, or total return.[6] Investment strategies used by a fund that are not principal strategies, and the risks of those strategies, should generally be disclosed in the fund's statement of additional information.[7]

Similarly, Form N-2, the form used by closed-end funds to register under the Investment Company Act and to offer their securities under the Securities Act, requires a closed-end fund to describe the investment objectives and policies that will constitute its principal portfolio emphasis, including the types of securities in which the fund invests or will invest principally.[8] Form N-2 also requires a closed-end fund to discuss principal risk factors associated with investment in the fund specifically as well as factors generally associated with investment in a fund with investment objectives, investment policies, capital structure, or trading markets similar to those of the fund.[9] Finally, Form N-2 also requires discussion of the types of investments that will be made by the fund, other than those that will constitute its principal portfolio emphasis, and any policies or practices relating to those investments.[10]

As we have previously stated, we believe that all funds that use or intend to use derivative instruments should assess the accuracy and completeness of their disclosure, including whether the disclosure is presented in an understandable manner using plain English.[11] Further, any principal investment strategies disclosure related to derivatives should be tailored specifically to how a fund expects to be managed and should address those strategies that the fund expects to be the most important means of achieving its objectives and that it anticipates will have a significant effect on its performance.[12] In determining the appropriate disclosure, a fund should consider the degree of economic exposure the derivatives create, in addition to the amount invested in the derivatives strategy.[13] This disclosure also should describe the purpose that the derivatives are intended to serve in the portfolio (*e.g.*, hedging, speculation, or as a substitute for investing in conventional securities),[14] and the extent to which derivatives are expected to be used.

Additionally, the disclosure concerning the principal risks of the fund should similarly be tailored to the types of derivatives used by the fund, the extent of their use, and the purpose for using derivatives transactions.[15] The risk disclosure in the prospectus for each fund should provide an investor with a complete risk profile of the fund's investments taken as a whole, rather than a list of risks of various derivative strategies, and should reflect anticipated derivatives usage. We note that investment strategies that employ derivatives, including commodity interests, may introduce risks in addition to those associated with investments in the cash markets, and that we expect funds that use such strategies to address those risks in their disclosures where the information is material to investors. Such a fund should, for example, disclose material risks relating to volatility, leverage, liquidity, and counterparty creditworthiness that are associated with trading and investments in derivatives that are engaged in, or expected to be engaged in, by the fund.

Finally, a fund should assess on an ongoing basis the completeness and accuracy of the derivatives-related disclosures in its registration statement in light of its actual operations. In

particular, a fund should assess, based upon its actual operations, whether it is meeting the requirements to completely and accurately disclose its anticipated principal investment strategies and risks. A fund should review its use of derivatives when it updates its registration statement annually and assess whether it needs to revise the disclosures in its registration statement that describe its principal derivatives strategies and risks. Revisions may also be required at other times in light of a fund's actual operations.[16]

II. Performance Presentations

At times, a new fund, with no (or a short) performance track record of its own, may seek to include in its prospectus the performance record of other funds or private accounts managed by the fund's investment adviser. A fund that pursues a strategy of investing in commodity interests, for example, may seek to include in its prospectus the performance records of other funds or private accounts that are managed by the fund's investment adviser and that also invest in commodity interests.

Section 34(b) of the Investment Company Act makes it unlawful for a fund to include in a registration statement filed with the SEC any untrue statement of a material fact, or to omit to state any fact necessary in order to make the information in a registration statement not materially misleading.[17] Section 34(b), however, does not prohibit a fund from including in its registration statement information that is not required by the applicable registration form. The general instructions for preparing a registration statement on Form N-1A or Form N-2 expressly contemplate that a fund may include non-required information. Those instructions state that a fund may include information in addition to that called for by the applicable items of the form, provided that "the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of" the required information.[18] The staff of the Division of Investment Management has previously expressed the view that a fund may include in its prospectus information concerning the performance of private accounts and other funds managed by the fund's adviser that have substantially similar investment objectives, policies, and strategies to the fund, provided that the information is not presented in a misleading manner and does not obscure or impede understanding of information that is required to be included in the fund's prospectus (including the fund's own performance information).[19]

We wish to emphasize that a fund, such as a newly registered fund that invests in commodity interests, that includes in its registration statement information concerning the performance of private accounts or other funds managed by the fund's adviser is responsible for ensuring that the information is not materially misleading. Specifically, we expect that a fund that includes the performance of other funds or private accounts managed by the fund's adviser in its registration statement would generally include the performance of all other funds and private accounts managed by the adviser that have investment objectives, policies, and strategies substantially similar to those of the fund. We note, in particular, that a fund should not exclude the performance of any other funds or private accounts that have substantially similar investment objectives, policies, and strategies if the exclusion would cause the performance shown to be materially higher

or more favorable than would be the case if the funds or accounts were included. A fund should only exclude funds or private accounts if the exclusion would not cause the performance to be materially misleading.[20]

III. Legend Requirement

Rule 481 under the Securities Act requires a fund to provide a legend in plain English on the outside front cover page that indicates that the SEC has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure in the prospectus and that any contrary representation is a criminal offense.[21] Although rule 481 sets forth examples of language that may be used for the legend, the rule also permits funds to use other clear and concise language. As a result, the staff would not object if a fund that invests in commodity interests includes in the required plain English legend language that also indicates that the CFTC has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure in the prospectus.

IV. Compliance and Risk Management

Effective implementation of a fund's investment objectives and policies requires effective management of the risks associated with those objectives and policies. A fund that uses commodity interests to implement its investment objectives and policies should effectively manage those derivatives, including their associated risks. Day-to-day responsibility for managing the fund's portfolio, including any commodity interests and their associated risks, rests with the fund's investment advisers. In addition, the fund's board generally oversees the adviser's risk management activities as part of the board's oversight of the adviser's management of the fund.

Rule 206(4)-7(a) under the Investment Advisers Act of 1940 ("Advisers Act") is a compliance rule for registered investment advisers. The rule makes it unlawful for an investment adviser registered with the SEC to provide investment advice unless the adviser has adopted and implemented written policies and procedures reasonably designed to prevent violation of the Advisers Act by the adviser or any of its supervised persons.[22]

In adopting the compliance rule for advisers, the SEC stated its expectation that an adviser's policies and procedures would, among other things, address portfolio management processes, including consistency of portfolios with clients' investment objectives, as well as the accuracy of disclosures made to investors, clients, and regulators.[23]

Rule 38a-1 under the Investment Company Act is a compliance rule for funds. The rule requires each fund to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund and to obtain the approval of those policies and procedures by the fund's board of directors, including a majority of directors who are not interested persons of the fund.[24] The fund's policies and procedures are required to include provisions for the fund to oversee compliance by its investment advisers and other service providers. In adopting the compliance rule for funds, the SEC noted that funds' or their advisers'

policies and procedures should address the same issues that it expected advisers to address under the advisers' compliance rule.[25] As noted in the preceding paragraph, this includes policies and procedures that address portfolio management processes, including consistency of portfolios with clients' investment objectives, as well as the accuracy of disclosures made to investors, clients, and regulators.

The staff would therefore expect that funds and their advisers would adopt policies and procedures that address, among other things, consistency of fund portfolio management with disclosed investment objectives and policies, strategies, and risks. We recognize that the policies and procedures of funds and their advisers may vary in the specificity with which they address consistency with particular disclosures, such as disclosures about the use of derivatives generally and commodity interests specifically. We would expect, however, that each fund would have in place policies and procedures that are sufficient to address the accuracy of disclosures made about the fund's use of derivatives, including commodity interests, and associated risks, as well as consistency of the fund's investments in these derivatives with the fund's investment objectives. These policies and procedures should be reasonably designed, for example, to prevent material misstatements about the fund's use of derivatives, including commodity interests, and the associated risks. In addition, the fund's annual review required under rule 38a-1 should assess the adequacy of such policies and procedures and the effectiveness of their implementation.

We also remind funds that they are required to disclose in the statement of additional information the extent of the board's role in the risk oversight of the fund, such as how the board administers its oversight function.[26] In adopting this requirement, the SEC noted that funds face a number of risks, including investment risk.[27] The SEC also stated its belief that the required disclosures would improve investor understanding of the role of the board in the fund's risk management practices and should provide important information to investors about how a fund perceives the role of its board and the relationship between the board and the fund's adviser in managing material risks facing the fund.[28]

Finally, we note that a Risk and Examinations Office has recently been created within the Division of Investment Management. The Risk and Examinations Office is responsible for analyzing and monitoring the risk management activities of investment advisers, investment companies, and the investment management industry as well as new products. The group has already started to work closely with the SEC's Office of Compliance Inspections and Examinations to make onsite visits to investment management firms. These visits are designed to increase the staff's understanding of firms' risk management activities, including risk management activities related to commodity interests and other derivatives; generate an active dialogue between the staff and firms on key risk and other issues facing firms and the industry; and help inform policy and the examination process.

Endnotes

[1]*See* 17 CFR 1.3(yy) (definition of "commodity interest," which includes commodity futures, commodity options contracts, and swaps).

[2]Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 FR 11252 (Feb. 24, 2012).

[3]Harmonization of Compliance Obligations for Registered Investment Companies Required To Register as Commodity Pool Operators, 77 FR 11345 (Feb. 24, 2012).

[4]Letter from Barry D. Miller, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to Karrie McMillan, General Counsel, Investment Company Institute (July 30, 2010).

[5]*See* Items 4(a) and 9(b)(1) of Form N-1A. Whether a particular strategy, including a strategy to invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the fund's investment objectives, and how the strategy affects the fund's potential risks and returns. *See* Instruction 2 to Item 9(b)(1) of Form N-1A. In assessing what is a principal investment strategy, a fund should consider, among other things, the amount of the fund's assets expected to be committed to the strategy, the amount of the fund's assets expected to be placed at risk by the strategy, and the likelihood of the fund losing some or all of those assets from implementing the strategy. *Id.*

[6]*See* Items 4(b)(1) and 9(c) of Form N-1A.

[7]*See* Item 16(b) of Form N-1A.

[8]*See* Item 8.2 of Form N-2.

[9]*See* Item 8.3(a) of Form N-2.

[10]*See* Item 8.4 of Form N-2.

[11]Letter from Barry D. Miller, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to Karrie McMillan, General Counsel, Investment Company Institute, at 4 (July 30, 2010).

[12]In the staff's view, a fund that references types of derivatives in its principal investment strategies disclosure that the fund does not expect to use in connection with the fund's principal investment strategies has not provided disclosure that is consistent with the intent of the registration form requirements. Any strategy that is not a principal investment strategy, including one involving derivatives, should be clearly described as non-principal in the registration statement. *See* Item 16(b) of Form N-1A; Item 8.4 of Form N-2.

[13]*See* Instruction 2 to Item 9(b)(1) of Form N-1A. Derivatives-related disclosure should also be provided commensurate with the level of derivatives exposure of a fund. For example, a small investment in some derivatives does not necessarily correlate with little effect on a fund's performance because of the impact of leverage. Alternatively, a fund may have significant exposure to derivatives, but that exposure may not make the fund substantially riskier (*e.g.,* exposure by an international fund to currency forwards, entered into to hedge against the currency risk of securities that trade in those currencies, would more likely reduce the fund's overall risk rather than increase it).

[14]For example, some funds invest in the combination of an equity-linked derivative and fixed-income securities to create the economic equivalent of investing directly in the underlying equity security. Some funds invest in derivatives in an attempt to enhance returns, *i.e.,* to magnify the gain. Still other funds may invest in interest rate swaps to hedge against their interest rate exposure.

[15]Some funds generically describe the risks of investing in derivatives, yet different derivatives are subject to varying risks. For example, derivatives that are not traded on an exchange may be subject to heightened liquidity and valuation risks.

[16]*See, e.g., In the Matter of OppenheimerFunds, Inc., and OppenheimerFunds Distributor, Inc.,* Admin. Proc. File No. 3-14909, Securities Act Release No. 9329 (June 6, 2012) (finding violations of Section 34(b) of the Investment Company Act and Section 17(a)(2) of the Securities Act when a fund, which had disclosed that its returns would mainly be a function of investments in high-yield bonds, failed to disclose its practice of using total return swaps to obtain leveraged exposure to residential mortgage-backed securities, and the risks associated therewith).

[17]*See In the Matter of Fred Alger Management, Inc.,* Admin. Proc. File No. 3-7320, Investment Company Act Release No. 17358 (Feb. 26, 1990) (finding violation of Section 34(b) when a fund failed to include information in its prospectus necessary to make presentation of adviser's prior performance not materially misleading).

In addition, rule 10b-5 under the Securities Exchange Act of 1934 makes it unlawful to make any untrue statement of a material fact in connection with the purchase or sale of any security or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. 17 CFR 240.10b-5.

[18]General Instruction C.3(b) to Form N-1A; General Instruction 2 for Parts A and B to Form N-2.

[19] *See, e.g.,* ITT Hartford Mutual Funds (pub. avail. Feb. 7, 1997) (fund may include in marketing materials performance information for other funds managed by the same adviser with investment objectives, policies, and strategies substantially similar to those of the fund); Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996) (fund may include in prospectus performance information for private accounts managed by the fund's adviser with investment objectives, policies, and strategies substantially similar to those of the fund).

[20] *See* Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996) (fund may exclude similar accounts from a composite, so long as the exclusion would not cause the composite performance to be misleading).

[21] 17 CFR 230.481.

[22] 17 CFR 275.206(4)-7(a).

[23] Investment Advisers Act Release No. 2204, text accompanying note 17 (Dec. 17, 2003) [68 FR 74714, 74716 (Dec. 24, 2003)].

[24] 17 CFR 270.38a-1.

[25] Investment Advisers Act Release No. 2204, text accompanying note 37 (Dec. 17, 2003) [68 FR 74714, 74717 (Dec. 24, 2003)].

[26] Item 17(b)(1) of Form N-1A; Item 18.5(a) of Form N-2.

[27] Investment Company Act Release No. 29092 (Dec. 16, 2009) [74 FR 68334, 68345 (Dec. 23, 2009)].

[28] *Id.*

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FUND NAMES SUGGESTING PROTECTION FROM LOSS

In the staff's view, when a mutual fund or other investment company ("fund") uses a name that suggests safety or protection from loss, the name may contribute to investor misunderstanding of the risks associated with an investment in the fund and, in some circumstances, could be misleading. The staff encourages any fund that exposes investors to market, credit, or other risks, and whose name suggests safety or protection from loss, to reevaluate the name and to consider changing the name, as appropriate, to eliminate the potential for investor misunderstanding.

The staff has recently heightened its scrutiny of fund names suggesting safety or protection from loss and has determined to object to names that may create an impression of protection or safety or absence of risk of loss, where the name does not include qualifying language that defines the scope and limits of such protection. We believe that the terms "protected," "guaranteed," and similar terms, when used in a fund name without some additional qualification, may contribute to investor misunderstanding about the potential for loss associated with an investment in the fund.[1] As a result, in the disclosure review process, the staff recently requested that some existing and new funds change their names. The staff took this action in response to an increase in the use of the term "protected" in fund names in situations where that term was used without a qualification that would adequately describe the nature and limits of any protection offered by the fund.

For example, some funds that seek to manage the fund's volatility by investing a portion of the fund's assets in cash, short-term fixed income instruments, short positions on exchange-traded futures, or other investments included the term "protected" in their name. The staff was concerned that these names could convey to investors a level of protection from loss that was not present because the degree to which a managed volatility strategy may succeed or fail is uncertain. In response to the staff's recently articulated concerns, some funds have chosen to replace the term "protected" with terms such as "managed risk."

The staff has also become concerned about the inclusion of the term "protected" in a fund's name in some cases where the fund has entered into a contract with a third party to make up a shortfall in the net asset value of the fund. In those cases, the protection may be limited in various ways, including by contractual limits on the amount of protection or the window of time during which the third party is obligated to make up any shortfall in the fund's net asset value, or by contractual provisions for termination of the third party's obligation in certain scenarios. In addition, an investor in the fund is subject to credit risk associated with the third party provider, which could become unable to fulfill its obligation under the contract. For these reasons, the staff believes that a fund that has entered into a contract with a third party to make up a shortfall in the net asset value of the fund should not use a term like "protected" in its name unless the name adequately communicates the limitations of the "protection" provided by the third party. To date, the staff has not identified any fund names that use the term "protected" in these circumstances and that adequately communicate the limitations of the third party "protection."

The staff acknowledges that a fund's name, like any other piece of information about a fund, cannot tell the whole story about the fund.[2] We also acknowledge that the staff has recently requested name changes in situations in which a fund had provided prospectus disclosures that explained limitations on the scope of "protection" provided by the fund that were not revealed by the name itself. We have made these requests because we believe that, in practice, investors sometimes focus on a fund's name to determine the fund's investments and risks, either because the name sometimes appears without the clarifying prospectus disclosures (*e.g.*, in advertisements) or because of the prominence of a fund's name or for other reasons.[3] As a result, the staff believes that when a fund uses a name that suggests safety or protection from loss investors may conclude, at least in certain circumstances, that the fund offers greater protection from loss than is the case. Accordingly, we encourage investment advisers and funds' boards of directors to carefully evaluate any fund name that suggests safety or protection from loss and to consider whether a name change is appropriate to address any potential for investor misunderstanding.

Endnotes

[1]The staff of the Division of Corporation Finance has expressed similar concerns about the titles of structured notes. *See* Sample Letter Sent to Financial Institutions Regarding Their Structured Note Offerings Disclosure in Their Prospectus Supplements and Exchange Act Reports (Apr. 2012), www.sec.gov/divisions/corpfin/guidance/structurednote0412.htm (noting that Division of Corporation Finance staff had previously indicated that note titles using the term "principal protected" should also include balanced information about limitations to the principal protection feature and advising issuers in future structured note offerings to evaluate the titles of the notes and revise them to clearly describe the product in a balanced manner and avoid titles that stress positive features without also identifying limiting or negative features).

[2]Investment Company Act Release No. 24828, Section I (Jan. 17, 2001) [66 FR 8509, at 8509-10 (Feb. 1, 2001)].

[3]*See* S. Rep. No. 293, 104th Cong., 2d Sess. 9 (1996) (noting that when making an investment decision, investors may focus on fund names to determine the fund's investment objective and level of risk).

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GUIDANCE REGARDING MUTUAL FUND ENHANCED DISCLOSURE

To further the Commission's goal of clear and concise, user-friendly disclosure, the staff is providing this guidance related to the Commission's enhanced mutual fund disclosure amendments adopted in 2009.[1] This guidance is based on comments the staff of the Division of Investment Management has provided to a number of funds and their counsel related to these amendments, and is intended to focus funds on certain form and rule requirements to provide investors with improved disclosure.

Background

On January 13, 2009, the Commission issued amendments to Form N-1A, the registration form used by mutual funds, in order to enhance the disclosures that are provided to mutual fund investors.[2] Noting that mutual fund prospectuses were often long and too frequently the language was complex and legalistic, the Commission adopted, among other things, amendments to Form N-1A to provide investors with information that is easier to use and more readily accessible.[3] The foundation of the improved disclosure framework was the provision to all investors of streamlined and user-friendly information that is key to an investment decision.[4] The amendments required the information to appear in plain English in a standardized order at the beginning (*i.e.*, the "Summary Section") of the mutual fund statutory prospectus.[5] The key information in the Summary Section includes investment objectives and strategies, risks, costs and performance.[6] The Commission stated that it intended this information be presented succinctly, in three or four pages, at the front of the prospectus.[7]

In addition to the amendments to Form N-1A, the Commission also adopted amendments to Rule 498 under the Securities Act, providing a new option for satisfying prospectus delivery obligations with respect to mutual fund securities under the Securities Act.[8] Under this option, the key information that is included in the Summary Section of the statutory prospectus is sent or given to investors in the form of a Summary Prospectus. The statutory prospectus is provided on an Internet Web site and funds are required to send it by paper or email upon an investor's request. The Commission's framework provides for a layered approach to disclosure in which key information is sent or given to the investor and access to more detailed information is provided.[9] While use of the Summary Prospectus is optional, it has been widely adopted. In the staff's estimate, based on the number of Summary Prospectuses filed with the Commission as of March 31, 2014, well in excess of 80% of mutual funds offer investors Summary Prospectuses.

The staff has now reviewed disclosures related to these amendments for several years, and the staff continues to provide registrants with comments concerning these amendments. This guidance is intended to further the Commission's goal of clear and concise, user-friendly disclosure. While this guidance does not specifically relate to compliance with Rule 498, it does relate to the content of Summary Prospectuses, through the disclosures contained in the Summary Section of the statutory prospectus.

Staff Observations

The staff has observed that funds often provide clear and concise disclosure in response to the specific Summary Section requirements of Form N-1A. There are a significant number of prospectuses, however, in which disclosure remains complex, technical and duplicative. Further, the staff continues to see what it believes are unnecessarily long Summary Sections. In the Adopting Release, the Commission explicitly noted that it shares the concerns of some commenters that, over time, Summary Sections could get longer, undermining the usefulness of the summary.[10] While the Commission did not impose page limits on the Summary Section, stating that doing so could constrain appropriate disclosure, the Commission emphasized its intent that funds prepare a concise summary (on the order of three or four pages) that will provide key information.[11] Notwithstanding the Commission's expressed intent, it is not unusual for the staff to review filings with Summary Sections that are longer than ten pages for a single mutual fund and sometimes almost twenty pages in length.

Based on comments the staff has provided, the staff highlights below certain rule and form requirements that, while not exhaustive of the disclosure requirements, are intended to focus funds on providing investors clear and concise disclosure:

- *Summarize the Principal Investment Strategies and Risks*: Form N-1A provides that the principal investment strategies and risks, required by Item 4 in the Summary Section, should be based on the information given in response to Item 9 of the Form, and should be a *summary* of that information.[12] The Form also provides that information included in response to Items 2 through 8 need not be repeated elsewhere in the prospectus.[13] Instead of a concise summary, however, the staff often observes in Item 4 of the Summary Section long, complex and detailed descriptions of principal investment strategies and risks that are dense, are not user-friendly, and do not appear to be summaries of the information in Item 9 later in the prospectus. The staff also often reviews prospectuses that substantially repeat the same principal investment strategies and risks disclosure in response to Item 4 and in response to Item 9. Indeed, many times this disclosure is identical.

  The layered disclosure regime adopted by the Commission may be undermined by Summary Sections that do not, in fact, summarize the information available elsewhere. In the staff's view, the repetition of substantially the same-or identical-information in response to both Items 4 and 9 often highlights that a fund has not provided a summary in response to Item 4. In addition, the unnecessary duplication of information increases the length of the prospectus. When the staff observes a Summary Section that is long, dense and complex and does not, in fact, appear to summarize a fund's principal strategies and risks, the staff will remind the fund that the Summary Section is intended to summarize the key information that is important to an investment decision, with more detailed information presented elsewhere. Further, when a fund substantially duplicates its disclosure, the staff will remind the fund that information need not be duplicated.

- *Plain English Requirements*: Form N-1A provides that the Summary Section must be provided in plain English under Rule 421(d) under the Securities Act.[14] In addition, the prospectus, in its entirety, is subject to the requirement that the information be presented

in a clear, concise, and understandable manner.[15] Similarly, Form N-1A also provides that the prospectus disclosure requirements "are intended to elicit information for an average or typical investor who may not be sophisticated in legal or financial matters."[16]

Notwithstanding these requirements, the staff continues to observe the use of technical terms that are not explained in plain English. Funds also often use unnecessary defined terms, long, compound sentences, and long, dense paragraphs that the staff believes may be difficult for investors to read. The use of plain English principles in the Summary Section is intended to further the Commission's goal of encouraging funds to create useable summaries at the front of their prospectuses.[17] Failure to follow the plain English requirements undermines the usefulness of the Summary Section, and, thus, the Summary Prospectus. Funds are reminded to revisit their disclosures in light of these requirements.

- *Summary Section Must Only Include Required or Permitted Information*: Form N-1A provides that the Summary Section of the prospectus "may not include disclosure other than that required or permitted by [Items 2 through 8]."[18] A fund may, however, include information elsewhere in the prospectus or in the SAI that is not otherwise required by Form N-1A.[19]

  The staff closely scrutinizes the disclosure in the Summary Section, and when information is included that is not required or permitted, comments that the information should be moved out of the Summary Section. For example, to streamline the disclosure and foster comparison between funds, the staff, in particular, assesses whether information in the footnotes to the Fee Table is permitted or required. As another example, the staff often comments about the inclusion of purchase and sale information that is neither permitted nor required by Item 6 ("Purchase and Sale of Fund Shares"), which generally requires a fund to disclose its minimum initial or subsequent investment requirements, that the fund's shares are redeemable, and briefly identify the procedures for redeeming shares. Funds are reminded to include only information in the Summary Section that is either permitted or required by Form N-1A.

- *Inclusion of Non-Principal Strategies and Risks in the Prospectus*: As noted above, Form N-1A requires a fund to disclose its principal investment strategies and risks in its prospectus.[20] The Form provides that a fund should describe any investment strategies and risks that are not principal in the SAI.[21] Form N-1A, however, also provides that a fund may include (except in the Summary Section) information in the prospectus that is not otherwise required.[22] Many funds include in their prospectus additional information related to strategies and risks that are not principal. In the view of the staff, however, funds that include this additional information often do not clearly indicate which of the strategies and risks are principal and which are not principal. The staff believes that this can result in prospectus disclosure that does not clearly and concisely inform investors about how the fund principally intends to invest and the related risks. In such cases, the staff will comment that funds should distinguish which of the strategies and risks are principal and which are not principal.

- *Avoid Cross-References*: Form N-1A provides that, in responding to the required information in the prospectus, funds should avoid cross-references to the SAI or shareholder

reports.[23] The Form further provides that "[c]ross references within the prospectus are most useful when their use assists investors in understanding the information presented and does not add complexity to the prospectus."[24] The staff frequently observes funds with numerous cross-references in the Summary Section, which the staff believes can add complexity. When appropriate, the staff suggests that the cross-references be deleted to streamline the Summary Section.

Conclusion

In the staff's view, if the 2009 amendments are to have their intended effect of providing investors with clear and concise, user-friendly disclosure, funds and their service providers must act diligently to focus on the established framework. The staff encourages funds to revisit their disclosure in light of this guidance.

Endnotes

[1]*See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 FR 4546 (Jan. 26, 2009)] ('Adopting Release"), available at: http://www.sec.gov/rules/final/2009/33-8998.pdf.

[2]Form N-1A is the form used by mutual funds to register under the Investment Company Act of 1940 ("1940 Act") and to offer their securities under the Securities Act of 1933 ("Securities Act"). Form N-1A consists of three parts. Form N-1A is available at: http://www.sec.gov/about/forms/formn-1a.pdf. Part A includes the information required in a fund's prospectus under Section 10(a) of the Securities Act. Part B, called the Statement of Additional Information ("SAI"), includes additional information about the fund that the Commission has concluded is not necessary or appropriate in the public interest or for the protection of investors to be in the prospectus, but that some investors may find useful. Part C includes other information required in a fund's registration statement, primarily exhibits.

[3]Adopting Release, 74 FR at 4546-47.

[4]*Id.* at 74 FR at 4546. The Commission noted that it "is committed to encouraging statutory prospectuses that are simpler, clearer, and more useful to investors. The prospectus summary section is intended to provide investors with streamlined disclosure of key mutual fund information at the front of the statutory prospectus, in a standardized order that facilitates comparisons across funds." *Id.* at 74 FR at 4549.

[5]*Id.* at 74 FR at 4546.

[6]*Id.* Specifically, the "Summary Section" consists of Items 2 through 8 of Form N-1A, as follows: investment objectives (Item 2), costs (Item 3), a summary of principal investment strategies and risks and the fund's performance (Item 4), investment advisers and portfolio managers (Item 5), brief purchase and sale and tax information (Items 6 and 7), and a statement regarding financial intermediary compensation (Item 8).

[7]*Id.* at 74 FR at 4548.

[8]17 CFR 230.498.

[9]Adopting Release, 74 FR at 4560. The form and rule amendments were intended to create a disclosure regime tailored to the unique needs of mutual fund investors in a manner that provides ready access to the information that investors need, want, and choose to review. *Id.* The Summary Prospectus, containing key information about the fund, coupled with online provision of more detailed information, was intended to aid investors in comparing funds and to provide investors with more useable information in a format that investors are more likely to use. *Id.*

[10]*Id.* at 74 FR at 4551.

[11]*Id.*

[12]Form N-1A requires a fund to disclose its principal investment strategies, including the type or types of securities in which the fund principally invests or will invest. *See* Items 4(a) and 9(b) of Form N-1A. Whether a particular strategy, including a strategy to invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the fund's investment objectives, and how the strategy affects the fund's potential risks and returns. *See* Instr. 2 to Item 9(b) of Form N-1A. In assessing what is a principal investment strategy, a fund

should consider, among other things, the amount of the fund's assets expected to be committed to the strategy, the amount of the fund's assets expected to be placed at risk by the strategy, and the likelihood of the fund losing some or all of those assets from implementing the strategy. *Id*. Further, Form N-1A requires a mutual fund to disclose the principal risks of investing in the fund, including the risks to which the fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, or total return. *See* Items 4(b) and 9(c) of Form N-1A.

[13]General Instruction C.3.(a) of Form N-1A.

[14]*See* General Instruction B.4.(c) of Form N-1A. Rule 421(d) [17 CFR 230.421(d)] requires an issuer to use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors sections of its prospectus. Specifically, Rule 421(d) lists the following plain English principles: (1) short sentences; (2) definite, concrete, everyday words; (3) active voice; (4) tabular presentation or bullet lists for complex material, wherever possible; (5) no legal jargon or highly technical business terms; and (6) no multiple negatives.

[15]Pursunt to Rule 421(b) [17 CFR 230.421(b)], the following standards must be used when preparing prospectuses: (1) present information in clear, concise sections, paragraphs, and sentences; (2) use descriptive headings and subheadings; (3) avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus; and (4) avoid legal and highly technical business terminology.

[16]General Instruction 3.C.l.(b) of Form N-1A. Form N-1A also provides that responses to the Items in the Form: (1) "should be as simple and direct as reasonably possible and should include only as much information as is necessary to enable an average or typical investor to understand the particular characteristics of the Fund"; (2) should avoid: "including lengthy and technical discussions; simply restating legal or regulatory requirements to which Funds generally are subject; and disproportionately emphasizing possible investments or activities of the Fund that are not a significant part of the Fund's investment operations"; (3) should "[a]void excessive detail, technical or legal terminology, and complex language"; and (4) should "avoid lengthy sentences and paragraphs that make the prospectus difficult for many investors to understand and detract from its usefulness." General Instruction 3.C.l.(c) of Form N-1A.

[17]Adopting Release, 74 FR at 4549.

[18]General Instruction C.2.(b) of Form N-1A.

[19]*Id*

[20]*See* supra note 12.

[21]Item 16(b) of Form N-1A.

[22]General Instruction C.3.(b) of Form N-1A. Such information may be included so long as the information is not incomplete, inaccurate, or misleading and does not, because of its nature, quantity, or manner of presentation, obscure or impede understanding of the information that is required to be included. *Id*.

[23]General Instruction C.3.(a) of Form N-1A.

[24]*Id.*

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FUND DISCLOSURE REFLECTING RISKS RELATED TO CURRENT MARKET CONDITIONS

The staff is issuing this Guidance Update in order to foster investor protection by reminding mutual funds, exchange traded funds, and other registered investment companies of the importance to investors of full and accurate information about fund risks, including risks that arise as a result of changing market conditions. In particular, the staff believes that funds should review their risk disclosures on an ongoing basis and consider whether these disclosures remain adequate in light of current conditions.

Background: Importance of Risk Disclosure; Previous Commission and Staff Statements

Clear and accurate disclosure of the risks of investing in funds is important to informed investment decisions and, therefore, to investor protection. The Commission has long recognized the importance to investors of fund risk disclosure,[1] and the Commission's disclosure requirements reflect that recognition. A mutual fund, for example, is required to summarize the principal risks of investing in the fund, including the risks to which the fund's portfolio as a whole is subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, and total return, in both its summary prospectus and at the front of its statutory prospectus.[2] In addition to this summary information, the fund's statutory prospectus must provide a fuller description of the principal risks of investing in the fund.[3]

Because of the importance of risk disclosure to investors, the staff has provided guidance on various aspects of risk disclosure on a number of occasions. For example, the staff has highlighted the importance of providing a concise summary of principal investment risks, rather than a long, complex, and detailed description of those risks, in the summary section of the prospectus.[4] The staff has also encouraged any fund that exposes investors to market, credit, or other risks, and whose name suggests safety or protection from loss, to reevaluate the name and to consider changing the name, as appropriate, to eliminate the potential for investor misunderstanding.[5] The staff has also noted important aspects of disclosures related to fund use of derivatives, including the staff's expectation that funds that use investment strategies that employ derivatives should disclose material risks relating to volatility, leverage, liquidity, and counterparty creditworthiness associated with the fund's trading and investments in derivatives.[6] Further, the staff has observed that it is of limited usefulness to investors for funds to provide disclosure about the risks of investing in derivatives that is generic and not tailored to the specific derivative instruments in which a fund invests or will invest principally.[7]

Risk Disclosure Addressing Changing Market Conditions

This Guidance Update is intended to address another important aspect of fund risk disclosure, namely, the changes in a fund's susceptibility to risk that may result from changes in

market conditions and the need for funds to review and assess risk disclosures in light of changing market conditions. Degree of risk is dynamic in nature rather than static; it changes in response to market conditions, and different risks may be heightened or lessened at different points in time. As a result, a fund may determine that risk disclosure that may have been adequate at one time may need to be reconsidered in light of new or changed market conditions. If a fund determines that its risk disclosure is not adequate, the staff believes that the fund should consider the appropriate manner of communicating changed risks to existing and potential investors, for example, in the prospectus, shareholder reports, fund website, and/or marketing materials.[8] We understand that many fund boards request that the fund's adviser report to the board on its process for preparing the fund's disclosure materials.[9] As part of this process, the staff believes that a fund's adviser should consider providing information to the fund board on the steps taken by the adviser to evaluate fund risk disclosures and consider whether changes are appropriate.

In the staff's view, undertaking the following steps on an ongoing basis should help funds in providing risk disclosures to investors that remain robust in changing market conditions.

- **Monitor Market Conditions and their Impact on Fund Risks**. In order for a fund to determine whether its risk disclosures appropriately address current market conditions, the fund should effectively monitor market conditions on an ongoing basis and assess the impact of changing conditions on the fund and the risks associated with its investments. Monitoring market conditions for their impact on the fund is, of course, a part of prudent portfolio management by the adviser, so we would expect that funds would routinely engage in this practice as a normal part of day-to-day operations.
- **Assess Whether Fund Risks Have Been Adequately Communicated to Investors in Light of Current Market Conditions**. If a fund determines that changed market conditions have affected the risks associated with the fund, the fund should assess the significance of the change and whether it is material to investors. If so, a fund should consider whether its existing disclosures are adequate in light of the changed conditions.
- **Communicate with Investors**. A fund that determines that changes in current market conditions have resulted in changes to the fund's risks that are material to investors, and that its current disclosures do not adequately communicate the changes, should update its communications to investors as needed. The fund should provide any such updated communications to investors, at the time and in the manner required by the federal securities laws and as otherwise appropriate. Means of communication to be considered include the prospectus (which, for example, would be updated when the fund determines that the risk disclosure in its prospectus would be materially misleading) and shareholder reports, as well as less formal methods, such as website disclosure and letters to shareholders.

In its reviews of fund disclosures concerning risks, the staff has observed a number of instances where funds have updated disclosures to address current market conditions. To illustrate the types of disclosures that a fund may wish to consider, we describe below examples of disclosures we have seen in two circumstances where market conditions are changing. The first relates to disclosures by fixed income funds regarding interest rate risk, liquidity risk, and duration risk. The second relates to investments by funds in debt securities issued by the Commonwealth

of Puerto Rico and its agencies and instrumentalities (together, "Puerto Rico debt"). In each case, we have observed disclosures that highlight current conditions in a manner that we believe can make risk disclosure more timely, more meaningful, and more complete. We have observed prospectuses, shareholder reports, and fund websites where such disclosures are included. We believe that such disclosures could help investors better evaluate the risks of investment in the fund in light of changing circumstances.

Fixed Income Funds

Following the financial crisis of 2008, the Federal Reserve Board lowered the target range for the federal funds rate to near zero and implemented quantitative easing programs. Quantitative easing ended in 2014. In a statement issued in March of 2015, the Federal Open Market Committee stated that it anticipated that it would be appropriate to raise the target range for the federal funds rate when it had seen some further improvement in the labor market and was reasonably confident that inflation would move back to its two percent objective over the medium term.[10] In December of 2015, the Federal Open Market Committee decided to raise the target range for the federal funds rate to one-quarter to one-half percent and addressed how it would determine the timing and size of future adjustments to the target range for the federal funds rate.[11]

Interest Rate Risk. We have observed that prospectus disclosure for a number of bond funds addresses these current conditions. We have also observed disclosure in shareholder reports, particularly in the Management's Discussion of Fund Performance and Presidents' letters, as well as fund websites, bearing on current conditions and the level of current interest rate risk. Some funds include in their disclosure references to current historically low interest rates. In addition, some funds also include references to recent and potential future changes in government policy that may affect interest rates. These disclosures indicate that current conditions may result in a rise in interest rates, which in turn may result in a decline in the value of the fixed income investments held by the fund. We believe that the benefit of addressing current conditions in this manner is that it can alert investors that, for the present, interest rate risk may be heightened.[12] Indeed, some fund disclosures expressly state that the current conditions may pose an increased risk.

Liquidity Risk. In addition, in connection with disclosure of interest rate risk, some funds are disclosing that a potential rise in interest rates may result in periods of volatility and increased redemptions. Some of these funds state that, as a result of increased redemptions, they may have to liquidate portfolio securities at disadvantageous prices and times, which could reduce the returns of the fund. Some funds are also disclosing that the reduction in dealer market-making capacity in the fixed income markets that has occurred in recent years has the potential to decrease liquidity. Disclosures such as these may be useful in alerting investors to the secondary impacts that could result from increased interest rates.

Duration Risk. Many funds, in connection with disclosure of interest rate risk, also disclose that longer-term securities may be more sensitive to interest rate changes. Some funds provide numerical examples to illustrate how interest rate changes may have a greater impact on

securities with longer terms. This disclosure, when coupled with disclosure about current, historically low interest rates and the potential for increases in those rates, may be effective in communicating to investors the heightened risk that rising interest rates may pose to a fund whose portfolios include longer-term fixed income securities.

Puerto Rico Debt

A number of funds have investments in Puerto Rico debt. For some time, there have been concerns that Puerto Rico would default on its debt or restructure its upcoming obligations.[13] Indeed, on August 3, 2015, the Puerto Rico Public Finance Corporation reportedly failed to make a bond payment that was due, because the Commonwealth's legislature had not appropriated the necessary funds.[14] Again, on January 4, 2016, Puerto Rico reportedly failed to make scheduled payments to some bondholders.[15]

Some tax-exempt funds have names that indicate that they invest in securities that are exempt from both federal income tax and the tax of a particular state (*e.g.*, the Florida Tax-Exempt Fund). Because Puerto Rico debt is exempt from taxation by all states,[16] some of these "single-state" funds may have significant exposure to Puerto Rico debt.[17] We have observed that a number of these funds, in addition to required disclosure that they may invest in tax-exempt securities of issuers located outside of the named state,[18] expressly disclose in their prospectus risk disclosure that they invest in Puerto Rico debt. This disclosure has also been included in the prospectuses of other types of funds that have significant exposure to Puerto Rico debt. We believe that this disclosure can help communicate to investors that the fund is exposed to risks associated with Puerto Rico.

We have also observed that some funds that include express disclosure about the risks associated with Puerto Rico debt have updated that disclosure to communicate the existence of heightened risk under current conditions. We have observed such disclosure in fund prospectuses, as well as shareholder reports and fund websites. These disclosures refer to current factors that may be expected to have an impact on the value of the Puerto Rico debt held by the fund. For example, some of the disclosures refer to significant financial difficulties, including budget deficits, that Puerto Rico is currently experiencing. Disclosures also refer to recent downgrades in ratings of Puerto Rico debt, and state that these downgrades may adversely affect market values and liquidity of the fund's securities. In the staff's view, any fund investing in Puerto Rico debt should consider, based on the nature and significance of its investments, whether such disclosure is appropriate.

* * *

The Division believes that full and accurate information about fund risks, including risks that arise as a result of changing market conditions, is important to investors in mutual funds, exchange traded funds, and other registered investment companies. As noted above, in our disclosure reviews, we have observed instances of funds providing useful information to their investors regarding current market conditions. We encourage funds to review their risk disclosures on an ongoing basis and consider whether these disclosures remain adequate in light of current conditions.

IM Guidance Updates are recurring publications that summarize the staff's views regarding various requirements of the federal securities laws. The Division generally issues *IM Guidance Updates* as a result of emerging asset management industry trends, discussions with industry participants, reviews of registrant disclosures, and no-action and interpretive requests.

The statements in this *IM Guidance Update* represent the views of the Division of Investment Management. This guidance is not a rule, regulation or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content. Future changes in rules, regulations and/or staff no-action and interpretive positions may supersede some or all of the guidance in a particular *IM Guidance Update*.

The mission of the Securities and Exchange Commission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

If you have any questions about this IM Guidance Update, please contact:
Disclosure Review Office
Phone: 202.551.6921
Email: IMOCC@sec.gov.

Endnotes

[1] For instance, in a 1998 release adopting amendments to Form N-1A, the form used by mutual funds to register under the Investment Company Act of 1940 and to offer their shares under the Securities Act of 1933, the Commission stated:

> A fund's prospectus principally should include essential information about the fundamental characteristics of, and risks of investing in, the fund. Whenever possible, a fund should present this information in a manner that:
>
> —assists investors in comparing and contrasting the fund with other funds;
>
> —avoids simply restating legal or regulatory requirements to which funds generally are subject; and
>
> —avoids a disproportionate emphasis on possible investments or activities of the fund that are not a significant part of the fund's investment operations.
>
> Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 23064 (March 13,1998) [63 FR 13916 at 13919 (March 23,1998)], *available at* http://www.sec.gov/rules/final/33-7512r.htm.

[2] Item 4(b) of Form N-1A.

[3] Item 9(c) of Form N-1A.

[4] Guidance Regarding Mutual Fund Enhanced Disclosure, IM Guidance Update 2014-08 at 2-3 (June 2014).

[5] Fund Names Suggesting Protection from Loss, IM Guidance Update 2013-12 (Nov. 2013).

[6] Disclosure and Compliance Matters for Investment Company Registrants That Invest in Commodity Interests, IM Guidance Update 2013-05 at 2-3 (Aug. 2013).

[7] Letter from Barry D. Miller, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to Karrie McMillan, General Counsel, Investment Company Institute (July 30, 2010), *available at* https://www.sec.gov/divisions/investment/guidance/ici073010.pdf.

[8] *See* Letter from Carolyn B. Lewis, Assistant Director, Division of Investment Management, U.S. Securities and Exchange Commission, to Investment Company Registrants (Feb. 3,1995) (It is a fund's responsibility, "on an ongoing basis to analyze fund risk and review prospectus risk disclosure, and to update prospectus disclosure when appropriate.");

Statement of the Commission Regarding Disclosure of Year 2000 Issues and Consequences by Public Companies, Investment Advisers, Investment Companies, and Municipal Securities Issuers, Securities Act Release No. 7558 (July 29,1998) [63 FR 41394 at 41402 (Aug. 4,1998)], *available at* http://www.sec.gov/rules/interp/33-7558.htm ("... it is unlawful for investment companies to omit from registration statements and other public filings 'any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being misleading.' If investment companies determine that their Year 2000 risks are material, they are required to discuss such risks in their registration statements and other public documents ...."); Adoption of Integrated Disclosure System, Securities Act Release No. 6383 (March 3,1982) [47 FR 11380 at 11395 (March 16,1982)] ("One of the basic concerns which must be met in the context of shelf registration is ensuring that investors are provided accurate and current information where offers or sales are not to be made immediately after the registration statement becomes effective.").

[9] ABA Section of Business Law, Fund Director's Guidebook, § 11.A (1) (2015).

[10] Federal Reserve Monetary Policy Release, Federal Reserve Issues FOMC Statement (March 18, 2015), *available at* http://www.federalreserve.gov/newsevents/press/ monetary/20150318a.htm.

[11] Federal Reserve Monetary Policy Release, Federal Reserve Issues FOMC Statement (Dec. 16, 2015), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20151216a.htm.

[12] *See* Risk Management in Changing Fixed Income Market Conditions, IM Guidance Update 2014-01 (Jan. 2014) (suggesting steps that fund advisers may consider with respect to risk management and disclosure matters relating to changing conditions in fixed income markets).

[13] *See* Matt Wirz, Nick Timiraos, and Aaron Kuriloff, Puerto Rico, Treasury in Talks to Restructure Island's Debt, Wall Street Journal (Oct. 14, 2015), *available at* http://www.wsj.com/articles/puerto-rico-treasury-in-talks-to-restructure-islands-debt-1444853744; Michelle Kaske and Elizabeth Campbell, Puerto Rico Debt-Crisis Grows as Island Defaults, Conserves Cash, Bloomberg Business (Aug. 3, 2015), *available at* http://www.bloomberg.com/news/articles/2015-08-04/puerto-rico-debt-crisis-grows-as-payments-halt-agency-defaults; Elizabeth Foos, Puerto Rico Back in the Hot Seat, Morningstar (July 30, 2015), *available at* http://ibd.morningstar.com/archive/archive.asp?inputs=days=14;frmtld=12,%20brf295; Michael A. Fletcher, Puerto Rico Bonds Downgraded to Junk Levels, Washington Post (Feb. 4, 2014), *available at* http://www.washingtonpost.com/business/economy/puerto-rico-bonds-downgraded-to-junk-levels/2014/02/04/c9495a22-8ddf-11e3-833c-33098f9e5267 story.html.

[14] Michael A. Fletcher, Debt-Plagued Puerto Rico Defaults on a Bond Payment for the First Time, Washington Post (Aug. 3, 2015), *available at* http://www.washingtonpost.com/business/economv/puerto-rico-defaults-on-a-bond-payment-for-the-first-time/2015/08/03/8a703cOa-3a20-11e5-9c2d-ed991d848c48story.html.

[15] Mary Williams Walsh, Struggling Puerto Rico Defaults on Its Debt Payments, New York Times (Jan. 4, 2016), *available at* http://www.nytimes.com/2016/01/05/ business/dealbook/puerto-rico-defaults-on-debt-pavments.html; Robert Slavin, It's Bondholders' Move After Puerto Rico Defaults, Bond Buyer (Jan. 5, 2016), *available at* http://www.bondbuyer.com/news/regionalnews/its-bondholders-move-after-puerto-rico-defaults-1093208-1.html.

[16] 48 U.S.C. 745 provides:

> All bonds issued by the Government of Puerto Rico, or by its authority, shall be exempt from taxation by the Government of the United States, or by the Government of Puerto Rico or of any political or municipal subdivision thereof, or by any State, Territory, or possession, or by any county, municipality, or other municipal subdivision of any State, Territory, or possession of the United States, or by the District of Columbia.

[17] Rule 35d-1(a)(4) under the Investment Company Act provides in part:

> A fund with a name suggesting that the fund's distributions are exempt from both federal and state income tax is required to adopt a fundamental policy
>
> (i) To invest, under normal circumstances, at least 80% of the value of its assets in investments the income from which is exempt from both federal and state income tax; or
>
> (ii) To invest, under normal circumstances, its assets so that at least 80% of the income that it distributes will be exempt from both federal and state income tax.

[18] Frequently Asked Questions about Rule 35d-1 (Investment Company Names) at Question 3, *available at* https://www.sec.gov/divisions/investment/guidance/rule35d-1faq.htm; Investment Company Names, Investment Company Act Release No. 24828 at n. 30 (Jan. 17, 2001) [66 FR 8509 at 8512 (Feb. 1, 2001)], *available at* http://www.sec.gov/rules/final/ic-24828.htm.

MUTUAL FUND FEE STRUCTURES

Recently, the Department of Labor adopted a rule and certain exemptions (together, the "DOL Rule") designed to address conflicts of interest in retirement advice.[1] Since the DOL Rule's adoption, representatives of mutual funds ("Funds") have been considering a variety of issues related to the DOL Rule's implementation, including contemplating certain changes to Fund fee structures that would, in certain instances, level the compensation provided to a financial intermediary ("Intermediary") for the sale of Fund shares by that Intermediary and facilitate Intermediaries' compliance with the rule. We also understand some Funds are considering streamlined sales load structures to simplify costs for investors and to help address operational and compliance challenges that can exist for Intermediaries that sell shares of multiple Funds.[2] This Guidance Update is focused on disclosure issues and certain procedural requirements with offering variations in Fund sales loads and new Fund share classes.[3] We also remind Funds of certain administrative procedures that will assist in streamlining the review of disclosure filings.

Variations in Sales Loads

A Fund may sell shares at prices that reflect scheduled variations in, or elimination of, sales loads as long as each sales load variation is disclosed in the prospectus. Rule 22d-1 under the Investment Company Act of 1940 ("1940 Act") and item 12(a)(2) of Form N-1A require that each variation be applied uniformly to particular "classes" of investors or transactions and disclosed in the prospectus with specificity.[4]

We understand that Funds are considering new variations to sales loads that would apply uniformly to investors that purchase Fund shares through a single Intermediary (or category of multiple Intermediaries). In these circumstances, item 12(a)(2) of Form N-1A requires that the prospectus: (1) briefly describe the arrangements that result in breakpoints in, or elimination of, sales loads; (2) identify each class of individuals or transactions to which the arrangements apply; and (3) state each different breakpoint as a percentage of both the offering price and net amount invested. Under this approach, investors who purchase through a designated Intermediary would be a "class" under item 12(a)(2). Therefore, the disclosure should specifically identify each Intermediary whose investors receive a sales load variation. This information must be presented in a clear, concise, and understandable manner, and should include tables, schedules, and charts where doing so would facilitate understanding.[5] In addition, the narrative explanation to the Fund fee table must alert investors to the existence of sales load discounts or waivers and provide a cross-reference to the section and page of the prospectus and statement of additional information that describes these arrangements.[6]

Some Funds are concerned that if a Fund creates multiple scheduled variations, it could lead to lengthy prospectus disclosure that may be difficult for an investor to navigate and comprehend.[7] Given the Commission and staff focus on improving disclosure,[8] we would not object if lengthy sales load variation disclosure for multiple intermediaries is included in an appendix to the statutory prospectus.[9]

We believe that this approach will benefit investors by making it easier for them to find information about the sales loads that differ by Intermediary. In order to use an appendix under this approach:

- The section of the prospectus that includes disclosure that is required by Item 12 to Form N-1A should include a prominent statement to the effect that different Intermediaries may impose different sales loads and that these variations are described in an appendix to the prospectus (the specific appendix should be named).
- The cross-reference in the narrative explanation to the fee table must cross-refer to the appendix.
- The appendix must specifically identify the name of the Intermediary as required by item 12(a)(2). It also should include sufficient information to allow an investor that purchases Fund shares through a specific Intermediary to determine which scheduled variation applies to its investment, which may depend on the type of account held at the Intermediary.[10] For example, individual retirement accounts, retail taxable accounts, and 529 plan accounts available through the same Intermediary each may have variations in their sales load structures.

We would not object to an appendix that is a standalone document so long as the Fund:

- Incorporates the appendix into the prospectus by reference and files the appendix with the prospectus;
- Includes a legend on the front cover page of the appendix explaining that the information disclosed in the appendix is part of, and incorporated in, the prospectus;
- Includes a statement on the outside back cover page of the prospectus that information about the different sales loads variations is provided in a separate document that is incorporated by reference into the prospectus;
- Delivers the appendix with the prospectus; and
- Posts the appendix on its website consistent with rule 498(e) under the Securities Act, if the Fund uses a summary prospectus.

To add disclosure about sales load variations, a Fund will need to file the amendment to its registration statement under rule 485(a) under the Securities Act of 1933 ("Securities Act").[11] In order to focus staff review in a way that will be meaningful for investors, we encourage Funds to seek selective review of the filing as described below, if only certain disclosures about the Fund are changing, such as adding sales load variations. In addition, if sales load variation disclosures will be substantially identical across multiple Funds within a fund complex, the Funds should consider whether it is appropriate to request relief under rule 485(b)(1)(vii) under the Securities Act ("Template Filing Relief") as described below. In addition, Funds must ensure that investors are provided with accurate and current information and must update their prospectuses or appendices on an ongoing basis to reflect any new or modified sales load variations.

New Share Classes

We also understand that Funds are considering offering new share classes that differ with respect to sales loads, transaction charges, and certain ongoing expenses.[12] As with the scheduled variation procedures described above, adding a new class to an existing Fund requires a filing under rule 485(a).[13] When reviewing a rule 485(a) filing that adds a new share class, we focus on the disclosure of Fund fees, performance, and distribution arrangements. If only certain disclosures about the Fund are changing, such as to describe the new share class, we encourage Funds to seek selective review of the filing as described below. Also, because share class specific information is often substantially identical across Funds within the same fund complex, Funds should consider whether it is appropriate to request Template Filing Relief as described below.

Administrative Procedures

To improve the efficiency of the review process for both staff and registrants, we are providing guidance to registrants with respect to requests for selective review and Template Filing Relief.

Selective Review

We encourage registrants to request a selective review of a filing that contains disclosure that is not substantially different from the disclosure contained in one or more prior filings by the Fund or other Funds in the complex.[14] In particular, a request for selective review may be appropriate for the rule 485(a) filing of a Fund that first reflects a new share class or sales load variation that is expected to be introduced for other Funds in the complex. Any such request should be made in the cover letter accompanying the filing and should include: (i) a statement as to whether the disclosure in the filing has been reviewed by the staff in another context; (ii) a statement identifying prior filings that the registrant considers similar to, or intends as precedent for, the current filing; (iii) a summary of the material changes made in the current filing from the previous filings; and (iv) any specific areas that the registrant believes warrant particular attention.[15]

Template Filing Relief

In circumstances in which a Fund complex makes substantially identical changes to multiple Funds, it may be appropriate for the registrant to request rule 485(b)(i) (vii) relief to avoid the need to file multiple rule 485(a) filings.[16] Instead, the registrant could file a single rule 485(a) filing (a "Template filing") for staff review, together with a Template Filing Relief request for other Funds with substantially identical disclosure. Funds are encouraged to submit any Template Filing Relief requests as soon as possible, and we will consider any requests as expeditiously as possible.

If a registrant wishes to request Template Filing Relief, it should do so in correspondence filed on the EDGAR system under the central index key ("CIK") of the Template filing. The

registrant's request should state: (i) the reason for making the post-effective amendment; (ii) the identity of the Template filing;[17] (iii) the identity of the registration statements that intend to rely on the relief ("Replicate filings");[18] and make the following representations:

- The disclosure changes in the Template filing are substantially identical to disclosure changes that will be made in the Replicate filings.
- The Replicate filings will incorporate changes made to the disclosure included in the Template filing to resolve any staff comments thereon.[19]
- The Replicate filings will not include any other changes that would otherwise render them ineligible for filing under rule 485(b).

Any rule 485(b) filing relying on Template Filing Relief should include a cover letter or an explanatory note in the filing explaining that it is relying on this relief.

Endnotes

[1] *See* Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 FR 20946 (Apr. 8, 2016); and Best Interest Contract Exemption, 81 FR 21002 (Apr. 8, 2016).

[2] *See, e.g.,* FINRA News Release, FINRA Orders an Additional Five Firms to Pay $18 Million in Restitution to Charities and Retirement Accounts Overcharged for Mutual Funds (Oct. 27, 2015), *available at* http://www.finra.org/newsroom/2015/finra-orders-5-firms-pay-18-million-failing-waive-fund-sales-charges (describing regulatory actions relating to Intermediaries failing to apply Fund sales load waivers to certain investors).

[3] The Division cannot provide any assurances that any approach described in this Guidance Update will satisfy the requirements of the DOL Rule. Rather, this Guidance Update discusses the requirements under the applicable federal securities laws with respect to Funds that wish to use certain fee structures.

[4] The reference to "classes" in rule 22d-1 predates rule 18f-3 under the 1940 Act (governing multi-class Fund structures). Accordingly, the reference to "classes" in item 12(a)(2) should not be read to refer to a multi-class structure, but rather to a category of persons.

Sales load variation required under items 17(d) (relating to sales load variations available to directors and other affiliated person of the Fund) and 23(b) (relating to fee arrangements in connection with a Fund reorganization) of Form N-1A may be disclosed in the Fund's statement of additional information.

[5] *See* instruction following item 12(a)(5) of Form N-1A.

[6] *See* item 3 to Form N-1A.

[7] Form N-1A requires all information about distribution arrangements to be disclosed in one place in the prospectus. See General Instruction C.3.A of Form N-1A. See also instruction to item 12(a) to Form N-1A (requiring all information responsive to item 12(a) be adjacent to the table required by item 12(a)(1) of Form N-1A).

[8] *See, e.g.,* Guidance Regarding Mutual Fund Enhanced Disclosure, IM Guidance Update 2014-08 (June 2014) (staff guidance highlighting the importance of providing a concise summary of principal investment risk in the summary section of the prospectus); and Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) (release adopting the mutual fund summary prospectus).

[9] If a Fund intends to rely on this approach, all of the information required by item 12(a) of Form N-1A for each Intermediary must be described in the appendix.

[10] *See* instruction 1 to item 12(a)(2) to Form N-1A.

[11] Rule 485 under the Securities Act specifies the procedures by which post-effective amendments for mutual funds become effective. Rule 485(b) generally permits certain post-effective amendments to become effective immediately on filing or on a date specified by the registrant. Post-effective amendments filed for reasons other than those described under rule 485(b) must be filed under rule 485(a). 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. This permits the staff to review the filing prior to its effectiveness.

[12] *See* rule 18f-3 under the 1940 Act.

[13] *See infra* note 11.

[14] Notwithstanding any request for selective review, we may comment on any portion of a filing.

[15] *See* Revised Procedures for Processing Registration Statements, Post-Effective Amendments and Preliminary Proxy Materials Filed by Registered Investment Companies. Investment Co Act Rel. No 13768 (Feb. 15, 1984).

[16] Rule 485(b)(1)(vii) under the Securities Act permits the Commission to approve the filing of a post-effective amendment to a registration statement under rule 485(b) for a purpose other than those specifically enumerated in the rule. The staff has been delegated this authority by the Commission.

[17] This identifying information should include the name of the Fund and the registrant, the Securities Act file number, and the filing date of the rule 485(a) filing.

[18] This identifying information should include the name of the registrant, the Securities Act file number, and the series and class name for each of the Funds that intend to rely on the relief.

[19] If the Template filing is already effective, this representation should be replaced with the following:

> The Replicate filings incorporate changes made to the disclosure included in the Template filing to resolve any staff comments thereon.

> *IM Guidance Updates* are recurring publications that summarize the staff's views regarding various requirements of the federal securities laws. The Division generally issues *IM Guidance Updates* as a result of emerging asset management industry trends, discussions with industry participants, reviews of registrant disclosures, and no-action and interpretive requests.

> The statements in this *IM Guidance Update* represent the views of the Division of Investment Management. This guidance is not a rule, regulation or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content. Future changes in rules, regulations and/or staff no-action and interpretive positions may supersede some or all of the guidance in a particular *IM Guidance Update*.

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APPENDIX IV

RELEASES: USE OF ELECTRONIC MEDIA AND INTERNET RELATED ISSUES

Use of electronic media for delivery purposes
Release No. 33-7233; Release No. 34-36345; Release No. IC-21399
October 6, 1995

AGENCY: Securities and Exchange Commission

ACTION: Interpretation; Solicitation of comment.

SUMMARY: The Securities and Exchange Commission (the Commission) is publishing its views with respect to the use of electronic media for information delivery under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. This interpretive guidance is intended to assist market participants in using electronic media to provide information under the federal securities laws and to encourage continued research and development and use of such media. The Commission is seeking comment on issues discussed in this release. In a companion release, the Commission is proposing technical amendments to Commission rules that are currently premised on the distribution of paper documents.

DATES: This Interpretation is effective on October 6, 1995. Comments should be received on or before [insert date 45 days after Federal Register publication].

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Stop 6-9, Washington, D.C. 20549. Comment letters should refer to File No. S7-31-95. All comments received will be available for public inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Joseph Babits or James Budge (202) 942-2910, Division of Corporation Finance; and, with regard to questions concerning investment companies or investment advisers, Robert G. Bagnall or Emanuel D. Strauss (202) 942-0660, Division of Investment Management, U.S. Securities and Exchange Commission, 450 Fifth Street, NW, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. INTRODUCTION

The Commission today is publishing its views with respect to using electronic media as a means of delivering information required under the Securities Act of 1933 "Securities Act", the Securities Exchange Act of 1934 ("Exchange Act"), and the Investment Company Act of 1940 ("Investment Company Act"). Advances in computers and electronic media technology are enabling companies to disseminate information to more people at a faster and more cost-effective rate than traditional distribution methods, which have been largely paper-based. The Commission appreciates the promise of electronic distribution of information in enhancing investors' ability to access, research, and analyze information, and in facilitating the provision of information by issuers and others. The Commission believes that, given the numerous benefits of

electronic distribution of information and the fact that in many respects it may be more useful to investors than paper, its use should not be disfavored.

Until recently, on-line use of corporate information was generally limited to large corporations and institutional investors. The dramatic growth in personal computer ownership,[1] however, is enabling many small investors to access on-line corporate information just as readily as institutions. Access to information through electronic means permits small investors to communicate quickly and efficiently with companies as well as with each other.[2]

Use of electronic media also enhances the efficiency of the securities markets by allowing for the rapid dissemination of information to investors and financial markets in a more cost-efficient, widespread, and equitable manner than traditional paper-based methods. Recognizing the multiple benefits of electronic technology, the Commission initiated its Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system in 1984 to automate the receipt, processing and dissemination of disclosure documents filed with the Commission under the Securities Act, Exchange Act and Investment Company Act.[3] As a result of this automation, filings made with the Commission through EDGAR are available promptly to the public and financial markets. Today, more than 70% of all domestic public companies file electronically through EDGAR, and by May 1996, all domestic registrants will be required to file electronically through EDGAR.[4]

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[1]*While estimates of computer ownership vary from survey to survey, it is anticipated that computer ownership will grow dramatically in the next few years. One recent survey suggests that nearly half of all American households own at least one computer and about 16% of those households that own a computer subscribe to on-line services.* See *B. L. McLaughlan, "Wired Nations: Half of U.S. Homes Now Have a Computer, The Detroit News.*

[2]See, *G. Weiss, "Online Investing—At Your Fingertips Is A Powerful New Financial Tool", Business Week, June 5, 1995, at 64.*

[3]*Access to EDGAR filings is generally available through information resellers that have purchased the data from the EDGAR dissemination subsystem and created a variety of on-line and CD-ROM versions. At the present time, 20 firms purchase data and create value-added products for analysts and the investor community. In addition, there is strong interest in ensuring that EDGAR documents are available, especially to individual investors, at the lowest possible cost. In January 1993, the New York University School of Business and the Internet Multicasting Service, a non-profit organization, received a grant from the National Science Foundation to make most EDGAR material available on the Internet. This grant expired on October 1, 1995. The Commission recently announced that it would package EDGAR filings with its own separate Internet service. This service, which began September 28, 1995, makes EDGAR filings as well as certain Commission releases and announcements available on the Internet. The Internet World Wide Web site address is http://www.sec.gov.*

[4]*In order to encourage the rapid dissemination of additional information considered valuable by many members of the investment community, the Commission today is announcing its intention to expand the capacity of the EDGAR system to accommodate the electronic filing of ownership and transaction reports filed pursuant to Section 16 of the Exchange Act and Rule 144 under the Securities Act.* See *Release No. 33-7231. The necessary programming already has been initiated and filers should be able to file these documents electronically on a voluntary basis by late 1995 or early 1996. A further announcement will be made when the effective date is determined.*

The EDGAR rules apply only to filings made with the Commission; the rules do not affect the obligation of filers to deliver to security holders or potential investors documents such as prospectuses, tender offer materials and proxy or information statements.[5] As the ability to send and receive information in electronic form has become more prevalent, issuers and other market participants have begun requesting interpretive guidance regarding the electronic delivery of these documents.[6] Moreover, hundreds of issuers are providing information through electronic means, primarily through computer networks.

In February 1995, the Commission's Division of Corporation Finance issued an interpretive letter intending to address certain legal issues relating to electronic delivery of prospectuses ("Brown & Wood letter").[7] The Brown & Wood letter established a number of conditions in order for a prospectus to be considered "delivered" electronically. The intention at the time of the release of the Brown & Wood letter was that the Commission would review this area in greater detail after the issuance of the letter with a view toward, through an appropriate release, providing further interpretive advice or proposed rulemaking. Because of these developments, along with the fact that none of the federal securities statutes exclusively require paper delivery of information, the Commission believes that interpretive guidance on the use of electronic media is appropriate. While the Commission anticipates that issuers and others will rely upon the guidance of this release, continued reliance on the generally more stringent requirements of the Brown & Wood letter is no longer required, but would be permissible.

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[5]See *Release No. 33-6977 at Section V.F (February 23, 1993).*

[6]*For purposes of this release, the term "electronic" refers to media such as audiotapes, videotapes, facsimiles, CD-ROM, electronic mail, bulletin boards, Internet Web sites and computer networks (*e.g.*, local area networks and commercial on-line services) to provide documents required by the federal securities laws to investors, security holders, and offerees. Such documents include: prospectuses required to be delivered in connection with offerings under the Securities Act; annual reports to security holders and proxy or information statements required to be furnished pursuant to Section 14 of the Exchange Act; annual and semi-annual reports required by Section 30(d) of the Investment Company Act; documents furnished to investors in connection with tender offers or going private transactions; offering circulars delivered in connection with Regulation A offerings; and disclosure required to be furnished in connection with Regulation D offerings (issuers should be mindful of the current prohibition in Rules 505 and 506 regarding general solicitation,* See *Examples 20 and 21). Other documents may include annual reports on Form 10-K and other reports required to be furnished upon request to a security holder or the recipient of a prospectus using incorporation by reference. Additionally, this release addresses the electronic delivery of elective information, such as quarterly reports to security holders and sales literature. But* See *n. 12, below.*

[7]See *Brown & Wood (February 17, 1995).*

This interpretive release addresses only the procedural aspects under the federal securities laws of electronic delivery, and does not affect the rights and responsibilities of any party under the federal securities laws.[8] This release addresses the delivery of information by or on behalf of issuers, as well as by or on behalf of third parties (such as persons making tender offers or soliciting proxies) with respect to issuers.[9]

Additionally, to facilitate further electronic delivery, the Commission proposes in a companion release to codify certain interpretations regarding Commission rules that are premised on the distribution of paper documents.[10] The rules would be revised to make it clear that paper-based requirements relating to font size, boldface type, red ink, graphics, and mailing may be modified as appropriate for documents delivered in electronic format.[11] The proposals are not intended to affect any substantive requirement.

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[8] *The liability provisions of the federal securities laws apply equally to electronic and paper-based media. For instance, the antifraud provisions of the federal securities laws as set forth in Section 10(b) of the Exchange Act and Rule 10b-5 thereunder would apply to any information delivered electronically, as it does to information delivered in paper. As another example, Section 17(b) of the Securities Act would apply to any report circulated on the Internet just as if the report were provided in paper. In addition, this release does not affect any applicable state laws or self-regulatory organization rules. Consequently, issuers and others need to consider the potential application of state law* (e.g., *state securities laws and business corporation laws) and other rules. At least one state has addressed issues relating to the use of electronic media in securities offerings. Recently, the Pennsylvania Securities Commission issued an order, effective for a period of one year beginning September 1, 1995, exempting from state qualification requirements securities offers made on the Internet where: 1) the offer indicates directly or indirectly that the securities are not being offered to persons in Pennsylvania; 2) an offer is not being made to any person in Pennsylvania by other means; and (3) no sales of the issuer's securities are made in Pennsylvania as a result of the Internet offer.* See *Order of the Pennsylvania Securities Commission In Re Offers Effected Through Internet That Do Not Result in Sales in Pennsylvania, dated August 31, 1995. In addition, the North American Securities Administrators Association, Inc., an association of securities commissioners from each of the 50 states, the District of Columbia, Puerto Rico, Mexico, and several Canadian provinces, has a committee that is addressing various issues, including jurisdictional authority, surrounding the use of electronic media in the offering of securities across state lines. The National Association of Securities Dealers, Inc. recently reminded its members of the applicability of its Rules for Fair Practice to electronic communications.*

[9] *Although Section 2(10) of the Securities Act defines "prospectus" to include a writing that "confirms the sale of any security", this release does not authorize transmission of confirmations, as required by Rule 10b-10 under the Exchange Act through electronic means. Consequently, while this release anticipates the electronic delivery of Section 10(a) prospectuses, confirmations that are used to satisfy the delivery of a Section 10(a) prospectus, as permitted by Securities Act Rule 434, cannot be delivered electronically at this time, unless specifically permitted as discussed below. Under current interpretations of Rule 10b-10, confirmations may not be delivered electronically unless the Commission has specifically permitted such delivery. The Commission has recognized the use of a facsimile machine to send customer confirmations. Thus, if a customer has a facsimile machine, a broker-dealer would fulfill its confirmation delivery obligation if it sent the confirmation via facsimile transmission. Release No. 34-34962 (November 9, 1994). The Commission, acting by delegated authority, also has allowed, under specified conditions, confirmations to be sent by electronic means.* See, *e.g., Thomson Financial Services (October 8, 1993). Applications for exemption from the requirements under Rule 10b-10 for delivery by paper or facsimile, pursuant to paragraph (e) of the Rule, may be sent to Catherine McGuire, Chief Counsel, Division of Market Regulation, U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 5-10, Washington, D.C. 20549. The Commission has directed the Division of Market Regulation to review this and other rules to determine if and under what conditions electronic delivery of information required by those rules is feasible. The Commission expects that this review will result in the issuance of additional releases relating to these rules.*

[10] See *Release No. 33-7234.*

[11] See *Section III,* below.

Given the numerous benefits of electronic media, the Commission encourages further technological research, development and application. The Commission believes that the use of electronic media should be at least an equal alternative to the use of paper-based media. Accordingly, issuer or third party information that can be delivered in paper under the federal securities laws may be delivered in electronic format.[12] The Commission also expects that paper delivery of information will continue to be made available by issuers and others until such time as electronic media become more universally accessible and accepted, although the Commission recognizes that, for example, various offerings may now be made exclusively through electronic means.[13]

In connection with the June 1995 proposals on permitting the use of abbreviated financial statements in documents delivered to investors,[14] comment was solicited on whether the increasing availability of disclosure through electronic media warrants reassessment of the current overall regulatory framework.[15] Any comments received on the June 1995 proposals will be evaluated and appropriate action will be considered. By issuing this release in the interim, however, the Commission intends to assist issuers and other market participants in using electronic media to comply with the current regulatory scheme.

II. USE OF ELECTRONIC MEDIA

A. General

The federal securities statutes do not prescribe the medium to be used for providing information by or on behalf of issuers, or by or on behalf of third parties with respect to issuers.[16] The Commission believes that delivery of information through an electronic medium generally could satisfy delivery or transmission obligations under the federal securities laws.

The federal securities laws, among other purposes, seek to promote fair and orderly markets by requiring the disclosure of material information that enables investors to make informed investment and voting decisions. The extent to which required disclosure is made, as opposed to the medium for providing it, should be most important to the analysis of whether sufficient disclosure has occurred under the securities laws. An electronic medium would not provide an adequate means for the delivery of required disclosure, and thus not serve the statutory purposes, if the medium does not permit effective communication to investors or is practically unavailable.[17]

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[12]See *n. 9 and 12,* above.

[13]See *n. 27,* below.

[14]*Release No. 33-7183 (June 27, 1995).*

[15]See *Section II.B to Release No. 33-7183.*

[16]But See *n. 12,* above.

[17]*Electronically delivered documents must be prepared, updated, and delivered consistent with the provisions of the federal securities laws in the same manner as paper documents. Regardless of whether information is delivered through paper or electronic means, it should, of course, convey all material and required information. If a paper document is required to present information in a certain order, then the electronic document should convey the information in substantially the same order. For example, in an audio or video prospectus, the information required to be on the cover page of a paper prospectus pursuant to Item 501(c) of Regulation S-K.*

The Commission believes that the question of whether delivery through electronic media has been achieved is most easily examined by analogy to paper delivery procedures. The Commission would view information distributed through electronic means as satisfying the delivery or transmission requirements of the federal securities laws if such distribution results in the delivery[18] to the intended recipients of substantially equivalent information as these recipients would have had if the information were delivered to them in paper form.[19] As is the case with paper delivery, there should be an opportunity to retain a permanent record of the information.

B. Guidance Regarding Electronic Delivery

The Commission believes that the analysis of whether an electronic communication is delivered or transmitted for purposes of the federal securities laws should be determined in accordance with the preceding discussion. In making such determination with respect to information communicated, in particular, over the Internet, through online services, or through analogous computer networks, the Commission believes that the following concepts discussed in this section reflect issues that should be considered in determining whether applicable statutory requirements have been satisfied.

This release is intended to provide guidance and a degree of certainty regarding the manner in which electronic delivery can be achieved. An issuer or other party that structures its delivery in accordance with the principles and examples set forth below can be assured that it is satisfying its delivery obligations under the federal securities laws. The Commission wishes to emphasize, however, that the factors discussed below are not the only factors relevant to determining whether the legal requirements pertaining to delivery or transmission of documents have been satisfied. If an issuer or third party develops a method of electronic delivery that differs from those discussed below, but provides assurance comparable to paper delivery that the required information will be delivered, that method may satisfy delivery or transmission obligations. The ultimate responsibility for satisfying the applicable statutory requirements remains with the issuer or other party to whom the law assigns the responsibility.

Notice. When an issuer delivers a paper document through the postal mail, the investor will most likely be made aware that new information exists and that the investor might have to take some action within a certain period of time. The Commission believes that those providing electronic information should consider the extent to which the electronic communication provides timely and adequate notice to investors that information for them is available and, if necessary, consider supplementing the electronic communication with another communication that would provide notice similar to that provided by delivery in paper. If an electronic document it-

[18] *Under the various federal securities statutes and rules, there are differing delivery obligations depending upon the context of the requirements. This release does not alter these requirements.*

[19] *Issuers and other persons required to satisfy delivery requirements should consider establishing record-keeping or other procedures to evidence satisfaction of applicable requirements through electronic means. Presumably, such procedures would be analogous to comparable procedures followed when a paper document is delivered. Those providing information also should take reasonable precautions to ensure the integrity and security of that information, regardless of whether it is to be delivered through electronic means or paper, so as to ensure that it is the information intended to be delivered.*

self is provided for example, on computer disk, CD-ROM, audio tape, videotape, or e-mail that communication itself should generally be sufficient notice. If the document is provided on an Internet Web site, however, separate notice would be necessary to satisfy the delivery requirements unless the issuer can otherwise evidence that delivery to the investor has been satisfied or the document is not required to be delivered under the federal securities laws.[20]

Access. When a document is delivered through the postal mail, a recipient is provided with access to the required disclosure. The Commission believes that recipients who are provided information through electronic delivery should have comparable access; consequently, the use of a particular medium should not be so burdensome that intended recipients cannot effectively access the information provided.[21] Moreover, as is the case with a paper document, a recipient should have the opportunity to retain the information or have ongoing access equivalent to personal retention.[22]

If disclosure is made available by posting it on the Internet, making it available through online services, or making it available by similar means, the document should be accessible for as long as the delivery requirement applies.[23]

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[20]*For example, in an offering, notice of an updated or final prospectus and/or the updated or final prospectus itself need not be sent at all, through any means, to persons who have received an electronic preliminary prospectus, but to whom securities are not expected to be sold. Of course, the final prospectus would have to be delivered, through electronic means or otherwise, to those investors to whom securities are sold.*

[21]*For example, if an investor must proceed through a confusing series of ever-changing menus to access a required document so that it is not reasonable to expect that access would generally occur, this procedure would likely be viewed as unduly burdensome. In that case, delivery would be deemed not to have occurred unless delivery otherwise could be shown. There are some circumstances where burdensome procedures may be appropriate.* See *Example 48.*

[22]*In many cases, the investor will be able to download the document from the electronic medium, which is sufficient to satisfy this need.*

[23]*For example, after a paper preliminary prospectus has been provided, issuers make the most recent version of the prospectus available to all persons to whom they expect to sell. If an issuer posts electronically a preliminary prospectus on its Web site, the prospectus should be updated to the same degree as paper and be available to all persons to whom the issuer expects to sell securities in reliance on the electronic delivery of the prospectus. It likely would not be sufficient to show effective delivery if the information was merely posted for a brief period of time and then taken off the Web site, absent some other showing that delivery of the updated prospectus actually had occurred. In the case of a continuous offering, the prospectus should remain available for as long as the issuer will rely on its delivery through the electronic system. Annual reports should be available electronically for a sufficient length of time for delivery to be satisfied. In the case of proxy soliciting materials regarding the election of directors, investors might reasonably expect the proxy soliciting materials and annual report to be available on the Web site until their votes have been cast and the meeting adjourned.*

Finally, because of possible system failures, computer incompatibilities, and those cases, for example, where consents are used in connection with the delivery of information electronically and the person providing the consent revokes it, a necessary precaution given the current state and use of communications technology is that issuers must be able to make available paper versions of documents delivered in an electronic medium. Specifically, the Commission believes that, as a matter of policy, where a person has a right to receive a document under the federal securities laws and chooses to receive it electronically, that person should be provided with a paper version of the document if any consent to receive documents electronically were revoked or the person specifically requests a paper copy (regardless of whether any previously provided consent was revoked).[24]

C. Evidence to Show Delivery

Providing information through postal mail provides reasonable assurance that the delivery requirement is satisfied. The Commission believes that issuers and others[25] providing electronic delivery of information should similarly have reason to believe that any electronic means so selected will result in the satisfaction of the delivery requirements. Examples of procedures evidencing satisfaction of the delivery requirements include:

(1) obtaining an informed consent from an investor to receive the information through a particular electronic medium[26] coupled with assuring appropriate notice and access, as discussed above;

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[24]*This policy would not preclude an issuer from structuring its offering as one that will be made only through electronic documents. However, companies conducting initial public offerings must consider prospectus delivery requirements for secondary markets trading under Securities Act Rule 174. Further, if a potential investor makes it known that the receipt of information through electronic means by that person is no longer to be relied upon by the issuer (for example, due to the revocation of a consent previously given), then the issuer would not be able to rely on the electronic delivery of information subsequently to provide information to such person. If such subsequent information is required to be provided under the federal securities laws to such person because, for example, the person is now a shareholder and is entitled to receive a proxy statement then, absent some alternative, the issuer would be required to deliver the information through paper.*

[25]*For example, broker-dealers, banks, associations and other fiduciary entities may have delivery obligations to forward proxy soliciting materials and annual reports to shareholders under Exchange Act Rules 14b-1 and 14b-2.* See *Example 29.*

[26]*If a consent is used, the consent should be an informed consent. Recipients generally should be apprised: that information provided would be available through a specific electronic medium or source (*e.g., *via a limited proprietary system, or at a World Wide Web site); of the potential that investors may incur costs (*e.g., *on-line time); and of the period during, and the documents for, which the consent will be effective. For instance, investors should be made aware of whether the consent extends to more than one type of document. If an investor revokes a consent that extends to more than one document, and consent is being relied upon by the provider of the information to ensure effective delivery or transmission, future documents should be delivered in paper unless the provider of the information has an alternative mechanism for ensuring effective electronic delivery. If not, it would appear likely that continued electronic delivery, after revocation of the consent, would not be considered to result in the investor's having access to the information and, therefore, the delivery requirement would not be satisfied. Moreover, an issuer could rely on consents provided to an underwriter, a brokerage firm or other service provider. Similarly, an underwriter or brokerage firm could rely on a consent that its customer provided to the issuer, and deliver that issuer's documents through the same electronic medium. Information may be provided through more than one medium; for example, proxy statements and proxy cards might continue to be delivered in paper while prospectuses might be delivered electronically. If the recipient of information provides a general consent to receive all documents electronically, it would be permissible for a provider of information to attempt to accommodate that request if the provider so desired.*

(2) obtaining evidence that an investor actually received the information, for example, by electronic mail return-receipt or confirmation of accessing, downloading, or printing (see example 36);

(3) disseminating information through certain facsimile methods (see example 32);

(4) an investor's accessing a document with hyperlinking to a required document (see examples 15 and 35); and

(5) using forms or other material available only by accessing the information (see examples 31 and 33).

The Commission requests comment on these concepts and on whether additional or alternative concepts would be more useful.

D. Examples

A series of examples is provided below to illustrate various applications of the above concepts and to provide guidance in applying them to specific facts and circumstances. The analysis required to determine compliance with the delivery requirements is fact-specific, and any different or additional facts might require a different conclusion. Although this interpretation is effective immediately, the Commission requests comment on whether other examples might be appropriate for publication in a subsequent release.

Securities Act

(1) Company XYZ places its final prospectus on its Internet Web site. Company XYZ then confirms by mail the sale of securities to investors with a note stating that the final prospectus is available on its Web site and giving the Internet location of the Web site.

Unlike paper delivery of a final prospectus where access to the document can be presumed with delivery, not all investors purchasing securities could be presumed to have the ability to access the final prospectus via an Internet Web site. Therefore, absent other factors such as express consent from the investor or an investor's actually accessing the document on the Web site, the procedures described above by themselves would not satisfy the delivery requirements under the Securities Act.

(2) Company XYZ places its final prospectus on its Internet Web site. Company XYZ then confirms by mail the sale of securities to those investors who have consented to electronic delivery via the Company's Internet Web site. A note on the bottom of the confirmation[27] states that the final prospectus is available on its Web site and the Internet location of the Web site.

This would satisfy delivery obligations, as it is reasonable to presume that investors who have consented to delivery of the final prospectus via an Internet Web site have the ability to access the final prospectus once such investors are supplied with notice of the Internet location of the Web site.

[27]*A separate document accompanying the confirmation also may be used.*

(3) While reviewing Company XYZ's preliminary prospectus on its Internet Web site, Investor John Doe consented to delivery of all future documents only through electronic mail, not by Web site access. Company XYZ subsequently places its final prospectus on its Internet Web site. Company XYZ then confirms by mail the sale of securities to John Doe. A note on the bottom of the confirmation states that the final prospectus is available on its Internet Web site and the location of that Web site.

Again, absent other factors such as John Doe's actually accessing the final prospectus on the Web site, the above-stated procedure of Company XYZ would not by itself satisfy the obligations to deliver the final prospectus to John Doe, as John Doe consented to delivery only by electronic mail, not via an Internet Web site. If consent is to be relied upon, the consent should indicate the specific electronic medium or media that may be used for delivery.

(4) While reviewing Company XYZ's preliminary prospectus on its Internet Web site, Investor John Doe consented to delivery of all future Company documents by 3½ floppy disk. Company XYZ places its final prospectus on its Internet Web site. Company XYZ then confirms by mail the sale of securities to John Doe. A 3½ floppy disk containing the final prospectus is included with the confirmation.

This would satisfy the obligation to deliver the final prospectus to John Doe, since the Company included with the confirmation the final prospectus on a 3½ floppy disk.

(5) Investor John Doe consents to delivery of all documents electronically via Company XYZ's Web site. Two days after consenting, John Doe realizes that the online service he subscribes to does not allow Internet access. John Doe notifies Company XYZ that he is revoking his consent for any electronic delivery as he is not able to access the Company's Internet Web site. Three weeks later, John Doe receives in the mail a confirmation of his purchase of Company XYZ's securities stating the Internet location of the Company's Web site where the final prospectus can be obtained.

Since John Doe revoked his consent for electronic delivery, the Company's notice to John Doe is insufficient because the Company knows that its attempted delivery through the Internet will not satisfy the statutory requirements for John Doe. A final paper prospectus would have to be delivered to John Doe instead. Although a consent is revocable at any time, revocation would have to be given to the company or its agent a reasonable time before electronic delivery has commenced for the company to be on notice that electronic delivery will not satisfy the statutory requirements.

(6) Company LMN, a non-reporting issuer, commences an initial public offering. Company LMN agrees with its underwriter, Brokerage Firm DFG, to place its preliminary prospectus on the Company's Internet Web site at least 48 hours prior to confirmations being sent. Investors John and Jane Doe are both expected to purchase securities in the Company's initial public offering. Both John and Jane Doe previously provided Company LMN with con-

sents for electronic delivery through the Company's Internet Web site. Brokerage Firm DFG, pursuant to its prospectus delivery obligation under Exchange Act Rule 15c2-8(b), provides notice to John and Jane Doe at least 48 hours prior to sending them confirmations.

The underwriter may satisfy its obligation under Rule 15c2-8(b) to John and Jane Doe by this means since both have consented to electronic delivery through the Company's Internet Web site. Although consent was not provided directly to the underwriter, the underwriter can rely on the consent supplied to the Company. Similarly, had the consent been provided to the underwriter, the Company could rely on it as well.

(7) Company ABC contracts with Company QRS, a computer technology company, to place its preliminary and final prospectuses on Company QRS's Internet Web site. Investor John Doe requests a copy of Company ABC's preliminary prospectus via electronic mail from Company ABC's underwriter, Brokerage Firm DFG. The underwriter sends a return electronic mail to John Doe asking if he would like the electronic or paper version of the preliminary prospectus. John Doe replies that the electronic version via the Internet Web site would be preferable. The underwriter then informs John Doe of the Internet location of Company QRS's Web site where the preliminary prospectus for Company ABC is available.

This would satisfy Brokerage Firm DFG's obligation to take reasonable steps to furnish to any person making a written request for a prospectus a copy of such prospectus.[28] John Doe's request for the electronic version via the Internet indicates that such electronic delivery would be effective.[29]

(8) Company XYZ sends the final prospectus via electronic mail to those investors that previously had requested delivery by electronic mail.

The company would meet its delivery obligation with this procedure.

(9) Company XYZ places a preliminary prospectus on its Internet Web site. After a material amendment to the registration statement, it is determined that recirculation of an updated prospectus will be required prior to effectiveness. Company XYZ updates the preliminary prospectus on its Web site.

The Company need only send notice of the update to those investors who are expected to purchase securities in the offering (or takes other measures to deliver the information to those investors). There is no need to send notice to individuals who are not expected to purchase securities in the offering.

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[28]*Exchange Act Rule 15c2-8(c), (d).*

[29]*In Release No. 34-35705 (May 11, 1995), the Commission stated that a managing underwriter may discharge its obligations pursuant to Rule 15c2-8(g) or (h) by delivering a prospectus (or any portion thereof) electronically to a participating broker-dealer, if the recipient broker-dealer expressly consents to delivery in such form, consistent with the Brown & Wood letter. As reflected in that release and as further discussed in this release and Examples 6 and 7 above, it is the Commission's view that broker-dealers may use a variety of means to satisfy the prospectus delivery obligations of Rule 15c2-8, including electronic delivery.*

(10) Company XYZ places its final prospectus on its Internet Web site. Its underwriters mail confirmations of sales to all purchasers. At the same time the confirmations are mailed, the underwriters send via electronic mail notice of the location of the Internet Web site where the final prospectus is available. Notice is sent to all investors who had consented to electronic delivery via an Internet Web site and who provided their electronic mail addresses for purposes of being notified. To those investors that did not provide an electronic mail address but did consent to electronic delivery of the final prospectus, the underwriters mailed the notice of the location of the Internet Web site with the confirmation.

As the notice made investors aware of the availability and location of the electronic document, the delivery requirement would be satisfied.

(11) Company XYZ posts its final prospectus for sale of its common stock on its Internet Web site. Company XYZ's stock is traded on the New York Stock Exchange (NYSE). The NYSE requests 300 paper copies of Company XYZ's final prospectus pursuant to Securities Act Rule 153. Rather than sending 300 copies of its final prospectus to the NYSE, Company XYZ provides the NYSE with notice of its Internet Web site, where the final prospectus can be accessed and downloaded.

This would be insufficient delivery under Securities Act Rule 153. Company XYZ must supply the 300 paper copies to the NYSE. The NYSE must be in the position to provide paper copies of Company XYZ's final prospectus because there is no reasonable expectation that delivery would otherwise be satisfied with regard to investors who do not use any electronic means to receive information. The NYSE would, however, satisfy its delivery obligations with respect to any investor who received delivery of the information through electronic means.

(12) Company XYZ places its preliminary prospectus on its Internet Web site. Upon effectiveness of its registration statement, the Company decides to deliver a term sheet pursuant to Securities Act Rule 434. The term sheet, however, will not be placed on the Company's Web site, but will be delivered in paper format with confirmation of the sale to all investors.

Delivery of a mixed medium final prospectus would satisfy delivery obligations. Generally, if investors received the preliminary prospectus electronically, issuers are encouraged to deliver all documents that constitute the final prospectus in electronic format. However, confirmations cannot be furnished electronically unless the Commission has specifically approved such delivery.[30]

(13) Company XYZ wants to deliver to investors a CD-ROM version of its prospectus. The CD-ROM version includes within the prospectus a movie illustrating the Company's operations. Investors viewing the CD-ROM prospectus would not have to exit the prospectus in order to view the movie, as the movie is actually a part of the prospectus.

[30]See *n. 12*, above.

While Company XYZ may include the movie as part of the prospectus, it would need to file with the Commission as an appendix to the prospectus the script of the movie and a fair and accurate narrative description of the graphic or image material just as it would have to supplementally provide to the Commission scripts and descriptions of such material in sales material.

(14) Company XYZ places a copy of its final prospectus on its Internet Web site. The electronic final prospectus will remain there throughout the period for which delivery is required. Company XYZ also places supplemental sales literature on its Internet Web site. Both the sales literature and the prospectus can be accessed from the same menu, are clearly identified on, and appear in close proximity to each other;[31] the supplemental sales literature may be accessed before viewing or downloading the prospectus.

Sales literature, whether in paper or electronic form, is required to be preceded or accompanied by a final prospectus.[32] In this example, the prospectus would accompany the sales literature since investors can access both the prospectus and sales literature from the same menu. The sales literature and final prospectus should appear in close proximity to each other on the menu. For example, the sales literature should not be presented on the first page of a menu while the final prospectus is buried within the menu.

(15) Company XYZ places its sales literature in a discussion forum located on the Internet World Wide Web. The sales literature contains a hyperlink to the Company's final prospectus. While viewing the literature the individual can click on a box marked "final prospectus", and almost instantly the person will be linked directly to the Company's Web site and the final prospectus will appear on the person's computer screen.

Sales literature, whether in paper or electronic form, is required to be preceded or accompanied by a final prospectus. The hyperlink function enables the final prospectus to be viewed directly as if it were packaged in the same envelope as the sales literature. Therefore, the final prospectus would be considered to have accompanied the sales literature. Consequently, the placing of sales literature in a discussion forum on a Web site would satisfy delivery obligations provided that a hyperlink that provides direct access to the final prospectus is included.

(16) Company XYZ places a preliminary prospectus on its Internet Web site and provides direct access via a hyperlink to a research report on the Company written by ABC Corporation, a registered brokerage firm. The investor reviewing the preliminary prospectus can click on a box marked "ABC's research report" and the investor will be linked to the brokerage firm's Web site where the research report is available.

The hyperlink function provides the ability to access information located on another Web site almost instantaneously. This direct and quick access to ABC's research report would be similar

[31]*Section 5(b) of the Securities Act.*
[32]*Section 5(b) of the Securities Act.*

to the Company including the paper version of the research report in the same envelope that it is using to mail the paper version of the preliminary prospectus to potential investors. During the waiting period, the Company may make offers only through the use of a preliminary prospectus,[33] whether in paper or electronic format; therefore, its use of the research report under these circumstances would not be permissible.

(17) Company XYZ places its final prospectus on its Internet Web site. The Company then mails sales literature to individuals for whom delivery through the Internet Web site was effective (regardless of whether the individuals consented to delivery). Similarly, Brokerage Firm ABC mails Company XYZ's sales literature to its customers for whom delivery through the Internet Web site was effective (regardless of whether the individuals consented to delivery). In the forepart of Company XYZ's sales literature is notice of the availability and Internet Web site location of its final prospectus.

The mailing of sales literature to these individuals is permissible, provided that notice of the availability of the final prospectus and its Internet Web site location accompanies or precedes the sales literature. When notice is included within sales literature, it should be in the forepart of the literature and clearly highlighted to make investors aware of the availability and location of the final prospectus.

(18) Company XYZ places a tombstone advertisement complying with Securities Act Rule 134 on its Internet Web site.

This would be permissible, provided that the advertisement otherwise complies with Rule 134.

(19) Company XYZ files a registration statement with the Commission. The Company then places a "tombstone" advertisement in accordance with Securities Act Rule 134 in the Wall Street Journal. In the advertisement the Company includes the name and address of the underwriter from whom a paper prospectus can be obtained as well as the location of its Internet Web site where an electronic prospectus can be obtained.

This inclusion of an electronic address for obtaining the materials in this "tombstone" advertisement would be permissible under Rule 134. (Similarly, an advertisement made pursuant to Rule 14a-2(a)(6) indicating the availability of proxy soliciting materials and the location of an Internet Web site where electronic proxy soliciting materials could be obtained would be permissible.)

(20) Company XYZ wants to raise $5 million by selling its common stock in a private placement pursuant to Securities Act Rule 506 of Regulation D. The Company places its offering materials on its Internet Web site, which requires various information from a person attempting to access the materials to be provided to the Company prior to displaying the offering materials.

[33] *Section 5(b) of the Securities Act.*

The placing of the offering materials on the Internet would not be consistent with the prohibition against general solicitation or advertising in Rule 502(c) of Regulation D.[34] Where prospective purchasers have been otherwise located without a general solicitation, a proprietary computer service could be used to deliver required disclosure documents.

(21) Company XYZ wants to raise $5 million by selling its common stock in a private placement pursuant to Rule 506 of Regulation D to certain individuals who have been located without a general solicitation. The Company transmits the offering materials via electronic mail addresses provided by these persons.

This would not be inconsistent with the offering restrictions in the rule.

(22) Company XYZ pays John Doe $10,000 to write a report about the Company and post the report on the Internet. John Doe writes the report and places it on the Growth Companies Investment Bulletin Board located on the Internet. The report does not disclose the $10,000 that the Company paid John Doe.

The Securities Act requires that the $10,000 compensation paid by Company XYZ to John Doe be disclosed in the report, regardless of whether it is in electronic or paper form.[35]

Exchange Act

(23) Company XYZ places its annual report and proxy soliciting materials on its Internet Web site. The Company then sends notice to all its record holders that its annual report and proxy soliciting materials are available on its Internet Web site along with the Internet location of the Web site and a telephone number that shareholders may call to request a paper copy.

Similar to Example (1), a company should not presume that all record holders have the ability to access the annual report and proxy soliciting materials via an Internet Web site. Therefore, absent other factors such as a consent from, or actual access by, a Company shareholder, posting of the annual report and proxy soliciting materials via the Company's Internet Web site would be insufficient to constitute delivery to all record holders. The Company, however, may place the materials on its Web site, but in this instance, it also would need to furnish paper copies of the materials to its record holders.

(24) In January 1995, Company XYZ places a copy of its final prospectus on its Internet Web site. The prospectus will remain there throughout the period for which delivery is required. Prior to viewing the final prospectus, Investor John Doe provides an express consent to the delivery of the prospectus and all future documents related to the offering via Company XYZ's

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[34] *In Release 33-7185 (June 27, 1995), the Commission solicited comment on the question of whether the prohibition against general solicitation in Regulation D offerings should be reconsidered.*

[35] *Section 17(b) of the Securities Act.*

Web site. Investor John Doe subsequently purchases the securities. In connection with its May 1995 annual meeting, Company XYZ places proxy soliciting materials on its Web site and places an advertisement in the Wall Street Journal indicating that its proxy materials are now available on its Web site.

This advertisement by itself, even coupled with the express consent that related to the offering documents, is insufficient for the company to assume that it has delivered its proxy statement to Investor John Doe. Although John Doe had provided consent to receiving documents electronically, there is no reason to believe that notice provided in the Wall Street Journal would make John aware of the availability of the proxy materials. Company XYZ must provide more direct delivery or notice to John Doe of the proxy materials. Notice by publication in a newspaper or on a Web site or bulletin board is insufficient.

(25) In September 1994, John Doe, a shareholder in Company XYZ, requests all future corporate communications including proxy statements and annual reports to shareholders ("annual report") to be delivered electronically through the Company's Internet Web site. The consent form states that Company XYZ expects that its annual report and proxy materials for its annual meeting will be available on its Web site on April 1, 1995. On April 1, 1995, the Company places its annual report and proxy soliciting materials on its Web site.

Unlike the delivery of paper annual reports and proxy soliciting materials, where the mere appearance in the mail of such materials places the shareholder on notice within close proximity to the time when shareholder action is requested, the advance request in this example, without more, may not be close enough in time to the requested action to be effective. However, if the Company reasonably expects for other specific reasons, such as a history of communications with that shareholder, that the shareholder would have effective delivery of the information through the Web site, then the procedure could be acceptable.

(26) Record holder Jane Doe consents to delivery of all documents via Company XYZ's Web site. On April 1, 1995, Company XYZ's provides notice to Jane Doe that its annual report and proxy materials are available on its Web site for its annual meeting scheduled to be held on May 5, 1995. On April 5, 1995, Jane Doe notifies the Company that her computer is broken and requests a paper copy of the annual report and proxy materials.

Because Jane Doe's notice to the Company indicates that electronic delivery will be ineffective, the Company should provide Jane Doe with paper copies of the annual report and proxy materials within a reasonable time of her request. She does not need to withdraw her consent in order to receive the paper copies.

(27) Company XYZ places its quarterly report to shareholders and Forms 8-K on its Internet Web site and advertises the location of its Web site in the Wall Street Journal. The Company takes no other action to deliver these materials to shareholders.

This would be permissible, since there generally is no requirement to deliver such materials to shareholders at all.

(28) Company XYZ places its annual report and proxy soliciting materials for the election of directors on its Internet Web site and provides notice to all record holders that previously had consented to electronic delivery via the Company's Web site. The record holders are instructed to print the proxy card, execute the proxy and then mail it back to the Company.

This would be consistent with the proxy rules.

(29) Brokerage Firm ABC solicits its customers who are beneficial owners of Company XYZ to determine whether they would like to receive Company XYZ annual report and proxy soliciting materials electronically via the Internet rather than in paper. The Brokerage Firm then informs the Company that 100 beneficial holders would like to receive the materials electronically and 200 beneficial holders would prefer paper materials.

The Company provides the Brokerage Firm with the location of its Internet Web site where the materials are posted and copies of its paper documents for the 200 beneficial owners who do not wish to receive the electronic delivery. The Brokerage Firm then forwards the notice of the location of the electronic materials to those beneficial holders who consented to receive electronic delivery and forwards the paper materials to those who did not.[36]

This would be consistent with the proxy rules.

(30) Company XYZ wishes to produce its annual report on videotape and CD-ROM. The videotape and CD-ROM will contain all the material information disclosed in the glossy annual report. Before distributing the Company's annual report, the Company sends a letter asking its shareholders whether they would be interested in receiving the Company's annual report on videotape or CD-ROM instead of paper. The Company then sends the videotape version of its annual report to its shareholders who wish to receive the videotape and the CD-ROM version to those shareholders who wish to receive the CD-ROM. The paper glossy annual report is sent to those shareholders who do not wish to receive either electronic format.

The federal securities laws do not preclude the delivery of a document through different media.

Mutual Funds

The Commission is aware that investment companies, particularly open-end investment companies ("mutual funds" or "funds") have been active in using electronic means to communicate with their shareholders and prospective investors.[37] Given the extent to which funds have

[36] *Exchange Act Rule 14b-1. This example also is applicable to delivery by banks and other entities pursuant to Rule 14b-2.*

[37] See *E. Savitz, Let A Thousand Web Site Bloom, Barron's, June 26, 1995, at 50.*

embraced the new technologies, the Commission believes that it is appropriate to include the following additional examples, which are tailored to the fund industry. Unless otherwise noted, however, investment companies other than mutual funds and other corporate issuers or third parties may use these examples for guidance as well.

Examples

(31) A fund sends an e-mail to a recipient with a prospectus attached. The prospectus file includes an application form. The recipient fills out the form and mails it with a check to the fund.

Delivery of the prospectus may be inferred from the recipient's use of the form (provided the fund can identify it as coming from the electronically transmitted prospectus).

(32) A current prospectus is faxed to a potential investor who has requested the prospectus and provided the phone number of the fax machine.

This transmission satisfies the prospectus delivery requirements.

(33) A current prospectus and an application are faxed to a potential investor. The investor did not request the fax, but the sender knows the investor's fax machine phone number.

If the investor completes and mails in the application form included in the faxed prospectus, delivery of the electronic prospectus may be inferred.

(34) A fund sends an unsolicited e-mail with a prospectus attached in one file, and supplemental sales literature in a separate file. The investor can access the sales literature and the prospectus with equal ease.

The fund may send the supplemental sales literature in this fashion.[38] Electronic delivery of the prospectus may be inferred even if the prospectus is not accessed. This would be analogous to an investor receiving by mail a prospectus and supplemental sales literature in the same envelope and electing to review the sales literature, but not the prospectus.

(35) A fund posts its supplemental sales literature and prospectus on a file server for open access over the Internet. The supplemental sales literature contains hyperlinks to the fund's electronic prospectus and includes a caption referring the investor to the prospectus. The investor would not need any additional software or need to take burdensome steps to access the prospectus and thus has reasonably comparable access to both documents. This system also provides for the downloading or printing of prospectuses and sales literature. An investor would not be required to retrieve, download, or print a prospectus before viewing the sales literature. The system does not require any consent by its users.

[38] *Sections 2(10)(a) and 5(b) of the Securities Act.*

When a user accesses the supplemental sales literature, electronic delivery of the prospectus can be inferred. This scenario is analogous to an investor's selecting an envelope containing a paper prospectus and supplemental sales literature from a display at an office of a broker-dealer.

This electronic delivery of the prospectus would be sufficient for other purposes if the fund could reasonably establish that the investor has actually accessed the sales literature or the prospectus.

(36) A prospectus is made available through an on-line system that allows users to access, download or print the entire prospectus and has the capacity to track which users accessed, printed or downloaded which documents.

A fund may rely upon a user's having accessed, printed or downloaded a prospectus for the fund in order to deliver supplemental sales literature or an order form for the fund or to establish delivery of the prospectus in connection with a sale of fund shares.

(37) A fund's prospectus is available through an on-line service that does not have the capacity for downloading or printing or to track retrieval by a user. Investors do not provide any consent. The fund mails or e-mails supplemental sales literature, or an application to all of the service's subscribers, without including a prospectus.

Absent other factors that would indicate delivery of the prospectus, the fund may not send the supplemental sales literature or an application in this fashion, because it is not preceded or accompanied by the prospectus for purposes of Section 2(10)(a) of the Securities Act.[39] This would be true even if the general subscription agreement for the service contained a provision consenting to receipt of documents, because such consent would not be sufficient to give the fund reason to believe that delivery requirements relating to the prospectus will actually be satisfied.

(38) A server available through the Internet contains a fund's prospectus and application form in separate files. Users can download or print the application form without first accessing, downloading or printing the prospectus; the form includes a statement that by signing the form, the investor certifies that he or she has received the prospectus. Logistically it is significantly more burdensome to access the prospectus than the application form (*e.g.*, the investor needs to download special software before accessing the prospectus).

The statement in the form about receipt of the prospectus would not by itself constitute electronic delivery of the prospectus, and the application form is not evidence of delivery of the prospectus, given the need to download special software before the prospectus can be viewed.

(39) A server available through the Internet contains a fund's prospectus. Users must download the prospectus to view or print it. When a user downloads the prospectus, the user receives

[39]*This is analogous to printing a fund prospectus in a magazine of general circulation and subsequently mailing supplemental sales literature to the magazine's subscribers, which would not comply with Sections 2(10) and 5(b) of the Securities Act.* See *William C. Lloyd (State of Wisconsin), June 7, 1990.*

the prospectus and an application form in separate files. It is not significantly more burdensome to access the prospectus than the application form (*e.g.*, no additional software is necessary to read either document, although the documents may be in different formats).

If the fund can identify the application form as coming from the electronic system, electronic delivery of the prospectus can be inferred. The application form is evidence of delivery of the prospectus.

(40) A fund's prospectus and application form are available through an electronic system like that described in the preceding example, except that the investor needs to download special software before the prospectus and application form can be downloaded.

If the fund can identify the application form as coming from the electronic system, electronic delivery of the prospectus can be inferred. The application form is evidence of access to the prospectus.

(41) A fund sends an e-mail with an attached file containing an advertisement satisfying the requirements of Securities Act Rule 482.[40]

There is no prospectus delivery requirement in this context; a Rule 482 advertisement need not be preceded or accompanied by a prospectus.

(42) A fund transmits prospectuses over an electronic bulletin board. Investors provide specific consent to receipt of the prospectus through that system. The consent states that the current version of the prospectus will be made continuously available and notice of material amendments will be given by mail, e-mail, or some other manner specifically directed to investors.

The prospectus delivery requirements will be satisfied with respect to subsequent additional purchases by those investors.

(43) A fund places its prospectus on its Internet Web site and revises the electronic version whenever the prospectus is modified. The fund materially amends the prospectus and decides to send a postcard or e-mail to persons to whom the prospectus has been delivered through electronic means or who have consented to electronic delivery notifying them of the availability of the amended prospectus.

This procedure provides for delivery of the prospectus to those who have consented and to those to whom the prospectus has been previously delivered (if the fund expects those persons to be able to receive the amended prospectus). Alternatively, the fund could choose to satisfy its prospectus delivery requirements by sending a paper copy of the amended prospectus to investors in the fund, including investors who consented to receive documents electronically.

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[40] *Rule 482 permits a registered investment company or business development company to use an "omitting prospectus" advertisement that contains only information the substance of which is included in the company's Section 10(a) prospectus.*

(44) A fund places its prospectus on its Internet Web site. Potential investor John Doe obtains access to the prospectus. John Doe does not purchase shares in the fund. Subsequently, the prospectus is amended.

The fund does not need to provide John Doe with notice of the amendment.

(45) A fund puts proxy solicitation materials on the fund's server on the World Wide Web. At the same time, the fund sends out postcards or e-mail messages (with investors having consented to receive notification by e-mail) giving notification that the proxy materials are available. Investors have signed up to receive documents through the server.

This would be consistent with the proxy rules.

(46) A fund transmits annual and semi-annual reports over an electronic bulletin board system. The fund makes the current versions of these materials available and informs investors who have consented to electronic delivery of this fact. The fund provides separate notification each time a shareholder report is posted by including the notification in the preceding quarterly account statement or shareholder newsletter. The notice informs investors of a date by which the report will be available.

Notification to shareholders in a statement or newsletter delivered within the preceding quarter would be considered sufficient notice under Section 30(d) of the Investment Company Act and the rules thereunder to constitute delivery.

(47) A fund sends investors upon request a CD-ROM containing its current prospectus and registration statement materials for the fund's offering.

This would provide delivery to investors.[41]

(48) Prospectuses and other materials are available through a computer server that requires users to obtain a user ID and password before they can access documents on the system. The process for obtaining the ID and password requires significant information from the user and involves a delay of one day or even several days before the user can access the system. After a user accesses a prospectus, a fund sends him or her supplemental sales literature.

The process provides for delivery of the prospectus. Although the system imposes burdens in the process for obtaining access to the prospectus, these burdens are part of the process of providing access to all the information, including the supplemental sales literature, and not burdens upon access to the prospectus that is delivered.

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[41] *The analysis would be the same if an investor requests and receives information on a diskette.*

(49) A prospectus is made available through an on-line system that allows users to download the entire prospectus. The system does not permit on-line viewing. An investor downloads the prospectus.

Assuming downloading, this method would satisfy the delivery requirements because on-line viewing is not a prerequisite to electronic delivery.

(50) A fund provides its prospectus, annual and semi-annual reports through an Internet Web site. After one year, the fund decides to terminate the Web site.

The fund may cease making its prospectus available through the Web site as soon as the fund no longer plans to rely on electronic delivery for satisfying its prospectus delivery requirements.[42] Generally, an annual or semi-annual report should be available until superseded by a later report. The fund in this example could terminate the posting of the most recent report when it is superseded by a new one, or earlier if it provides a replacement paper copy to shareholders who received the report electronically.

(51) The text of a fund's prospectus transmitted electronically on a CD-ROM or an Internet Web site follows the sequence requirements of Form N-1A. The prospectus includes a summary, which contains hyperlinks that allow the investor to move to later sections of the prospectus or to other documents (*e.g.*, the fund's statement of additional information or annual report). The summary is part of the prospectus text that is subject to the form's sequence requirements.

Even though the hyperlinks allow an investor to choose to view information out of sequence, the prospectus satisfies the requirements of Form N-1A, because the main text does comply with the sequence requirement.

(52) A fund places its prospectus (information required by Part A of Form N-1A) on its Internet Web site. The fund does not put its Statement of Additional Information ("SAI") (information required by Part B of Form N-1A) on its Web site; instead, it provides a paper copy of its SAI free of charge to any person that requests it.

Delivery of a paper copy of an SAI does not prevent a fund from satisfying its prospectus delivery requirements electronically.

III. PROPOSED AMENDMENTS

This release is intended to address practices involving electronic delivery that are acceptable under current rules; no substantive changes to filing or delivery requirements are contemplated here. However, in order to make it clear that current rules should be read to encompass

[42] *Continued sales of fund shares or delivery of sales literature or application forms to investors who had received the prospectus electronically would require delivery of paper prospectus to those investors. Funds should consider whether paper prospectuses should also be sent to other investors (*e.g.*, recent purchasers).*

electronic as well as paper dissemination, the Commission is proposing in a companion release a number of technical amendments to its rules.[43]

IV. ELECTRONIC FILING ISSUES

As emphasized previously, this release addresses only issues relating to electronic delivery of required disclosure documents and does not affect the Commission's electronic filing requirements. However, the Commission recognizes that the same rapid development of electronic communications in recent years that has led to the issuance of this release also has implications for how the Commission should receive, process and make publicly available the documents filed with it pursuant to the federal securities laws. Currently, filings are accepted by the Commission only in the electronic formats prescribed by the EDGAR system, or in paper, where the filer has not yet become subject to mandated electronic filing requirements or where there is an exemption pursuant to the electronic filing rules. While EDGAR may be modified in the future to accept and process a broader array of electronic formats, there may be ways to allow the filing of documents prepared and delivered in other electronic media on a more expedited timetable. As the Commission continues with its review of this area, it intends to issue additional releases. Comment on the costs and benefits to filers and the federal government with respect to these issues should be provided by persons submitting comment on these issues.

V. SOLICITATION OF COMMENT

Interested persons wishing to submit written comments relating to the views expressed in this release, or with respect to the rule proposals in the companion release, are invited to do so by submitting them in triplicate to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C., 20549. Commenters should refer to File Number S7-31-95. Comment is requested not only on the specific issues discussed on the release, but on any other approaches or issues that should be considered in connection with facilitating the use of electronic media to further the disclosure purposes of the federal securities laws. Comment is sought from the point of view of both parties providing the disclosure, such as issuers and those acting on behalf of issuers, and parties receiving and using the disclosure, such as investors and shareholders. The Commission further requests comment on any competitive burdens that might result from the adoption of the proposals. Comments on this inquiry will be considered by the Commission in complying with its responsibilities under Section 23(a) of the Exchange Act.[44]

By the Commission.

Jonathan G. Katz
Secretary

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[43]See *Release No. 33-7234 for the text of those amendments. Rule changes are proposed to be made to the following rules and forms: Rule 253 of Regulation A; Rule 420 of Regulation C; Rules 481 and 482 of Regulation C; Rule 605 of Regulation E; Rule 304 of Regulation S-T; Forms F-7, F-8, F-9; F-10 and F-80; Rule 12b-12; Rule 13e-3; Rule 13e-4; Schedule 13E-4F; Rule 14a-3; Rule 14a-5; Rule 14a-7; Rule 14c-4; Rule 14c-7; Rule 14e-5; Schedule 14D-1F; Schedule 14D-9F; and Rule 8b-12; Rule 30d-1 and Rule 30d-2.*

[44]*15 U.S.C. 78w(a).*

Use of electronic media by broker-dealers, transfer agents, and Investment advisers for delivery of information; additional Examples under the securities act of 1933, securities exchange Act of 1934, and investment company act of 1940
Securities and Exchange Commission
Release No. 33-7288; 34-37182; IC-21945; IA-1562; File No. S7-13-96
May 9, 1996

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation; Solicitation of Comments.

SUMMARY: The Securities and Exchange Commission ("Commission") is publishing its views with respect to the use of electronic media by broker-dealers, transfer agents, and investment advisers to deliver information as required under the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. This interpretation is intended to provide guidance in using electronic media to fulfill broker-dealers' obligations to deliver information to customers, transfer agents' obligations to deliver information upon written request, and investment advisers' disclosure delivery obligations. The Commission also is supplementing its interpretive release published on October 6, 1995, with seven additional examples illustrating the application of that earlier release to information delivery under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. Finally, the Commission is seeking comment on the issues discussed in this release.

DATES: This interpretation is effective on [insert date of publication in the Federal Register].

Comments must be received on or before [insert date 45 days after date of publication in the Federal Register].

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 6-9, Washington, D.C. 20549. Comments also may be submitted electronically at the following electronic mail address: rule-comments@sec.gov. All comment letters should refer to File Number S7-13-96. This file number should be included on the subject line if comments are submitted using electronic mail. Comment letters will be available for public inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Catherine McGuire, Chief Counsel, or Elizabeth King, Special Counsel, or Jack Drogin, Special Counsel (concerning Rules 10b-10, 10b-16, 15c1-5, 15c1-6, 15c2-12, and 15g-2 through 15g-9 under the Securities Exchange Act of 1934, and the release generally), 202/942-0073, Office of Chief Counsel, Mail Stop 5-10; Sheila Slevin, Assistant Director (concerning information about technology generally), 202/942-0796,

Mail Stop 5-1; Michael Walinskas, Special Counsel (concerning Rule 9b-1 under the Securities Exchange Act of 1934), 202/942-0188, Mail Stop 5-1; Elizabeth MacGregor, Special Counsel (concerning Rule 11Ac1-3 under the Securities Exchange Act of 1934), 202/942-0158, Mail Stop 5-1; Alan Reed, Attorney (concerning Rules 15c2-8 and 15c2-11 under the Securities Exchange Act of 1934), 202/942-0772, Mail Stop 5-1; Michael A. Macchiaroli, Associate Director (concerning Exchange Act Rules 8c-1, 15c2-5, 15c3-2, 15c3-3, and 17a-5), 202/942-0132, Mail Stop 5-1; Jerry Carpenter, Assistant Director (concerning Exchange Act Rule 17Ad-5), 202/942-4187, Mail Stop 5-1, Division of Market Regulation; Jack W. Murphy, Chief Counsel or Amy Doberman, Assistant Chief Counsel (concerning the Investment Advisers Act of 1940 and the examples illustrating application of electronic delivery to mutual funds), 202/942-0660, Mail Stop 10-6, Division of Investment Management; Joseph Babits, Special Counsel (concerning the examples regarding application of electronic delivery to issuers other than mutual funds), 202/942-2910, Mail Stop 3-7, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. INTRODUCTION

On October 6, 1995, the Commission published an interpretive release expressing its views on the electronic delivery of documents, such as prospectuses, annual reports to shareholders, and proxy solicitation materials under the Securities Act of 1933 ("Securities Act"), the Securities Exchange Act of 1934 ("Exchange Act"), and the Investment Company Act of 1940 ("October Interpretive Release").[45] In the October Interpretive Release, the Commission directed the Division of Market Regulation ("Division") to review Rule 10b-10 and other rules it administers under the Exchange Act to determine if and under what conditions electronic delivery of information required by those rules is feasible.[46] Accordingly, the Division conducted a review of the rules it administers under the Exchange Act. Based on that review, the Commission is issuing this release, which expresses its views with respect to the delivery of information through electronic media in satisfaction of broker-dealer and transfer agent requirements to deliver information under the Exchange Act and the rules thereunder. In conjunction with the results of that review, the Commission is publishing its views on the use of electronic media with respect to the disclosure delivery obligations of investment advisers and persons acting on their behalf[47] under the Investment Advisers Act of 1940 ("Advisers Act").

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[45] *Securities Act Release No. 7233 (Oct. 6, 1995), 60 FR 53458 (Oct. 13, 1995) (hereinafter "October Interpretive Release"). In a companion release, the Commission proposed technical amendments to certain of its rules that currently are premised on the distribution of paper documents. Securities Act Release No. 7234 (Oct. 6, 1995). Today the Commission is adopting these technical amendments substantially as proposed. Securities Act Release No. 7289 (May 9, 1996).*

[46] *October Interpretive Release,* supra *note 1, at 53459, n.12.*

[47] *The term investment adviser is used in the rest of this release to refer to both investment advisers and persons acting on their behalf (including any solicitor receiving cash compensation from an adviser in accordance with Advisers Act Rule 206(4)-3.*

This release addresses only the procedural aspects under the federal securities laws of the delivery of information by broker-dealers, transfer agents, and investment advisers. It does not affect the rights and responsibilities of any party under the federal securities laws.[48] This release also does not address or affect the applicability of any self-regulatory organization ("SRO") rules,[49] or of any state laws.

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[48]*The substantive requirements and liability provisions of the federal securities laws apply equally to electronic and paper-based media. For example, the antifraud provisions of the Exchange Act and Rule 10b-5 thereunder, as well as section 206 of the Advisers Act and the rules thereunder, apply to information delivered and communications transmitted electronically, to the same extent as they apply to information delivered in paper form.* See *October Interpretive Release,* supra *note 1, at 53459, n.11. In addition, broker-dealers, transfer agents, and investment advisers continue to be subject to their respective recordkeeping requirements under Exchange Act Rules 17a-3 and 17a-4, Exchange Act Rules 17Ad-6 and 16Ad-7, and Advisers Act Rule 204-2.*

The Commission proposed for comment amendments to the broker-dealer record preservation rule, which would permit broker-dealers to employ, under certain conditions, optical storage technology to maintain required records. See *Exchange Act Release No. 32609 (July 9, 1993) ("Proposing Release"). At the time these amendments were proposed, concerns were expressed that optical disk images would make it difficult, from an examination and discovery perspective, to detect alterations made to handwritten records and to records containing handwritten text. To address these concerns, the Proposing Release solicited comments on the adequacy of optical disk technology to preserve handwritten records or records that contain handwritten text.*

Simultaneous with the issuance of the Proposing Release, the Division of Market Regulation, with the Commission's concurrence, issued a no-action letter permitting broker-dealers to use optical disk technology immediately. See *Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC to Mr. Michael D. Udoff, Chairman, Ad Hoc Record Retention Committee, Securities Industry Association, Inc., (June 18, 1993). The no-action letter permits the optical storage of all paper records, including handwritten records, except those records required to be made under paragraphs (a)(6) and (a)(7) of Rule 17a-3 (proprietary and customer order tickets).*

The Commission's request for comment in the Proposing Release regarding handwritten records was in no way intended to limit reliance on the no-action letter. In addition, the Commission notes that paperless order tickets (i.e., *those generated by computers) may, under the no-action letter, be stored on optical disks. The Commission understands that most of the large firms generate paperless order tickets rather than handwritten order tickets.*

Finally, the Commission is aware that questions have been raised regarding the application of the optical storage no-action letter. The staff of the Division of Market Regulation is prepared to discuss with interested persons any issues in connection with this letter, as well as with the Proposing Release..

[49]See, e.g., *National Association of Securities Dealers, Inc. ("NASD") Notice to Members 95-80 (Sept. 26, 1995), NASD Rules of Fair Practice §35, and New York Stock Exchange, Inc. ("NYSE") Rule 472, which govern member firm responsibilities relating to communications with the public, including electronic communications.*

In order to determine whether new guidelines are needed for the use of electronic communications, on January 12, 1996, the NYSE sent a survey to its members and member organizations regarding the use of electronic systems to communicate with customers. The NYSE asked its members to return the survey by February 15, 1996. NYSE Information Memorandum (Jan.12, 1996). The Commission understands that the NASD intends to send a similar survey to its members.

The Commission strongly encourages the SROs to continue to work with broker-dealers to adapt SRO supervisory review requirements governing communications with customers to accommodate the use of electronic communications by broker-dealers. Because electronic delivery systems allow broker-dealers and their associated persons to freely contact the general public, as well as their clients, firms should maintain effective supervision and records of associated persons' communications to avoid potential sales practice problems. The Commission believes, however, that the SROs' rules concerning the supervisory requirements for electronic communications should be based on the content and audience of the message, and not merely the electronic form of the communication. For example, the SROs should consider whether electronic mail communications, that, as a practical matter, replace or substitute for telephone conversations, in many cases would not require advance authorization or prior supervisory review.

The Commission also recognizes that broker-dealers are concerned about the costs of maintaining electronic communications as records on a long term basis, and it intends to discuss these concerns further with the securities industry.

Broker-dealers, transfer agents, and investment advisers, therefore, are reminded to consider the applicability of SRO rules and state laws in connection with delivering information electronically.[50] The release further does not affect any rules promulgated under the Exchange Act by agencies other than the Commission.[51]

Finally, this interpretation does not address the existing paper filing requirements with the Commission,[52] other regulatory authorities,[53] and other third parties.[54]

II. USE OF ELECTRONIC MEDIA

In the October Interpretive Release, the Commission noted that the electronic distribution of information provides numerous benefits and that the use of this type of medium is growing among all participants in the securities industry. The Commission concluded that issuers, third parties (such as persons making tender offers or soliciting proxies), and persons acting on behalf of such third parties may use electronic media, in accordance with the guidance provided in the October Interpretive Release, to deliver information. In addition, the Commission believes that

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[50] Article 8 of the UCC was revised substantially in 1994, and the revisions were endorsed by both the American Law Institute and the National Conference of Commissioners on Uniform State Laws. This revised version has been adopted by 13 states. Under Revised Article 8 Section 8-102(6), parties to a transaction may "transmit information by any mechanism agreed upon by the persons transmitting and receiving the information." Revised Article 8 eliminates the current Section 8-319 requirement for a signed writing evidencing the terms of a securities transaction.

In states that have not yet codified the 1994 amendments, a confirmation bearing the broker-dealer's letterhead or some other identifying marking, generally, fulfills that requirement. See e.g., Kohlmeyer and Co. v. Bowen, 192 S.E.2d 400, 126 Ga. App. 700 (Ga. Ct. App. 1972); See also Bains v. Piper, Jaffray & Hopwood, 497 N.W.2d 263 (Minn. Ct. App. 1993) (computer generated confirmation held to satisfy the UCC requirement for a writing).

[51] See, e.g., Treas. Reg. §§ 404.4(e) and 403.5(d) (rules regarding hold in custody repurchase agreements applicable to government securities brokers and dealers that are financial institutions).

[52] For example, this interpretation does not apply to any requirements to file information with the Commission in connection with registering under sections 15, 15A, 15B, or 15C of the Exchange Act as a broker-dealer, national securities association, municipal securities dealer, or government securities broker-dealer. Broker-dealers currently register with the Commission, the SROs, and the states through the Central Registration Depository ("CRD") system operated by the ASD. A redesign of the CRD system will allow broker-dealers to file uniform registration forms electronically. In connection with the CRD redesign the Commission intends to adopt amendments to Form BD, the uniform application for broker-dealer registration under the Exchange Act. See Exchange Act Release No. 35224 (Jan. 12, 1995), 60 FR 4040 (Jan. 19, 1995) (proposing amendments to Form BD).

Because, at the present time, the Commission does not have the technological capacity to receive electronic transmissions of information from broker-dealers, transfer agents, or investment advisers, this interpretation also does not apply to other requirements to file information with the Commission under the Exchange and Advisers Acts. See, e.g., Exchange Act Rule 9b-1 (options markets' obligation to file with the Commission any revisions to an options disclosure document); Advisers Act Form ADV, 17 CFR 279.1 (application for registration of investment advisers). The Commission, nevertheless, recognizes the desirability of electronic filing and is examining the feasibility of establishing systems capable of receiving information electronically.

[53] For example, the notice requirements to the National Association of Securities Dealers, Inc. under Exchange Act Rule 10b-17, also are not within the scope of this interpretation.

[54] For example, Rule 15a-6 requires U.S. registered broker-dealers, under certain circumstances, to obtain certain foreign persons' consent to service of process. The Commission has never taken a position as to the specific means by which the U.S. broker-dealer may meet this obligation, but believes that a consent to service of process may be obtained through the use of a facsimile.

broker-dealers, transfer agents, and investment advisers may satisfy their delivery obligations under the Exchange Act and the Advisers Act by using electronic media as an alternative to paper-based media.[55]

This interpretation is intended to provide broker-dealers, transfer agents, and investment advisers with guidance in using electronic media to satisfy delivery requirements under the federal securities laws. This release generally covers those requirements that obligate broker-dealers to deliver information to customers, obligate transfer agents to deliver information upon written request, and obligate investment advisers to deliver information to their clients or prospective clients. Broker-dealers and investment advisers also may rely on this interpretation in obtaining customers' and clients' consents as required under certain provisions of the Exchange and Advisers Acts and the rules thereunder.[56] A discussion of the information delivery requirements covered by this interpretation is provided in section III of this release ("Covered Delivery Requirements"). Unless the Commission indicates otherwise, this interpretive release also is intended to apply to all rules promulgated under the Exchange and Advisers Acts, including rules promulgated subsequent to the issuance of this release, requiring broker-dealers or investment advisers to deliver information to customers or clients, and to rules requiring transfer agents to deliver information in response to written requests.

A. General

This discussion is intended to complement the discussion in the October Interpretive Release and to provide general guidance concerning issues under the Exchange and Advisers Acts. The Commission believes that broker-dealers, transfer agents, and investment advisers should be able to satisfy their obligations under the federal securities laws to deliver information required under the Covered Delivery Requirements by electronic distribution. The framework set forth in the October Interpretive Release is applicable to such electronic distribution.

In the October Interpretive Release, the Commission stated that it would view information distributed through electronic means as satisfying the delivery or transmission requirements of the federal securities laws if such distribution results in the delivery to the intended recipients of substantially equivalent information as such recipients would have if the required information were delivered to them in paper form.[57] The Commission is not specifying the electronic medium or source that broker-dealers, transfer agents, and investment advisers may use.

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[55] *The exact nature of the broker-dealer's, transfer agent's, and investment adviser's delivery obligations is defined broadly and includes such terms as "give," "furnish," "send," and "deliver." The Commission believes that, in general, these terms are sufficiently broad to accommodate the contemplated electronic transmission of documents by or on behalf of the broker-dealer, transfer agent, or investment adviser and, when called for, from a customer to a broker-dealer, transfer agent, or investment adviser. But see infra notes 12 and 50.*

[56] *In connection with transactions in penny stocks, however, the Commission believes that in order to fulfill the purposes of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, broker-dealers should continue to have customers manually sign and return in paper form any documents that require a customer's signature or written agreement. See infra note 50.*

[57] *October Interpretive Release, supra note 1, at 53460. See also supra example 7.*

Like paper documents, electronically delivered documents must be prepared and delivered in a manner consistent with the federal securities laws. Regardless of whether information is delivered in paper form or by electronic means, it should convey all material and required information. If a paper document is required to present information in a certain order, for instance, then the information delivered electronically should be in substantially the same order.[58]

Moreover, regardless of whether information is delivered in paper or electronic form, broker-dealers and investment advisers must reasonably supervise firm personnel with a view to preventing violations.[59] Thus, broker-dealers and investment advisers should consider the need for systems and procedures to deter or detect misconduct by firm personnel in connection with the delivery of information, whether by electronic or paper means.[60]

The Commission believes that, as a matter of policy, a person who has a right to receive a document under the federal securities laws and chooses to receive it electronically, should be provided with the information in paper form whenever specifically requesting paper.[61]

In the October Interpretive Release, the Commission discussed issues of notice and access that should be considered in determining whether the legal requirements pertaining to delivery or transmission of documents have been satisfied,[62] and stated that persons using electronic delivery of information should have reason to believe that any electronic means so selected will result in the satisfaction of the delivery requirements.[63] The Commission believes that broker-dealers, transfer agents, and investment advisers should apply the same considerations in using electronic media to satisfy their delivery obligations under the Covered Delivery Requirements.

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[58] *For a discussion of how requirements to present information in a certain order may be applied to documents containing hyperlinks, see example 51 in the October Interpretive Release. Id. at 53466.*

[59] *See Exchange Act §15(b)(4)(E); Advisers Act §203(e)(5). See also NASD Rules of Fair Practice §27; NYSE Rule 342.*

[60] *See, e.g., In re: Bryant, Securities Exchange Act Release No. 32357 (May 24, 1993), (Commission upheld a finding of the National Association of Securities Dealers, Inc. that, among other things, the failure to develop procedures to supervise a registered representative, who sent a false confirmation statement on behalf of the broker-dealer, and to enforce existing procedures constituted a failure to supervise on the part of the president of the firm).*

[61] *For example if a person revokes consent to receiving information electronically, even following delivery of the information, a paper copy should be delivered upon request. Revocation, however, is not a prerequisite to requesting a paper copy.*

The Commission understands that it can be very costly for broker-dealers to maintain records for long periods of time. This is particularly true with respect to information that is specific to a customer's account or to a transaction, such as the type of information defined below as Personal Financial Information. See infra section II.B. For this reason, the Commission has limited the time period that broker-dealers must preserve records required to be made under Exchange Act Rules 17a-3. Specifically, Exchange Act Rule 17a-4 requires broker-dealers to preserve records for a period of six years (3 years in the case of certain types of information), the first two years in an easily accessible place. For these same reasons, the Commission believes it is reasonable to expect that broker-dealers would provide customers with information in paper form upon request for a period of two years. Transfer agents and investment advisers are subject to similar recordkeeping requirements.

[62] *October Interpretive Release, supra note 1, at 53460-61.*

[63] *Id. at 53461.*

1. Notice

Broker-dealers, transfer agents, and investment advisers providing information electronically should consider the extent to which electronic communication provides timely and adequate notice that such information is available electronically.[64] When information is delivered on paper through the postal mail, recipients most likely will be made aware that they have received information that they may wish to review and, therefore, separate notice is not necessary. Information transmitted through electronic media, however, may not always provide a similar likelihood of notice that information has been sent that the recipient may wish to review.[65] Broker-dealers, transfer agents, and investment advisers, therefore, should consider whether it is necessary to supplement the electronic communication with another communication that would provide notice similar to that provided by delivery in paper through the postal mail.

2. Access

The Commission believes that customers, securities holders, and clients who are provided information through electronic delivery from broker-dealers, transfer agents, and investment advisers should have access to that information comparable to that which would be provided if the information were delivered in paper form. Thus, the use of a particular medium should not be so burdensome that intended recipients cannot effectively access the information provided. Also, persons to whom information is sent electronically should have an opportunity to retain the information through the selected medium or have ongoing access equivalent to personal retention.[66]

3. Evidence to Show Delivery

Providing information through postal mail provides reasonable assurance that the delivery requirements of the federal securities laws have been satisfied. The Commission believes that broker-dealers, transfer agents, and investment advisers similarly should have reason to believe that electronically delivered information will result in the satisfaction of the delivery requirements under the federal securities laws. Thus, whether using paper or electronic media, broker-dealers, transfer agents, and investment advisers should consider the need to establish procedures to ensure that applicable delivery obligations are met.

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[64] *See id. at 53460. See also infra section II.B.2. regarding additional requirements when broker-dealers, transfer agents, and investment advisers send certain types of information (defined as Personal Financial Information) to customers.*

[65] *For example, if information is provided by physically delivered material (such as a computer diskette or CD-ROM) or by electronic mail, that communication itself generally should be sufficient notice. If information is made available electronically through a passive delivery system, such as an Internet Web Site, however, separate notice would be necessary to satisfy the delivery requirements unless the broker-dealer, transfer agent, or investment adviser can otherwise evidence that delivery to the customer or client has been satisfied.*

[66] *For example, the intended recipient's ability to download or print information delivered electronically would enable a recipient to retain a permanent record. See October Interpretive Release, supra note 1, at 53460.*

Broker-dealers, transfer agents, and investment advisers may be able to evidence satisfaction of delivery obligations, for example, by: (1) obtaining the intended recipient's informed consent[67] to delivery through a specified electronic medium, and ensuring that the recipient has appropriate notice and access, as discussed above; (2) obtaining evidence that the intended recipient actually received the information, such as by an electronic mail return-receipt or by confirmation that the information was accessed, downloaded, or printed;[68] or (3) disseminating information through certain facsimile methods. In order to ensure that information is delivered as intended, broker-dealers, transfer agents, and investment advisers delivering information using either electronic or paper-media should take reasonable precautions to ensure the integrity and security of that information.[69]

B. Personal Financial Information

Certain information that broker-dealers, transfer agents, and investment advisers deliver is specific to a particular person's personal financial matters ("Personal Financial Information"). For example, the information reported to customers under Exchange Act Rule 10b-10 relates to specific securities transactions and includes the identity and number of shares bought or sold and the net dollar price for the shares. Under Exchange Act Rule 10b-16, a broker-dealer that imposes finance charges on a customer's account during a quarterly period must deliver a quarterly statement disclosing, among other things, the account's beginning and closing balances, debits and credits entered during the period, the interest charged, and the rate or rates of interest. Similarly, under Advisers Act Rule 206(3)-2, investment advisers engaging in agency cross transactions involving clients are required to send the clients disclosure about those transactions.[70]

1. Confidentiality and Security

Broker-dealers, transfer agents, and investment advisers sending Personal Financial Information should take reasonable precautions to ensure the integrity, confidentiality, and security

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[67] *See id. at 53460. If a consent is used, the consent should be an informed consent. An informed consent should specify the electronic medium or source through which the information will be delivered and the period during which the consent will be effective, and should describe the information that will be delivered using such means. The broker-dealer, transfer agent, or investment adviser also should inform the customer that there may be potential costs associated with electronic delivery, such as on-line charges. Except where a manual signature is required under the penny stock rules, see infra note 50, broker-dealers may obtain consents either manually or electronically. In most cases in which a request for information is made through an electronic medium, consent to receive the requested information by means of electronic delivery may be presumed.*

In addition, if the broker-dealer, transfer agent, or investment adviser is relying on the consent to ensure effective delivery and the intended recipient revokes the consent, future documents should be delivered in paper.

[68] *For example, depending on the circumstances and the procedures used, customers' and clients' written consent or acknowledgment, as required under certain Exchange and Advisers Acts rules and discussed infra notes 28-29 and accompanying text, may serve as sufficient evidence to show delivery.*

[69] *October Interpretive Release, supra note 1, at 53460, n.22.*

[70] *17 CFR 275.206(3)-2(a)(2) (written confirmation of each transaction "at or before the completion of each such transaction"); 17 CFR 275.206(3)-2(a)(3) (annual written disclosure statement identifying transactions). In addition, investment advisers having custody of client assets are required to send an itemized statement to each client at least quarterly showing assets in custody of the adviser. 17 CFR 275.206(4)-2(a)(4).*

of that information, regardless of whether it is delivered through electronic means or in paper form. The Commission believes that broker-dealers, transfer agents, and investment advisers transmitting Personal Financial Information electronically must tailor those precautions to the medium used in order to ensure that the information is reasonably secure from tampering or alteration.

2. Consent

Because of the need to maintain the confidentiality and security of Personal Financial Information, it is important that the intended recipient is willing to accept the delivery of such information through electronic media and has actual notice that the Personal Financial Information will be delivered electronically. Therefore, in order to ensure that Personal Financial Information can be delivered in a manner that maintains the information's confidentiality, unless a broker-dealer, transfer agent, or investment adviser is responding to a request for information that is made through electronic media or the person making the request specifies delivery through a particular electronic medium, the broker-dealer, transfer agent, or investment adviser should obtain the intended recipient's informed consent prior to delivering Personal Financial Information electronically.[71] This consent will ensure that the intended recipient is willing to accept the delivery of Personal Financial Information through electronic media and has actual notice that the Personal Financial Information will be delivered electronically. The Commission believes that such consent by the customer or client to the delivery of Personal Financial Information may be made either by a manual signature or by electronic means.

C. Communications From Broker-Dealers' Customers and Investment Advisers' Clients

In addition to requirements to deliver information, the Exchange Act and the Advisers Act provide for broker-dealers and investment advisers to "receive" or "obtain" responses from their customers or clients. For example, Exchange Act Rules 8c-1 and 15c2-1 require, under certain circumstances, broker-dealers to obtain a customer's written consent in order to hypothecate securities. Similarly, under the Advisers Act, certain provisions call for clients to consent to a transaction or acknowledge receipt of certain disclosures.[72] The Commission generally views an electronic communication from a customer to a broker-dealer or from a client to an investment adviser as satisfying the requirements for such written consent or acknowledgment.[73]

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[71] *See discussion supra note 23 regarding informed consent.*

[72] *See, e.g. Advisers Act §§ 205(a)(2) and 206(3).*

[73] *Of course, broker-dealers and investment advisers should be cognizant of their responsibilities to prevent, and the potential liability associated with, unauthorized transactions. See, e.g., supra note 16. In this regard, the Commission believes that broker-dealers and investment advisers should have reasonable assurance that the response received from a customer or client is authentic.*

In addition, for policy reason discussed infra note 50, the Commission will continue to require broker-dealers to obtain the manual signature of customers on certain disclosure documents required under Exchange Act Rules 15g-2 and 15g-9.

D. Electronic Transmission of Non-Required Disclosure

The guidance provided above is intended to permit broker-dealers, transfer agents, and investment advisers to comply with their delivery obligations under the federal securities laws when using electronic media. This interpretation does not apply to the electronic delivery of non-required information that in some cases is being provided voluntarily to customers, securities holders, and clients[74] in that it is not necessary (although it is, of course, permitted) to conform the electronic delivery of such information to the guidance in this release. Nevertheless, the Commission urges broker-dealers, transfer agents, and investment advisers to take into consideration the need to implement security measures when using electronic media to provide personal financial information.

The staff also has received inquiries about the permissibility of using various electronic media to disseminate advertisements for an investment adviser's services or other information that is not subject to a delivery requirement. Such communications are permissible, subject to the same requirements and restrictions that apply to such communications in paper. For example, electronically disseminated advertisements are subject to the same prohibitions against misleading disclosure as advertisements in paper.[75] Materials concerning an adviser that are potentially available to ten or more persons through an electronic system would be considered subject to the recordkeeping requirements applicable to such communications.[76] Similarly, if an adviser uses a publicly available electronic medium such as a World Wide Web site to provide information about its services, the adviser would not qualify for the exemption from registration in section 203(b)(3) of the Advisers Act. That exemption is available only if, among other things, an adviser does not hold itself out generally to the public as an investment adviser.

III. COVERED DELIVERY REQUIREMENTS

For clarity, below is a list of current rules under the Exchange Act and requirements under the Advisers Act to which broker-dealers, transfer agents, and investment advisers may apply the guidance provided in this interpretation. The Commission believes that the list sets forth all of the rules that require or permit communications between broker-dealers, transfer agents, investment advisers and customers, securities holders, and clients under the Exchange and Advisers Acts.[77] The interpretation in this release is intended to cover all optional and required

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[74] *See, e.g., Kimberly Weisul, Calvert Becomes First Fund to Offer Info On-Line; Mutual Fund Company Dodges the Security Issue, Investment Dealers' Digest, Jan. 22, 1996, at 9; Jon Birger, Prudential Web Site to Let Clients Track Their Accounts Daily, Bond Buyer, Oct. 18, 1995, at 10.*

[75] *Broker-dealers' advertisements and sales literature are subject to NASD rules, which have recently been amended specifically to include electronic communications. NASD, Notice to Members 95-74 (Sept. 1995); NASD, Notice to Members 95-80 (Sept. 26, 1995).*

[76] *Broker-dealers also are subject to recordkeeping requirements that would be applicable to all electronic communications received and sent by the firm relating to its business. 17 CFR 17a-4(a)(4).*

[77] *The summary provided of the delivery obligations under the Covered Delivery Requirements is intended for ease of reference only. It is not intended to be a statement of all the requirements under the rules and provisions listed, and has no legal force or effect. Reference should be made to the full text of the rules, which is published in the Code of Federal Regulations, as well as to relevant releases, interpretations, and no-action letters, and to the full text of the Exchange and Advisers Acts.*

communications under the Exchange and Advisers Acts between broker-dealers, transfer agents, and investment advisers, and customers, securities holders, and clients.[78]

A. Exchange Act

Subject to the guidelines in this release, broker-dealers and transfer agents may fulfill their requirements to deliver information to customers and securities holders under the following Exchange Act rules:[79]

- Rule 8c-1, which requires broker-dealers to obtain customers' written consent in order to hypothecate securities under circumstances that would permit the commingling of customers' securities and to give written notice to a pledgee that, among other things, a security pledged is carried for the account of a customer.
- Rule 9b-1, which, among other things, requires a broker-dealer to furnish to each customer, and keep current, an options disclosure document, prior to accepting an order to purchase or sell an option on behalf of that customer.
- Rule 10b-10, which requires a broker-dealer to give or send confirmation information to customers.[80] In addition, broker-dealers must furnish to customers upon written request information such as the factors that affect the yield calculation related to asset-based securities.
- Rule 10b-16, which requires both initial and periodic written disclosure of the credit terms of margin loans.
- Revenue 11Ac1-3, which requires a broker-dealer to deliver to each customer, upon opening a new account and on an annual basis thereafter, an account statement disclosing the broker-dealer's policies relating to payment for order flow and its order routing policies.
- Rule 15c1-5, which requires, under specified circumstances, written disclosure of control if a broker-dealer or municipal securities dealer is controlled by, controlling, or under common control with the issuer of a security.

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[78]*But see supra notes 4-10 and accompanying text. See also infra notes 35 and 50.*

[79]*This release does not address the prospectus delivery requirements under Exchange Act Rule 15c2-8. Broker-dealer requirements to deliver a preliminary prospectus in connection with the issuance of securities by an issuer that has not previously been required to file reports pursuant to Exchange Act Section 13(a) or 15(d), were addressed in the October Interpretive Release. See October Interpretive Release, supra note 1, at 53462, n. 31.*

[80]*This release, therefore, resolves the issues in the October Interpretive Release with respect to Exchange Act Rule 10b-10, which requires broker-dealers to send confirmations at or before completion of the transaction by permitting electronic delivery of the confirmation. See October Interpretive Release, supra note 1, at 53459, n.12.*

In a release adopting certain amendments to Rule 10b-10, the Commission recognized the use of a facsimile machine to send customer confirmation statements. At that time, however, the Commission believed that the use of other electronic means to send confirmations should be viewed on a case-by-case basis. See Exchange Act Release No. 34962 (Nov. 10, 1994). This interpretation supersedes the view expressed in the 1994 release.

Broker-dealers are reminded that, when a prospectus is required to be delivered, it should be delivered prior to, or concurrent with, delivery of the confirmation. Thus, if a confirmation is sent by facsimile, the prospectus also should be sent by facsimile or equally prompt means. This release, therefore, resolves the issues in the October Interpretive Release with respect to Exchange Act Rule 10b-10, which requires broker-dealers to send confirmations at or before completion of the transaction by permitting electronic delivery of the confirmation. See October Interpretive Release, supra note 1, at 53459, n.12.

- Rule 15c1-6, which requires a broker-dealer or municipal securities dealer receiving advisory fees to disclose any participation or financial interest in the distribution of a security at or before the completion of a transaction in such security for the account of a customer.
- Rule 15c2-1, which requires broker-dealers to obtain customers' written consent in order to hypothecate securities under circumstances that would permit the commingling of customers' securities.
- Rule 15c2-5, which requires a written statement making disclosures prior to effecting transactions in special insurance premium funding accounts that would involve an extension or arrangement of credit, as well as retaining for its files, a written statement setting forth the basis for making a determination that the arrangement is suitable for the customer.
- Rule 15c2-11, with regard to the requirement that broker-dealers make certain information enumerated in the rule reasonably available upon request.
- Rule 15c2-12, with regard to the requirements that municipal securities underwriters provide, upon request, a preliminary official statement (if one exists) and a final official statement.
- Rule 15c3-2, which requires a broker-dealer to give or send to its customers a written notification of a free credit balance, that the broker-dealer may use that free credit balance in its business operations, and that the funds are payable upon demand of the customer.
- Rule 15c3-3, which requires that broker-dealers obtain repurchase agreements in writing and confirm in writing the specific securities that are the subject of hold in custody repurchase agreements.
- Rules 15g-3 through 15g-8, which require a broker-dealer, among other things, to disclose to its customers, both prior to effecting a transaction in a penny stock and on the written confirmation, bid and ask quotations and broker-dealer and associated person compensation.[81]

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[81]*The Commission believes that the requirements under Exchange Act Rules 15g-2 and 15g-9, which require broker-dealers to obtain from a customer prior to effecting transactions in penny stocks (1) a manually signed acknowledgment of the receipt of a risk disclosure document, (2) a written agreement to transactions involving penny stocks, and (3) a manually signed and dated copy of a written suitability statement, should not be met by means of electronic media. In adopting these provisions pursuant to the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, the Commission intended to provide customers with an opportunity to make an informed, deliberate decision without the high pressure sales practices that sometimes are characteristic of transactions in these securities. For similar reasons, a facsimile copy of a customer's signature has not been sufficient to satisfy the requirements under Rules 15g-2 and 5g-9 that certain documents be manually signed and dated. See Exchange Act Release No. 32576 (July 2, 1993); NASD Notice to Members 90-65 (Oct. 1990); NASD Notice to Members 90-18 (Mar. 1990).*

While broker-dealers may not meet the signature requirement under Rule 15g-9 by electronic means, the Commission believes that, consistent with the guidance set forth in this interpretation, they may meet their delivery obligations to their customers under this rule by electronic means. The "risk disclosure document" that broker-dealers are required to furnish to their customers under Rule 15g-2 is subject to strict formatting and typefacing restrictions. In order to comply with the requirements set forth in the instructions to Schedule 15G, a risk disclosure document delivered electronically, when printed, would have to result in a document that meets the requirements and contains the exact text of Schedule 15G. When the Commission next reviews the penny stock rules, it may be willing to consider a "cooling-off" period as an alternative to the requirement of a manual signature under Rules 15g-2 and 15g-9. The Commission requests comment on this approach.

- Rule 17a-5, which requires a broker-dealer to send to its customers audited and unaudited financial statements.[82]
- Rule 17Ad-5, which requires a transfer agent to respond within certain time frames to written requests for the status of items presented for transfer, for acknowledgment of transfer instructions, for confirmation of a transfer agent's possession of a certificate, for a transcript of a person's account, or for dividend and interest payments.[83]

B. Advisers Act

- Section 205(a)(2) of the Advisers Act, which requires an investment adviser to obtain its client's consent to the assignment of an advisory contract.
- Section 205(a)(3) of the Advisers Act, which requires an investment adviser to notify its clients, if the adviser is organized as a partnership and there is a change in members of partnership.
- Section 206(3) of the Advisers Act, which prohibits certain principal and agency transactions with a client without prior written disclosure about the transaction and consent of the client.
- Rule 204-3, which requires investment advisers to deliver a written disclosure statement, or "brochure," to clients at least 48 hours before entering into an advisory contract, unless the client has the right to terminate the contract without penalty within five business days.[84] In addition, investment advisers are required, except in certain cases, to make available "without charge" updates to its brochure.[85]
- Rule 205-3(d), which requires disclosure regarding advisory arrangements involving performance fees.
- Rule 206(3)-2, which permits agency cross transactions, provided that the investment adviser provides general written disclosure about its role in the transactions, receives from clients consent to agency cross transactions, and sends both written confirmation of each transaction and an annual written disclosure statement.

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[82] *17 CFR 240.17a-5(c).*

[83] *Under certain circumstances, transfer agents currently are permitted to respond to requests by telephone.*

[84] *To the extent an adviser relies on 48-hour advance delivery rather than the five-day cancellation period, the 48-hour period would be measured from the time at which notice is given to the client that the statement is available through a specified electronic medium or source. Investment advisers should have reason to believe that the nature of the system or any limitations on the client's access to that system will not result in any material delay in the client's access to the information following receipt of the notice.*

[85] *If a client has elected to receive the disclosure statement electronically, and neither the adviser nor any system used by the adviser to disseminate updates electronically imposes a charge upon the client specifically for the receipt of this information, the Commission would consider this requirement satisfied, even though a system selected by a client to gain access to the adviser's system may impose charges for access, printing or downloading. Alternatively, the Commission would consider the requirement satisfied so long as a paper version of the update is available without charge, notwithstanding any charges that may be imposed upon a client for access, printing or downloading by the system used by an adviser to disseminate updates electronically.*

- Rule 206(4)-2, which requires certain disclosure relating to adviser custody of client assets.
- Rule 206(4)-3, which requires certain disclosures to be made by solicitors who receive cash solicitation fees from advisers and a signed and dated acknowledgment from clients of the receipt of the investment advisers and solicitors written disclosure statements.[86]

IV. ADDITIONAL SECURITIES ACT, EXCHANGE ACT, AND INVESTMENT COMPANY ACT EXAMPLES

The October Interpretive Release included a series of examples illustrating the general concepts set forth earlier in that release in order to provide guidance in applying those concepts to specific facts and circumstances. The Commission is publishing here the following, additional examples to provide further guidance and illustration. These examples are based on questions that have been raised with the staff by industry representatives since the publication of the October Interpretive Release. Any party (whether or not a registered investment company) may look to these examples for guidance.

(1) Company XYZ places a prospectus for any securities offering on its electronic mail system. Company XYZ also uses its electronic mail system to disseminate documents required under the Exchange Act. Employees use the company's electronic mail in the ordinary course of performing their duties as employees and ordinarily are expected to log-on to electronic mail routinely to receive mail and communications. Those employees who do not log-on have alternative means of receiving electronic mail messages, such as having them sent to secretaries or coworkers who then deliver them to the employee. The electronic mail either includes the actual document or announces the availability of the document and provides information as to how to access the document through the local area network. The electronic mail also prominently states that a paper version of the document is available upon request.

This would satisfy delivery obligations with respect to employees who use the company's electronic mail system in the course of performing their duties or who are expected to have alternative means made available to receive electronic mail messages.

(2) Company XYZ places a notice announcing its unregistered Dividend Reinvestment Plan[87] on its Internet Web site under a menu heading "Dividend Reinvestment Plan." The announcement also contains the phone number of the Company's agent (which is independent from the Company) from whom additional information regarding the operation of the Dividend

[86] *Cf. Investment Company Act Release No. 21260 at n. 38 (July 27, 1995) (contemplating that notification required under proposed Investment Company Act Rule 3a-4 could be provided electronically by investment advisers and other sponsors of investment advisory programs).*

[87] *A company need not register its dividend reinvestment plan under the Securities Act where its involvement in the plan is limited to administrative or ministerial functions. For additional information, including a listing of permitted functions, see Securities Act Release No. 4790 (July 13, 1965); Securities Act Release No. 5515 (July 22, 1974); Securities Act Release No. 6188 (February 1, 1980).*

Reinvestment Plan can be obtained. Additionally, the Company's Internet Web site contains a hypertext link to the independent agent's Internet Web site where a brochure describing the operation of the Dividend Reinvestment Plan and an enrollment card can be obtained.

This would be permissible, so long as the information on the Company's Internet Web site is limited to the announcement of the unregistered Dividend Reinvestment Plan and the name and address of the independent agent from whom additional information can be obtained. (This would be analogous to the communications that an issuer of an unregistered plan could make in paper format.) As with communications in paper format, the Company may not use its Internet Web site to advertise the Dividend Reinvestment Plan or its benefits. Further, the use of a hypertext link to the home page of the independent agent would be permitted; however, the Company could not provide a hypertext link directly to the Dividend Reinvestment Plan materials.

(3) Brokerage firm ABC, a recordholder of Company XYZ's common stock, received consents from beneficial holders of Company XYZ's common stock for electronic delivery of Company XYZ's annual report and proxy materials and for electronic processing of voting instructions. These customers are provided with the Internet Web site address where Company XYZ's annual report and proxy materials are located and the Internet Web site address where they can provide their voting instructions electronically to the brokerage firm.

The electronic processing of voting instructions from beneficial holders and the electronic voting of proxies would be consistent with the proxy rules. Issuers and others are reminded to consider any applicable state laws or self-regulatory organization rules.

(4) A fund makes supplemental sales literature and its prospectus available through a commercial on-line service. Under section 5(b) of the Securities Act, sales literature, whether in paper or electronic form is required to be preceded or accompanied by a final prospectus meeting the requirements of section 10(a) of the Securities Act. By contrast, an advertisement satisfying the requirements of Securities Act Rule 134 or 482 need not be preceded or accompanied by a prospectus. Users could click on a box in the supplemental sales literature to have the prospectus downloaded or to request that a prospectus be mailed. While the system permits the sales literature to be viewed on-line, it does not allow users to view the prospectus. Unlike the system in example 36 in the October Interpretive Release, this system would not require that a user have downloaded or printed the prospectus before viewing the supplemental sales literature. Users accessing the supplemental sales literature would give specific consent to electronic delivery of the prospectus.

This would not satisfy the prospectus delivery requirement because there would not be sufficient access to the prospectus. Because the system does not give users the opportunity to view the prospectus, it would lack the sort of reasonably comparable access to the prospectus and the sales literature present in examples 14, 15, and 35 in the October Interpretive Release. The opportunity to request that a prospectus be mailed or downloaded would not, under current technology, be considered to give investors sufficient access to the prospectus. Instead, it would be analogous to giving investors sales literature in paper with a toll-free telephone number for re-

questing the prospectus: under those circumstances the prospectus would be received later and would not be considered to have preceded or accompanied the sales literature.[88]

(5) A fund places its prospectus on its site on the World Wide Web or some other electronic system. Shareholders provide a written, revocable consent to receive prospectuses electronically through the system. The consent informs shareholders that the current version of each prospectus will be available continuously on the system and that the fund will use the quarterly account statement or quarterly newsletter as the means of notification of prospectus amendments. It also states that another means of notification may be used, but only after shareholders have been notified of the change by the then current means of notification.[89] The fund replaces its prospectus with an annual amendment updating the fund's financial information and making other changes.[90] The fund has provided notification that the prospectus will be updated by including notification in the preceding account statement or shareholder newsletter; the notification provides the approximate date on which the amendment will be available. A subsequent amendment to the fund's prospectus reflects the addition of a redemption fee.

Notification of the prospectus amendment has been included in the preceding statement or newsletter.[91]

Just as the use of a newsletter or statement in example 46 in the October Interpretive Release constituted sufficient notice for effective delivery of the semi-annual reports required under the Investment Company Act of 1940, the use of a newsletter or statement here would constitute sufficient notice for effective delivery with respect to the scheduled prospectus update.

(6) A fund's on-line prospectus has the same text as the paper version, but the text appears in a different format. For example, text that appears as a block in the margin of a page in the paper prospectus appears in a box in the flow of the text in the electronic version. The fund does not make a separate filing under Securities Act Rule 497 with respect to the electronic version.

The mere difference in format without any difference in text would not qualify the electronic version as a different "form of prospectus" for which filing is required.

(7) An investment company produces both an electronic version (such as a CD-ROM) and a paper version of its prospectus. Each version contains all information required by, and otherwise

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[88]*As technology develops, some users may have the capacity to download and view a prospectus in no more time than it takes to jump via hyperlink from the sales literature to the prospectus. Under those circumstances, the capacity to download would be considered to give those users reasonably comparable access to the prospectus that would provide sufficient access.*

[89]*A change in means of notification under such circumstances would also be effective in the case of notification of the availability of shareholder reports discussed in example 46 in the October Interpretive Release. October Interpretive Release, supra note 1.*

[90]*Under section 10(a)(3) of the Securities Act, a fund that continuously offers its shares would have to amend its prospectus no less frequently than every 16 months in order to include updated financial statements.*

[91]*With unscheduled material prospectus amendments for which such advance notice would not be feasible, the fund would need to use other forms of notification such as a postcard or e-mail message. See October Interpretive Release, supra note 1, example 43.*

complies with, the applicable form and all other applicable provisions of the federal securities laws. The electronic version contains a movie that does not appear in the paper version. Each version of the prospectus indicates that there may be other versions of the prospectus and, if the issuer determines to make such other versions available, provides information on how to obtain such other versions.[92] The paper version does not include a summary or transcript of the movie in the electronic version. Both versions of the prospectus are filed with the Commission as part of the company's registration statement, or separately pursuant to Rule 497.[93]

The use of either version of the prospectus to satisfy delivery requirements would be permissible.[94] The issuer (or other party to whom the law assigns the responsibility) remains responsible for ensuring that each version satisfies applicable statutory requirements.[95]

V. SOLICITATION OF COMMENTS

Any interested person wishing to submit written comments relating to the views expressed in this release are invited to do so by submitting them in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 6-9, Washington, D.C. 20549. Comments also may be submitted electronically at the following electronic mail address: rule-comments@sec.gov. All comment letters should refer to File Number S7-13-96. This file number should be included on the subject line if comments are submitted using electronic mail. Comment is requested not only on the specific issues discussed in detail in the release, but on any other issues that should be considered in connection with facilitating the use of electronic media by broker-dealers, transfer agents, and investment advisers. Comment is sought from both the point of view of the sender and the intended recipient. The Commission further requests comment on any competitive burdens that may result from this interpretation. Comments must be received on or before [insert date 45 days after date of publication in the Federal Register]. Comments received will be available for public inspection and copying in the Commission's public reading room, 450 Fifth Street, N.W., Washington, D.C. 20549. Electronically submitted comment letters will be posted on the Commission's Internet web site (http://www.sec.gov).

By the Commission.

Jonathan G. Katz
Secretary

Dated: May 9, 1996

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[92] *The facts of this example should not be read as imposing any obligation on the issuer to make such other versions of its prospectus available to any person.*

[93] *Alternatively, the company may file with the Commission as an appendix to the prospectus the script of the movie and a fair and accurate narrative description of the graphic or image material. See October Interpretive Release, supra note 1, example 13.*

[94] *Of course, the general principles concerning electronic delivery, as described in the October Interpretive Release, supra note 1, would apply.*

[95] *See id. at 53460.*

Statement of the commission regarding use of internet web sites to offer securities, solicit securities transactions or advertise investment services offshore
Securities and Exchange Commission
(Release Nos. 33-7516, 34-39779, IA-1710, IC-23071)
International Series Release No. 1125
March 23, 1998

AGENCY: Securities and Exchange Commission

ACTION: Interpretation

SUMMARY: The Securities and Exchange Commission is publishing its views on the application of the registration obligations under the U.S. federal securities laws to the use of Internet Web sites to disseminate offering and solicitation materials for offshore sales of securities and investment services.

EFFECTIVE DATE: March 23, 1998

FOR FURTHER INFORMATION CONTACT: Paul Dudek, Chief, and Rani Doyle, Attorney, Office of International Corporate Finance at 202-942-2990 (with respect to Securities Act issues); Paula Jenson, Deputy Chief Counsel, Division of Market Regulation, at 202-942-0073 (with respect to broker-dealer registration issues), Elizabeth King, Senior Special Counsel, Division of Market Regulation, at 202-942-0140 (with respect to exchange registration issues); and Karrie McMillan, Assistant Chief Counsel, Sarah A. Wagman, Special Counsel, and Brendan C. Fox, Attorney, Division of Investment Management, at 202-942-0660 (with respect to matters relating to investment companies and investment advisers).

SUPPLEMENTARY INFORMATION:

I. EXECUTIVE SUMMARY

The Internet permits market participants to disseminate advertisements and other information regarding securities and investment services across national borders. Because persons in the United States have access to this securities-related information, market participants have expressed uncertainty about the application of the registration requirements of the U.S. securities laws to their offshore Internet offers (i.e., offers over Internet Web sites of securities or investment services that by their terms are not made to U.S. persons). Today, we are providing our views on how issuers, investment companies, broker-dealers, exchanges and investment advisers may use Internet Web sites to solicit offshore securities transactions and clients without the securities or investment company being registered with the Commission under the Securities Act of 1933[96] or the Investment Company Act of 1940,[97] or without the investment service provider

[96] *15 U.S.C. 77a, et seq. (the "Securities Act").*

[97] *15 U.S.C. 80a-1, et seq. (the "Investment Company Act").*

registering under Investment Advisors Act of 1940,[98] or the broker-dealer or exchange registering under the broker-dealer and exchange registration provisions under the Securities Act of 1934.[99]

The purpose of this interpretation is to clarify when the posting of offering or solicitation materials on Internet Web sites would not be considered activity taking place "in the United States." We are only providing clarification on this aspect of the registration requirements and are not altering the fundamental requirement that all offers and sales in the United States be registered under the U.S. securities laws or made under an applicable exemption.

Under this interpretation, application of the registration provisions of the U.S. securities laws depends on whether Internet offers, solicitations or other communications are targeted to the United States. We would not view issuers, broker-dealers, exchanges, and investment advisers that implement measures that are reasonably designed to guard against sales or the provision of services to U.S. persons to have targeted persons in the United States with their Internet offers. Under these circumstances, Internet postings would not, by themselves, result in a registration obligation under the U.S. securities laws.

The determination of whether measures reasonably designed to guard against sales to U.S. persons have been implemented depends on the facts and circumstances, and can be satisfied through different means. We discuss in this release examples of measures that are adequate to serve this purpose for both U.S. and foreign entities. We also discuss why measures that are adequate for foreign issuers would not necessarily be adequate measures for U.S. issuers. U.S. issuers should undertake more restrictive measures when using the Internet to solicit offshore securities transactions.

This interpretation does not address the anti-fraud and anti-manipulation provisions of the securities laws, which will continue to reach all Internet activities that satisfy the relevant jurisdictional tests.[100] Even in the absence of sales in the United States, we will take appropriate enforcement action whenever we believe that fraudulent or manipulative Internet activities have originated in the United States or placed U.S. investors at risk. Further, we are not addressing the circumstances under which a U.S. court could exercise personal jurisdiction over a non-U.S. person with respect to that person's offshore Internet offer.

The interaction between the U.S. securities laws and the Internet can be expected to continue to evolve. As technology and practice develop, we may revisit these and related issues.

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[98] *15 U.S.C. 80b-1, et seq. (the "Advisers Act").*

[99] *15 U.S.C. 78a, et seq. (the "Exchange Act").*

[100] *The courts have recognized U.S. jurisdiction over fraudulent conduct where substantial conduct or effects occur in the United States. See generally Itoba Ltd. v. LEP Group PLC, 54 F.3d 118 (2d Cir. 1995), cert. denied, 516 U.S. 1044 (1996) and Robinson v. TCI/US West Communications Inc., 117 F.3d 900 (5th Cir. 1997) (citing Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir.), rev'd on other grounds on rehrg. en banc, 405 F.2d 215 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969) (effects test)); Bersch v. Drexel Firestone Inc., 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975) (conduct test); Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972) (conduct test).*

II. BACKGROUND

A. The Global Reach of the Internet

The development of the Internet presents numerous opportunities and benefits for consumers and investors throughout the world. It also presents significant challenges for regulators charged with protecting consumers and investors. Regulators in many countries are attempting to administer their respective laws to preserve important protections provided by their regulatory schemes without stifling the Internet's vast communications potential.[101] We share this goal in our administration of the U.S. securities laws.[102]

Information posted on Internet Web sites concerning securities and investments can be made readily available without regard to geographic and political boundaries.[103] Additionally, the interactive nature of the Internet makes it possible for investors to purchase electronically the securities or services offered. For these and other reasons, we believe that the use of the Internet by market participants and investors presents significant issues under the U.S. securities laws.

Although this release focuses on Internet Web sites, the Internet offers a variety of forms of communication. We distinguish between Web site postings and more targeted Internet communication methods. More targeted communication methods are comparable to traditional mail because the sender directs the information to a particular person, group or entity. These methods include e-mail and technology that allows mass e-mailing or "spamming." Information posted on a Web site, however, is not sent to any particular person, although it is available for anyone to search for and retrieve.[104] Offerors using those more targeted technologies must assume the responsibility of identifying when their offering materials are being sent to persons in the United States and must comply fully with the U.S. securities laws.

B. Regulation of Offers

Many registration requirements under the U.S. securities laws are triggered when an offer of securities or financial services, such as brokerage or investment advisory services, is made to the general public.

- Under the Securities Act, absent an exemption, an issuer that offers or sells securities in the United States through use of the mails or other means of interstate commerce must

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[101] *See President William J. Clinton and Vice President Albert Gore, Jr., A Framework for Global Electronic Commerce (1997), http://www.iitf.nist.gov/eleccomm/ecomm.htm; European Ministerial Conference, "Global Information Networks: Realizing the Potential," July 6-8, 1997, Ministerial Declaration, Global Informational Networks.*

[102] *For a discussion of recent Commission actions addressing the Internet, see The Impact of Recent Technological Advances on the Securities Markets, Report prepared by the Staff of the U.S. Securities and Exchange Commission pursuant to Section 510(a) of the National Securities Markets Improvements Act of 1996 (Oct. 1997) http://www.sec.gov/news/studies/techrp97.htm.*

[103] *Wilske and Schiller, International Jurisdiction in Cyberspace: Which States May Regulate the Internet?, http://www.law.indiana.edu/fclj/pubs/v50/no1/wilske.html, Section II.A.2.(c).*

[104] *The Web site sponsor can aid Internet searches by adding "tags" to its Web site that facilitate a search engine identifying the site as containing information relating to targeted topics. Generally, we will not view the use of tags relating to securities or investments as transforming the Web site into a targeted communication that would require additional measures to assure against sales to U.S. persons, such as blocking access by U.S. persons to the offering materials.*

register the offering with the Commission.[105] An offering of securities may be exempt from registration if it is conducted as a "private placement," without any general solicitation of investors.[106]

- Under the Investment Company Act, a foreign investment company may not use the mails or other means of interstate commerce to publicly offer its securities in the United States or to U.S. persons unless the investment company receives an order from the Commission permitting it to register under the Investment Company Act.[107] A foreign investment company may, however, make a private offer of its securities in the United States or to U.S. persons in reliance on one of the exclusions from the definition of "investment company" under the Investment Company Act.[108]
- Under the Advisers Act, an adviser is prohibited from using the mails or other means of interstate commerce in connection with its business as an investment adviser, unless the adviser is registered with the Commission, or is exempted or excluded from the requirement to register.[109]
- Under the Exchange Act, a broker or dealer generally must register with the Commission if it uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security.[110]
- Under the Exchange Act, an exchange generally must register with the Commission if it uses the mails or any means of interstate commerce for the purpose of using its facilities to effect any transaction in a security or to report any such transaction.[111]

The posting of information on a Web site may constitute an offer of securities or investment services for purposes of the U.S. securities laws.[112] Our discussion of these issues will proceed on the assumption that the Web site contains information that constitutes an "offer" of securities or investment services under the U.S. securities laws.[113] Because anyone who has access to the Internet can obtain access to a Web site unless the Web site sponsor adopts special procedures to restrict access, the pertinent legal issue is whether those Web site postings are offers in the United States that must be registered.

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[105]*Section 5 of the Securities Act, 15 U.S.C. 77e.*

[106]*See, e.g., Section 4(2) of the Securities Act, 15 U.S.C. 77d(2); Regulation D (17 CFR 230.501-508).*

[107]*Section 7(d) of the Investment Company Act, 15 U.S.C. 80a-7(d).*

[108]*See Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act, 15 U.S.C. 80a-3(c)(1), 15 U.S.C. 80a-3(c)(7). See also Staff no-action letter, Goodwin, Procter & Hoar (available Feb. 28, 1997) ("Goodwin Procter").*

[109]*Section 203(a) of the Advisers Act, 15 U.S.C. 80b-3(a).*

[110]*Section 15(a) of the Exchange Act, 15 U.S.C. 78o(a).*

[111]*Section 6 of the Exchange Act, 15 U.S.C. 78f.*

[112]*See, e.g., Securities Act Release No. 7233, Question 20 (Oct. 6, 1995) (60 FR 53458) ("The placing of the offering materials on the Internet would not be consistent with the prohibition against general solicitation or advertising in Rule 502(c) of Regulation D.").*

[113]*We also assume that the Internet is an instrument of interstate commerce and that its use satisfies the "jurisdictional means" requirements of the federal securities laws. See American Library Ass'n v. Pataki, 969 F. Supp. 160, 161 (S.D.N.Y. 1997).*

III. OFFSHORE OFFERS AND SOLICITATIONS ON THE INTERNET

A. General Approach

Some may argue that regulators could best protect investors by requiring registration or licensing for any Internet offer of securities or investment services that their residents could access. As a practical matter, however, the adoption of such an approach by securities regulators could preclude some of the most promising Internet applications by investors, issuers, and financial service providers.

The regulation of offers is a fundamental element of federal and some U.S. state securities regulatory schemes. Absent the transaction of business in the United States or with U.S. persons, however, our interest in regulating solicitation activity is less compelling.[114] We believe that our investor protection concerns are best addressed through the implementation by issuers and financial service providers of precautionary measures that are reasonably designed to ensure that offshore Internet offers are not targeted to persons in the United States or to U.S. persons.[115]

B. Procedures Reasonably Designed to Avoid Targeting the United States

When offerors implement adequate measures to prevent U.S. persons from participating in an offshore Internet offer, we would not view the offer as targeted at the United States and thus would not treat it as occurring in the United States for registration purposes. What constitutes adequate measures will depend on all the facts and circumstances of any particular situation. We generally would not consider an offshore Internet offer made by a non-U.S. offeror as targeted at the United States, however, if:

- The Web site includes a prominent disclaimer making it clear that the offer is directed only to countries other than the United States. For example, the Web site could state that the securities or services are not being offered in the United States or to U.S.

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[114]*Under a resolution adopted by the North American Securities Administrators Association ("NASAA"), states are encouraged to take appropriate steps to exempt Internet offers from the registration provisions of their securities laws when the offers indicate that the securities are not being offered to residents of their state and the offers are not otherwise specifically made to any persons in their state. Sales of the securities that were the subject of the Internet offer could be made in that state after the offering has been registered and the final prospectus has been delivered to investors, or where the sales are exempt from registration. NASAA, Resolution Regarding Securities Offered on the Internet (adopted Jan. 7, 1996), 1996 CCH Par. 7040 (Jan. 1996). According to NASAA, 32 states have implemented the resolution and 15 states have indicated an intent to do so. Several foreign authorities have provided guidance on Internet and securities related issues. See, e.g., Policy Statement 107 on Electronic Prospectuses (Sept. 1996) http://www.asc.gov.au (Australia); Notice and Interpretation Note, Trading Securities and Providing Advice Respecting Securities on the Internet (Mar. 3, 1997), NIN #97/9 (British Columbia, Canada).*

[115]*We use the term "U.S. person" as it is defined in Rule 902(k) of Regulation S under the Securities Act (17 CFR 230.902(k)), which is premised on residence in the United States, regardless of any temporary presence outside the United States. See Securities Act Release No. 7505 (Feb. 18, 1998) (63 FR 9632 (Feb. 25, 1998)) (renumbering CFR sections). "U.S. person" generally has the same meaning for purposes of Section 7(d) of the Investment Company Act as under Rule 902(k) of Regulation S under the Securities Act. See Goodwin Procter, supra note 13. For purposes of this release, we deem Internet offers "targeted at the United States" to include Internet offers targeted to U.S. persons. Cf . Rule 902(h)(2) of Regulation S (17 CFR 230.902(h)(2)) (offers targeting identifiable groups of U.S. persons offshore are not offshore transactions).*

persons, or it could specify those jurisdictions (other than the United States) in which the offer is being made;[116] and

- The Web site offeror implements procedures that are reasonably designed to guard against sales to U.S. persons in the offshore offering. For example, the offeror could ascertain the purchaser's residence by obtaining such information as mailing addresses or telephone numbers (or area code) prior to the sale. This measure will allow the offeror to avoid sending or delivering securities, offering materials, services or products to a person at a U.S. address or telephone number.

These procedures are not exclusive; other procedures that suffice to guard against sales to U.S. persons also can be used to demonstrate that the offer is not targeted at the United States. Regardless of the precautions adopted, however, we would view solicitations that appear by their content to be targeted at U.S. persons as made in the United States. Examples of this type of solicitation include purportedly offshore offers that emphasize the investor's ability to avoid U.S. income taxes on the investments.[117] We are concerned that the advice that we provide to assist those who attempt to comply with both the letter and spirit of the securities laws will be used by others as a pretext to violate those laws. Sham offshore offerings or procedures, or other schemes will not allow issuers or promoters to escape their registration obligations under the U.S. securities laws.

C. Effect of Attempts by U.S. Persons to Evade Restrictions

We recognize that U.S. persons may respond falsely to residence questions, disguise their country of residence by using non-resident addresses, or use other devices, such as offshore nominees, in order to participate in offshore offerings of securities or investment services. Thus, even if the foreign market participant has taken measures reasonably designed to guard against sales to U.S. persons, a U.S. person nevertheless could circumvent those measures.

In our view, if a U.S. person purchases securities or investment services notwithstanding adequate procedures reasonably designed to prevent the purchase, we would not view the Internet offer after the fact as having been targeted at the United States, absent indications that would put the issuer on notice that the purchaser was a U.S. person. This information might include (but is not limited to): receipt of payment drawn on a U.S. bank; provision of a U.S. taxpayer identification or social security number; or, statements by the purchaser indicating that, notwithstanding a foreign address, he or she is a U.S. resident. Confronted with such information, we would expect offerors to take steps to verify that the purchaser is not a U.S. person before selling

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[116] *The disclaimer would have to be meaningful. For example, the disclaimer could state, "This offering is intended only to be available to residents of countries within the European Union." Because of the global reach of the Internet, a disclaimer that simply states, "The offer is not being made in any jurisdiction in which the offer would or could be illegal," however, would not be meaningful. In addition, if the disclaimer is not on the same screen as the offering material, or is not on a screen that must be viewed before a person can view the offering materials, it would not be meaningful.*

[117] *In our view, while a relevant factor, the fact that an Internet offeror posts offering materials in English even though it is based in a non-English speaking country will not, by itself, demonstrate that the offer is targeted at the United States.*

to that person.[118] Additionally, if despite its use of measures that appear to be reasonably designed to prevent sales to U.S. persons, the offeror discovers that it has sold to U.S. persons, it may need to evaluate whether other measures may be necessary to provide reasonable assurance against future sales to U.S. persons.

D. Third-Party Web Services

An issuer, underwriter or other type of offshore Internet offeror may seek to have its offering materials posted on a third-party's Web site. In that event, if the offeror uses a third-party Web service that employs at least the same level of precautions against sales to U.S. persons as would be adequate for the offshore Internet offeror to employ, we would not view the third-party Web site as an offer that is targeted to the United States.[119]

When an offeror, or those acting on its behalf, uses a third-party's Web site to generate interest in the Internet offer, more stringent precautions by the offeror than those outlined in Section III.B. may be warranted. These precautions may include limiting access to its Internet offering materials to persons who can demonstrate that they are not U.S. persons. For example, additional precautions may be called for when the Internet offeror:

- Posts offering or solicitation material or otherwise causes the offer to be listed on an investment-oriented Web site that has a significant number of U.S. clients or subscribers, or where U.S. investors could be expected to search for information about investment opportunities or services; or
- Arranges for direct or indirect hyperlinks from a third-party investment- oriented page to its own Web page containing the offering material.

IV. ADDITIONAL ISSUES UNDER THE SECURITIES ACT

Our Securities Act analysis assumes that the information posted on a Web site would, were we to deem it to occur in the United States, constitute an "offer" within the meaning of Section 5(c) of the Securities Act and Regulation S, a "public offering" prohibited under Section 4(2) of the Act, a "general solicitation or general advertising" prohibited under Rule 502(c) of Regulation D,[120] and a "directed selling effort" prohibited under Regulation S.[121] The focus of our analysis, then, is under what circumstances should we deem offshore Internet offers to which U.S. persons can gain access not to occur in the United States.

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[118] *These additional steps could include a request for further evidence (e.g., a copy of a passport or driver's license).*

[119] *Governmental authorities or securities exchanges could post issuer information that is required by law to be filed with them, including prospectuses, on their Web sites without restriction. Securities exchanges, however, should consider the U.S. registration implications of their Web sites as a whole. See infra Section VII.B.*

[120] *Rule 502(c) under the Securities Act (17 CFR 240.502(c)).*

[121] *Rule 902(c) (17 CFR 230.902(c)).*

A. Offshore Offerings by Foreign Issuers

1. Regulation S

When a foreign issuer is making an unregistered offshore Internet offer and does not plan to sell securities in the United States as part of the offering, it should implement the general measures outlined in Section III.B. to avoid targeting the United States. Assuming that the offering is made pursuant to Regulation S, the offering must comply with all of the applicable requirements under that regulation, including the requirement that all offers and sales be made in "offshore transactions."[122]

2. U.S. Exempt Component

Foreign issuers commonly make offshore offerings concurrently with private offerings to U.S. institutional buyers. An offering exempt under Section 4(2) of the Securities Act may not involve "any public offering." Regulation D specifically prohibits the offer or sale of securities through a "general solicitation or general advertising." Publicly accessible Web site postings may not be used as a means to locate investors to participate in a pending or imminent U.S. offering relying on those provisions. If a Web site posting would be inappropriate for a U.S. private placement, an issuer should not attempt to accomplish the same result indirectly through the posting of an offshore Internet offer.

In addition to implementing the type of precautionary measures previously discussed, foreign issuers could implement other procedures to prevent their offshore Internet offers from being used to solicit participants for their U.S.-based exempt offerings, including:

The Internet offeror could allow unrestricted access to its offshore Internet offering materials, but not permit persons responding to the offshore Internet offering to participate in its exempt U.S. offering, even if otherwise qualified to do so. In that situation, the offeror would keep a record of all persons responding over the Internet and all persons who otherwise indicate that they are responding to the offshore Internet offering;[123] or

The Web site offeror could ensure that access to the posted offering materials is limited to those viewers who first provide their residence information and, in doing so, do not provide

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[122]*Rule 902(h) and Rule 903 of Regulation S (17 CFR 230.902(h) and 230.903). The issuer's or underwriter's use of an Internet Web site to offer securities will not, by itself, prevent bona fide offshore purchasers in a Regulation S offering from reselling into the United States pursuant to registration or an exemption, such as Rule 144A (17 CFR 230.144A), provided that: (1) those purchasers are not part of the selling group; (2) those purchasers are not affiliated with the issuer or any member of the selling group; and (3) the issuer's or underwriter's use of the Web site was not undertaken as part of an arrangement with, or on behalf of, such offshore purchasers.*

[123]*To identify those persons who are responding to the Internet offer, the Web site could provide telephone numbers, contact persons, or addresses that differ from those used in the offeror's other, more traditional offering materials. Under an approach suggested in staff no-action letters, the offeror could communicate with U.S. persons on the list to determine whether they are accredited investors with a view towards permitting their participation in separate, future exempt U.S. offerings by the issuer or, where the Web site offeror is an intermediary, other issuers. See Staff no-action letters, Royce Exchange Fund (available Aug. 28, 1996); Bateman Eichler (available Dec. 3, 1985); E.F. Hutton & Co. (available Dec. 3, 1985); Woodtrails-Seattle (available Aug. 9, 1982). Likewise, any investor solicited by the issuer or underwriter prior to or independent of the Web site posting could participate in the private offer, regardless of whether the investor may have viewed the posted offshore offering materials.*

information such as a U.S. area code or address that indicates that they are a U.S. person.[124] Thus, U.S. persons could obtain access only by misrepresenting their residence information.[125]

We believe that it would not be advisable for us to dictate the use of any one particular technology or screening method to protect against general solicitation in these instances. Any less costly, less intrusive method that is equally or more effective than those that we have suggested would be adequate as well.

In addition, the posted offering materials should relate only to the offshore offering.[126] The materials should contain only that information (if any) concerning the private U.S. offering that is required by foreign law to be provided to investors participating in the offshore public offering.[127]

B. Offshore Offerings by U.S. Issuers

Our approach to the use of Web sites to post offshore securities offerings distinguishes between domestic and foreign issuers.[128] For the following reasons, additional precautions are justified for Web sites operated by domestic issuers purporting not to make a public offering in the United States:

- The substantial contacts that a U.S. issuer has with the United States justifies our exercise of more extensive regulatory jurisdiction over its securities-related activities;
- There is a strong likelihood that securities of U.S. issuers initially offered and sold offshore will enter the U.S. trading markets; and
- U.S. issuers and investors have a much greater expectation that securities offerings by domestic issuers will be subject to the U.S. securities laws.

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[124] This step could be accomplished in multiple ways. For example, when a person reaches the Web site and then attempts to move to a section that includes offering information, a screen could ask for the required residence information. After the user enters the information, the area code and address could be automatically and immediately screened to eliminate further access to those who match a U.S. area code or address. Alternatively, the offeror could require a password and not assign a password until it verifies that address information, or it could block access by using technology that recognizes the country from which the Web site is being accessed.

[125] Web site offerors must act in good faith to screen U.S. persons from viewing offering information. A screening mechanism that suggests ways of easy bypass would not be evidence of good faith.

[126] A foreign issuer that wishes to use an Internet Web site to conduct the concurrent private placement in the United States could follow the general procedures developed in the domestic context for private placements on the Internet. See, e.g., Staff no-action letters, IPONET (available July 26, 1996); Lamp Technologies, InC. (available May 29, 1997). Under these procedures, the public offer posted on the Web site may not provide a hyperlink or otherwise alert the viewer to any Web site containing private placement offering materials.

[127] Rule 135c under the Securities Act (17 CFR 230.135c) provides useful guidance on what limited information could be included on the Web site under these circumstances.

[128] We use the term "foreign issuer" as it is defined in Rule 902(e) of Regulation S (17 CFR 230.902(e)). See Securities Act Release No. 7505.

Our experience with abusive practices under Regulation S indicates that we should proceed cautiously when giving guidance to U.S. issuers in the area of unregistered offshore offerings. As a result, we would not consider a U.S. issuer using a Web site to make an unregistered offer to have implemented reasonable measures to prevent sales to U.S. persons unless, in addition to the general precautions discussed above in Section III.B., the U.S. issuer implements password-type procedures that are reasonably designed to ensure that only non-U.S. persons can obtain access to the offer.[129] Under this procedure, persons seeking access to the Internet offer would have to demonstrate to the issuer or intermediary that they are not U.S. persons before obtaining the password for the site.[130]

In the context of broader Securities Act reform, we have been considering whether the current general solicitation and other offering communications restrictions on issuers and other offering participants should be modified to create greater flexibility.[131] To the extent that we reform those restrictions on offering communications in the future, we also will consider the implications of those changes for unregistered offshore Internet offerings.

C. Concurrent U.S. Registered Offering

A registered offering in the United States that takes place concurrently with an unregistered offshore Internet offer presents concerns because of the Securities Act's restrictions on making offers prior to the filing of a registration statement or, in the case of written or published offers, outside of the statutory prospectus. Consistent with these requirements, therefore, premature posting of offering information must be avoided. Existing Commission rules that provide a safe harbor for announcements of anticipated offerings provide guidance in this respect.[132] The Commission is considering whether to provide further guidance or to make further changes concerning concurrent U.S. registered offerings and offshore Internet offers in the context of broader Securities Act reforms.

D. Underwriters

Just as an issuer must take reasonable steps to avoid offers of unregistered securities in the United States, so too must persons acting on behalf of the issuer, such as underwriters or distributors. These persons, for purposes of the Securities Act, stand in the place of the issuer. Thus,

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[129] *See, e.g., IPONET and Lamp Technologies, Inc., supra note 31. Our interpretation therefore would allow for the creation of limited-access systems. Eventually, closed systems may develop that target only non-U.S. persons and qualified U.S. investors.*

[130] *See Securities Act Release No. 7392 at n.31 (Feb. 28, 1997) (62 FR 9258) (issuer cannot accept at face value representations by investors regarding their residence). See also IPONET, supra note 31 (IPONET's activities were supervised by an entity that verified information provided to IPONET by people who filled out IPONET's on-line questionnaire. Information from the questionnaires was used to determine whether respondents qualified as accredited investors and therefore were eligible to obtain password to access password-protected Web pages where IPONET posted private offerings).*

[131] *Securities Act Release No. 7314 (July 25, 1996) (61 FR 40044); Securities Act Release No. 7187 (July 10, 1995) (60 FR 35645).*

[132] *See, e.g., Rule 135 under the Securities Act (17 CFR 230.135).*

regardless of whether the underwriter is foreign or domestic, what constitutes measures reasonably designed to prevent sales to U.S. persons will depend on the status of the issuer. For example, if the issuer is domestic and precautionary measures would call for its Web site containing offshore offering information to be password-protected, so too should the information be protected on the underwriter's Web site.[133]

V. ADDITIONAL ISSUES UNDER THE INVESTMENT COMPANY ACT

This portion of the release addresses certain issues that arise under the Investment Company Act when a foreign fund (that is, an investment company that is organized under the laws of a jurisdiction other than the United States) makes an offshore Internet offer of its securities. In general, as with other types of securities offerings, we would not consider an Internet offer by a foreign fund to cause the fund to be subject to regulation or registration under the Investment Company Act if the foreign fund implements measures reasonably designed to guard against sales to U.S. persons.

The issue raised by the use of the Internet is whether a foreign fund's Internet offer that can be accessed by U.S. persons should be considered a public offer in the United States.[134] Consistent with our position under the Securities Act, if a foreign fund implements measures reasonably designed to guard against sales to U.S. persons, we would not consider the foreign fund's Internet offer to be targeted to U.S. persons, and therefore would not consider the Internet offer to constitute a public offer in the United States subjecting the foreign fund to regulation and registration under the Investment Company Act.

An Internet offer by a foreign fund may arise in a number of situations. For example, a foreign fund could conduct an Internet offer that is targeted exclusively offshore. A foreign fund also could conduct an offshore Internet offer in addition to a private U.S. offer.[135] We discuss these situations separately below. We also address the use of the Internet by unregistered U.S. funds making private offshore offers, and the use of other forms of Internet marketing of investment company securities.

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[133] *This, however, would not include bona fide research that complies with the Commission's safe harbor rules for research reports. See Rules 137—139 under the Securities Act (17 CFR 230.137—230.139). Cf. Exchange Act Rule 15a-6(a)(2) (17 CFR 240.15a-6(a)(2)) (conditional exemption from U.S. broker-dealer registration for foreign broker-dealers that furnish research reports to "major institutional investors" as defined in the rule).*

[134] *Section 7(d) of the Investment Company Act generally prohibits a foreign fund from using U.S. jurisdictional means to make a public offer of its securities in the United States or to U.S. persons, unless the fund receives an order from the Commission permitting it to register under the Investment Company Act. The Commission may issue such an order only if it finds that it is legally and practically feasible to enforce the provisions of the Investment Company Act effectively against the foreign fund, and that the issuance of the order is consistent with the public interest and the protection of investors. For purposes of Section V, references to offers and sales to U.S. persons include offers or sales in the United States. Similarly, references to offers or sales in the United States include offers or sales to U.S. persons.*

[135] *In addition, a foreign fund also may use the Internet exclusively to conduct a private U.S. offer. This release does not address the ability of a foreign fund to conduct a private U.S. offer over the Internet, except to the extent that it is relevant to the foreign fund's ability to simultaneously conduct an offshore Internet offer. See infra note 45 and accompanying text. As discussed above in Section I, the statements made in this release do not alter the requirement that all offers and sales in the United States must be pursuant to registration under the U.S. securities laws or an applicable exemption.*

A. Internet Offers by a Foreign Fund

1. Offers Targeted Exclusively Offshore

When a foreign fund is making an unregistered offshore Internet offer and does not intend to sell securities in the United States as part of the offering, our general statements in Section III.B. outlining the need for precautionary measures to avoid targeting the United States apply here as well. We may view an Internet offer as being targeted to U.S. persons, however, if the foreign fund is engaged in activities, either as a part of or in addition to its Internet offer, that are designed to attract U.S. persons to the Internet offer, such as advertising the existence of the foreign fund's Web site in a U.S. publication.

2. Foreign Funds Conducting Offshore and Private U.S. Offers

Next, we address offshore Internet offers by foreign funds that also are conducting private U.S. offers.[136] We would not consider a foreign fund that is concurrently conducting both a private U.S. offer and an offshore Internet offer to be making a public offer of its securities in the United States if the foreign fund implements measures reasonably designed to guard against public sales of its securities to U.S. persons, and the Internet offer is not indirectly used as a general solicitation for participants in the private U.S. offer. As stated above, what constitutes adequate measures will depend on all of the facts and circumstances. In addition to implementing the type of precautionary measures discussed in Section III.B. (with one modification noted below), a foreign fund could use any procedures reasonably designed to guard against use of its Internet offer to generally solicit participants in the U.S. private offer.[137]

If a foreign fund that is concurrently conducting a private U.S. offer and an Internet offer uses a disclaimer that reflects the existence of two separate offers and indicates that the Internet offer is not being made in the United States, we would view this action as an indication that the fund has taken measures reasonably designed to guard against publicly selling its securities to U.S. persons. The disclaimer could state, for example, that this offer (the offshore Internet offer) is not being made in the United States (or identify the jurisdictions in which the Internet offer is being made) and that the offer and sale of securities in the United States is not permitted except pursuant to an exemption from registration.

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[136] *The staff previously took the position that under certain circumstances a foreign fund that is conducting an offshore offer also may make a private U.S. offer in reliance on the exclusion from the definition of "investment company" in Section 3(c)(1) of the Investment Company Act consistent with the public offering prohibition contained in Section 7(d). See Staff no-action letter, Touche Remnant & Co. (available Aug. 27, 1984) ("Touche Remnant"). In Goodwin Procter, supra note 13, the staff similarly took the position that under certain circumstances a foreign fund that is conducting an offshore offer also may make a private U.S. offer in reliance on the exclusion from the definition of "investment company" in Section 3(c)(7) of the Investment Company Act consistent with the public offering prohibition contained in Section 7(d). The staff also has stated that if U.S. persons become shareholders of a foreign fund for reasons beyond the control of the fund or persons acting on its behalf, the fund would not be required to count those shareholders as U.S. persons for purposes of determining whether the fund may rely on the exception from the definition of "investment company" in Section 3(c)(1) of the Investment Company Act. See Staff no-action letter, Investment Funds Institute of Canada (available Mar. 4, 1996). The same position applies to foreign funds relying on Section 3(c)(7) of the Investment Company Act. See generally Goodwin Procter, supra note 13. We take the position that Touche Remnant is superseded to the extent that it is inconsistent with these positions.*

[137] *See notes 28-32 supra and accompanying text.*

If, however, a foreign fund directly or indirectly provides any additional information on its Web site about the types of persons to whom offers and sales can be made pursuant to an exemption under U.S. law, or provides guidance on how U.S. persons may obtain this or other purchasing information, we would view this action as an indication that the foreign fund is using its Internet offer to target the United States, except to the extent that foreign law requires that the information be disclosed.[138] Moreover, if the foreign fund provides a hyperlink, or otherwise directs U.S. persons, to another source that provides information about the private offering, we would view this action as an indication that the foreign fund is targeting the United States. In our view, either of these actions could result in the foreign fund making a public offer in the United States.

A foreign fund also may be making a public offer in the United States if it provides any other information about the private U.S. offer on its Web site, except to the extent that foreign law requires that the information be disclosed.[139] If the foreign fund wishes to provide information on its Web site relating to its private U.S. offer (other than information required by foreign law), it generally may do so without registering under the Investment Company Act if it adopts and implements password-type procedures with respect to that information.[140]

As with our position under the Securities Act, we are concerned that our guidance with respect to the Investment Company Act may be used by some foreign funds that are conducting Internet offers to engage in activities that are part of a plan or scheme to make public offers in the United States. None of our statements in this release is intended to suggest that any foreign fund could do indirectly what it could not lawfully do directly.[141]

B. Offshore Offers by U.S. Funds

As previously noted, the Commission's position on the use of the Internet for unregistered offshore offers generally distinguishes between U.S. and foreign issuers, based upon the Commission's greater interest in regulating the conduct of U.S. issuers in the United States. As noted in Section IV.B., we will not require a U.S. issuer making an offshore offer over the Internet to

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[138] *Although Rule 135c by its terms applies only to Section 5 of the Securities Act, we would take a similar approach with respect to the type of information that a foreign fund may, if required by foreign law, provide on its Internet site about a U.S. private offer without violating the public offering prohibition contained in Section 7(d) of the Investment Company Act. See supra note 32 and accompanying text.*

[139] *An adviser to a foreign fund conducting an offshore Internet offer that also sponsors a U.S.-registered investment company with the same investment objectives and policies as the foreign fund may provide information about, or direct the viewer to, the registered U.S. offer without the Internet offer being considered to be a public offer of the foreign fund's securities in the United States.*

[140] *See Lamp Technologies, Inc. and IPONET, supra note 31. Prequalification and password-type procedures are intended to ensure that only persons eligible to privately purchase the securities can obtain access to a Web site used in connection with a private offer and that the dissemination of information through the Internet site does not constitute a "general solicitation" under Rule 502(c) of Regulation D under the Securities Act. In addition to the procedures discussed in Lamp Technologies, there may be other, equally effective procedures designed to restrict access to information on the Internet to those persons who are eligible to purchase securities in a private U.S. offer.*

[141] *See Section 48(a) of the Investment Company Act.*

register the offer under the Securities Act if it uses procedures reasonably designed to ensure that only non-U.S. persons may view the offer. We conclude that the same approach should apply under the Investment Company Act to U.S. funds making offshore Internet offers. Thus, we would not consider a U.S. fund making a private offshore offer in reliance on one of the exclusions from the definition of "investment company" in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act to be making a public offer in the United States if the fund uses procedures, such as password-protected web sites, reasonably designed to ensure the private nature of the offer.[142]

As noted above, we are considering whether the current restrictions on general solicitations in connection with private offers under the Securities Act should be modified.[143] In the event that we revise current Securities Act restrictions on exempt private offers and unregistered offshore offers, we anticipate that we would consider parallel revisions under the Investment Company Act.

C. Other Forms of Internet Marketing of Investment Company Securities

We analyze Internet offers made by or on behalf of a foreign fund in generally the same manner as offers by other types of issuers.[144] If a foreign fund or persons acting on its behalf seek to use a third-party Web site to generate interest in an offshore offer, the implementation of more stringent restrictions on the offshore Internet offer may be necessary to ensure that the offer is not being directed into the United States, including limiting access to the Internet offering materials to persons who can demonstrate that they are not U.S. persons.[145]

VI. OFFERS OF ADVISORY SERVICES UNDER THE ADVISERS ACT

This portion of the release addresses issues that arise under the Advisers Act when a foreign adviser (that is, an investment adviser that is organized under the laws of a jurisdiction other than the United States) offers its advisory services over the Internet. In general, a foreign adviser may be able to rely on an exemption from registration under the Advisers Act if it has fewer than fifteen U.S. clients and implements measures reasonably designed to ensure that, based on its Internet activities, the adviser is not holding itself out as an investment adviser in the United States.[146]

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[142]*See supra notes 34-35 and accompanying text.*

[143]*See supra note 36 and accompanying text.*

[144]*See Section III.D., supra.*

[145]*Id.*

[146]*Section 203(a) of the Advisers Act generally prohibits any investment adviser from using U.S. jurisdictional means in connection with its business as an investment adviser, unless the adviser is registered with the Commission, or is exempted or excluded from the requirement to register. Section 203(b)(3) of the Advisers Act provides for an exemption from registration for any adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds itself out generally to the public as an investment adviser nor acts as an adviser to a U.S.-registered investment company or business development company. The staff has taken the position that foreign advisers are required to count only their U.S. clients for purposes of determining whether they are exempt from registration under Section 203(b)(3). See Protecting Investors: A Half Century of Investment Company Regulation, at 223 n.6 (1992); Staff no-action letter, Murray Johnstone Ltd. (available Oct. 7, 1994).*

The issue raised by a foreign investment adviser's use of the Internet is whether and, if so, under what circumstances, the foreign adviser may provide information about its advisory services over the Internet without being considered to be holding itself out as an investment adviser in the United States. We conclude that a foreign adviser providing advisory services over the Internet generally would be holding itself out as an investment adviser. Specifically, we have stated that we generally will consider an adviser who uses a publicly available electronic medium, such as the Internet, to provide information about its services to be holding itself out to the public as an adviser, and to not qualify for the exemption from registration contained in Section 203(b)(3) of the Advisers Act.[147] If, however, the adviser implements measures reasonably designed to guard against directing information provided on the Internet about its advisory services to U.S. persons, we would not consider the foreign adviser to be holding itself out as an investment adviser in the United States for purposes of Section 203(b)(3).

What constitutes measures reasonably designed to guard against an adviser holding itself out as an investment adviser in the United States will depend on all of the facts and circumstances. We generally would consider an adviser to have implemented measures reasonably designed to guard against holding itself out as an investment adviser in the United States if:

- The Web site includes a prominent disclaimer making it clear to whom the site materials are (or are not) directed.[148]
- The adviser implements procedures reasonably designed to guard against directing information about its advisory services to U.S. persons (e.g., obtaining sufficient residency information such as mailing addresses or telephone numbers prior to sending further information), other than to its fourteen or fewer U.S. clients.[149]

Other measures also may provide adequate assurance that a foreign adviser is not holding itself out as an investment adviser in the United States.

VII. EXCHANGE ACT REGISTRATION ISSUES

The Internet activities of broker-dealers and markets (including exchanges) also raise issues under the Exchange Act. Foreign entities that perform these functions should consider whether their Internet activities would subject them to registration under the Exchange Act.

A. Broker-Dealer Activities

Broker-dealers must register with the Commission if they are physically present in the United States, or if, regardless of their location, they effect, induce, or attempt to induce securities transactions with investors in the United States. The issue, therefore, is whether the

[147] *See Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Securities Act Release No. 7288 (May 9, 1996) at text accompanying n. 32. But see Lamp Technologies, Inc., supra note 31.*

[148] *See supra note 21 and accompanying text.*

[149] *See text following supra note 21.*

Commission would deem a broker-dealer's Web site to be an attempt to induce securities transactions with U.S. persons. Broker-dealer Web sites may offer market information and investment tools, real-time or delayed quote information, market summaries, research, portfolio management tools, and analytic programs. Some sites also include information on commissions and other fees, branch office locations, and instructions on how to contact the broker-dealer. In essence, Web sites advertise the broker-dealers' services to potential investors with the intent of attracting securities business.

In keeping with the general principles outlined above (Section III.B.), the Commission will not consider a foreign broker-dealer's advertising on an Internet Web site to constitute an attempt to induce a securities transaction with U.S. persons if the foreign broker-dealer takes measures reasonably designed to ensure that it does not effect securities transactions with U.S. persons as a result of its Internet activities. Under our general principles, as applied in the broker-dealer context, a foreign broker-dealer generally would be considered to have taken measures reasonably designed to ensure it does not effect securities transactions with U.S. persons as a result of its Internet activities if it:

- Posts a prominent disclaimer on the Web site either affirmatively delineating the countries in which the broker-dealer's services are available, or stating that the services are not available to U.S. persons; and
- Refuses to provide brokerage services to any potential customer that the broker-dealer has reason to believe is, or that indicates that it is, a U.S. person, based on residence, mailing address, payment method, or other grounds.

As a means to implement the latter procedure, the broker-dealer should require potential customers to provide sufficient residence information.

These procedures are not exclusive. Adoption of other equally or more effective precautions can also suffice to demonstrate that the broker-dealer does not effect securities transactions with U.S. persons as a result of its Internet activities.

The Commission has exempted foreign broker-dealers that effect transactions with U.S. customers from registering in the United States if these customers initiated transactions with the foreign broker-dealers outside of the United States without solicitation. Specifically, Exchange Act Rule 15a-6 currently provides an exemption from U.S. broker-dealer registration for foreign broker-dealers that effect transactions in securities with or for persons that they have not solicited.[150] Foreign broker-dealers that solicit transactions with U.S. persons, however, are required to register as broker-dealers in the United States.

Foreign broker-dealers that have Internet Web sites and that intend to rely on Rule 15a-6 "unsolicited" exemption should ensure that the "unsolicited" customer's transactions are not in

[150]*Exchange Act Rule 15a-6(a)(1) (17 CFR 240.15a-6(a)(1)).*

fact solicited, either directly or indirectly, through customers accessing their Web sites.[151] In particular, these broker-dealers could obtain, as a precaution reasonably designed to prevent that result, affirmative representations from potential U.S. customers that they deem unsolicited that those customers have not previously accessed their Web sites. Alternatively, a broker-dealer could maintain records that are sufficiently detailed and verifiable to reliably determine that such U.S. customers had not obtained access to its Web site.

B. Exchange Activities

Until recently, in order to obtain current market information about, and to purchase or sell securities on, a foreign market, a U.S. investor typically contacted a U.S. broker-dealer by telephone or facsimile. Alternatively, the U.S. investor could directly contact a foreign broker-dealer that is a member of the foreign market. Today, however, the technology exists for investors to obtain real-time information about trading on foreign markets from a number of different sources, and to enter and execute orders on those markets electronically from the United States. Many exchanges, for example, offer Web sites through which they provide real-time quotes and other market information, e-mail addresses for questions, general contact and membership information (including the names and addresses of members), and other investing tools.

The U.S. securities laws require exchanges to register with the Commission if they (or any broker or dealer) "make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction."[152] The Commission currently is considering the question of under what circumstances a foreign market that provides the ability in the United States for U.S. persons to trade directly in the market must register as a U.S. exchange.[153]

At this time, however, the Commission will not apply the exchange registration requirements to a foreign market that sponsors a Web site generally advertising the foreign exchange, disseminating quotes (including real-time quotes with counterparty identification), or allowing orders to be directed to the market through its Web site, so long as the exchange takes steps reasonably designed to prevent U.S. persons from directing orders to the market through its Web site. In our view, an exchange generally would be considered to have taken steps reasonably designed to prevent U.S. persons from accessing the market through its Web site if it:

- Posts a disclaimer on the Web site affirmatively stating either the countries in which the exchange's services are directly available, or that the exchange's services are not directly available to U.S. persons;
- Requires potential members or direct participants in the exchange to state their residence and mailing address;

[151] *Because a securities firm's Web site itself typically is a solicitation, orders routed through the Web site would not be considered "unsolicited."*

[152] *Section 5 of the Exchange Act, 15 U.S.C. 78e.*

[153] *Exchange Act Release No. 38672 (May 23, 1997).*

- Refuses to allow trading on the exchange through the Web site by any person that the exchange has reason to believe, or that indicates it, is a U.S. person; and
- Refrains from making arrangements to provide U.S. persons with access to the exchange over the Internet indirectly through its members.[154]

By the Commission.

Jonathan G. Katz
Secretary

Dated: March 23, 1998

[154] *This last step would preclude an exchange from relying on this release if it, for example, sets the terms under which exchange members provide Internet access to the exchange, or makes arrangements for U.S. persons to directly clear and settle trades conducted on the exchange through the Internet. Foreign exchanges that knowingly provide U.S. persons with access to their trading facilities through the Internet would not be able to rely on this interpretation, and may be required to register with the Commission.*

SEC Interpretation: Use of Electronic Media.
[Release. No. 33-7856]
April 28, 2000

ACTION: Interpretation; Solicitation of Comment.

SUMMARY: We are publishing guidance on the use of electronic media by issuers of all types, including operating companies, investment companies and municipal securities issuers, as well as market intermediaries. The guidance addresses the use of electronic media in three areas. First, we update our previous guidance on the use of electronic media to deliver documents under the federal securities laws. Second, we discuss an issuer's liability for web site content. Third, we outline basic legal principles that issuers and market intermediaries should consider in conducting online offerings. Additionally, because technology is evolving rapidly, we seek comment on a number of issues to assist us in determining whether further regulatory action is necessary.

DATES: Effective Date: The interpretations are effective on May 4, 2000. Comment Date: Comments should be submitted on or before June 19, 2000.

ADDRESSES: You should submit three copies of your comments to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. You also may submit your comments electronically to the following electronic mail address: rule-comments@sec.gov. All comment letters should refer to File Number S7-11-00; please include this file number in the subject line if you use electronic mail. Comment letters will be available for inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. We will post electronically submitted comment letters on our Internet web site <http://www.sec.gov>.[155]

FOR FURTHER INFORMATION CONTACT: P.J. Himelfarb and Mark A. Borges in the Office of Chief Counsel, Division of Corporation Finance, at (202) 942-2900. For questions regarding broker-dealers (including municipal securities dealers), please contact Paula R. Jenson, Deputy Chief Counsel, and Laura S. Pruitt in the Office of Chief Counsel, Division of Market Regulation, at (202) 942-0073. For questions regarding broker-dealer capacity, please contact Irene A. Halpin and Joan M. Collopy in the Office of Risk Management and Control, Division of Market Regulation, at (202) 942-0772. For questions regarding investment companies and investment advisers, please contact Alison M. Fuller, Assistant Chief Counsel, and David W. Grim in the Office of Chief Counsel, Division of Investment Management, at (202) 942-0659.

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[155] *We do not edit personal, identifying information, such as names or electronic mail addresses, from electronic submissions. Submit only information you wish to make publicly available.*

SUPPLEMENTARY INFORMATION:

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III. Solicitation of Comment

I. Introduction

By facilitating rapid and widespread information dissemination, the Internet has had a significant impact on capital-raising techniques and, more broadly, on the structure of the securities industry. Today, almost seven million people invest in the U.S. securities markets through online brokerage accounts.[156] To serve this increasing interest in online trading, there has been a surge in online brokerage firms offering an array of financial services.[157] Additionally, many publicly traded companies are incorporating Internet-based technology into their routine business operations, including setting up their own web sites to furnish company and industry information. Some provide information about their securities and the markets in which their securities trade. Investment companies use the Internet to provide investors with fund-related information, as well as shareholder services and educational materials. Issuers of municipal securities also are beginning to use the Internet to provide information about themselves and their outstanding bonds, as well as new offerings of their securities. The increased availability of information through the Internet has helped to promote transparency, liquidity and efficiency in our capital markets.

This release is designed to provide guidance to issuers of all types, including operating companies, investment companies and municipal securities issuers, as well as market intermediaries, on several issues involving the application of the federal securities laws to electronic media. In developing this guidance, we considered the significant benefits that investors can gain from the increased use of electronic media. We also considered the potential for electronic media, as instruments of inexpensive, mass communication, to be used to defraud the investing public.[158] We believe that the guidance advances our central statutory goals: ensuring full and fair disclosure to investors; promoting the public interest, including investor protection, efficiency, competition and capital formation; and maintaining fair and orderly markets.

One of the key benefits of electronic media is that information can be disseminated to investors and the financial markets rapidly and in a cost-effective and widespread manner. Our recently

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[156]*Katrina Brooker, They Want You Wired; Brokerage Firms of All Kinds are Tripping Over Themselves to Compete Online for Customers, Fortune, Dec. 20, 1999, at 113. See also Online Brokerage: Keeping Apace of Cyberspace, Report of Laura S. Unger, Commissioner, U.S. Securities and Exchange Commission, Nov. 1999 (the Unger Report), at 1 (the percentage of equity trades conducted online in the first quarter of 1999 was 15.9% of all equity trades). The report is available on our Internet web site at <http://www.sec.gov/news/spstindx.htm>.*

[157]*It is estimated that over 160 brokerage firms offer their customers the ability to trade securities online. See the Unger Report, n. 2 above, at 15.*

[158]*Through March of this year, we had filed approximately 120 Internet-related enforcement actions. See Statement of Chairman Arthur Levitt before the Senate Subcommittee on Commerce, Justice, State and the Judiciary, Committee on Appropriations, re: Appropriations for Fiscal Year 2001, Mar. 21, 2000. The statement is available on our Internet web site at <http://www.sec.gov/news/testmony/ts052000.htm>. We also have conducted three Internet enforcement sweeps. See SEC Steps Up Nationwide Crackdown Against Internet Fraud, Charging 26 Companies and Individuals for Bogus Securities Offerings, SEC Press Release 99-49 (May 12, 1999); SEC Continues Internet Fraud Crackdown, SEC Press Release 99- 24 (Feb. 25, 1999); Purveyors of Fraudulent Spam, Online Newsletters, Message Board Postings, and Websites, SEC Press Release 98-117 (Oct. 28, 1998). These press releases are available on our Internet web site at <http://www.sec.gov/news/presindx.htm>.*

adopted rules permitting increased communications with security holders and the markets in connection with business combinations and similar transactions should enable issuers to take further advantage of this benefit.[159] Thus far, we have not extended the same flexible treatment to securities offerings aimed at raising capital. For these offerings, we are considering separately the liberalization of communications by issuers and other market participants.[160]

Today's interpretive guidance will do the following:

- Facilitate electronic delivery of communications by clarifying that
  - investors may consent to electronic delivery telephonically;
  - intermediaries may request consent to electronic delivery on a "global," multiple-issuer basis;
  - issuers and intermediaries may deliver documents in portable document format, or PDF, with appropriate measures to assure that investors can easily access the documents;
  - an embedded hyperlink[161] within a Section 10 prospectus[162] or any other document required to be filed or delivered under the federal securities laws causes the hyperlinked information to be a part of that document;
  - the close proximity of information on a web site to a Section 10 prospectus does not, by itself, make that information an "offer to sell," "offer for sale" or "offer" within the meaning of Section 2(a)(3) of the Securities Act;[163] and
  - municipal securities underwriters may rely on a municipal securities issuer to identify the documents on the issuer's web site that comprise the preliminary, deemed final and final official statements.
- Reduce uncertainty regarding permissible web site content to encourage more widespread information dissemination to all investors by clarifying
  - some of the facts and circumstances that may result in an issuer having adopted information on a third-party web site to which the issuer has established a hyperlink for purposes of the anti-fraud provisions of the federal securities laws; and

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[159] *See Securities Act Release No. 7760 (Oct. 22, 1999) [64 FR 61408]. This new regulatory system relaxes restrictions on communications in cash tender offers, mergers, exchange offers and proxy solicitations.*

[160] *We also are considering separately the use of road shows in the capital-raising context.*

[161] *A "hypertext link," or "hyperlink," is an electronic path often displayed in the form of highlighted text, graphics or a button that associates an object on a web page with another web page address. It allows the user to connect to the desired web page address immediately by clicking a computer-pointing device on the text, graphics or button. See Harvey L. Pitt & Dixie L. Johnson, Avoiding Spiders on the Web: Rules of Thumb for Issuers Using Web Sites and E-Mail, in Practising Law Institute, Securities Law & the Internet, No. 1127 (1999), at 107-118, n. 5.*

[162] *In this release, when we refer to a Section 10 prospectus, we are referring both to prospectuses satisfying the requirements of Section 10(a) of the Securities Act, 15 U.S.C. §77j(a), and prospectuses satisfying the requirements of Section 10(b) of the Securities Act, 15 U.S.C. §77j(b).*

[163] *15 U.S.C. §77b(a)(3).*

- general legal principles that govern permissible web site communications by issuers when in registration.[164]

- Facilitate online offerings by clarifying
  - general legal principles that broker-dealers should consider when developing and implementing procedures for online public offerings; and
  - circumstances under which a third-party service provide may establish a web site to facilitate online private offerings.

II. Interpretive Guidance

A. Electronic Delivery

We first published our views on the use of electronic media to deliver information to investors in 1995.[165] The 1995 Release focused on electronic delivery of prospectuses, annual reports to security holders and proxy solicitation materials under the Securities Act of 1933,[166] the Securities Exchange Act of 1934[167] and the Investment Company Act of 1940.[168] Our 1996 electronic media release[169] focused on electronic delivery of required information by broker-dealers (including municipal securities dealers) and transfer agents under the Exchange Act and investment advisers under the Investment Advisers Act of 1940.[170]

We believe that the framework for electronic delivery established in these releases continues to work well in today's technological environment. Issuers and market intermediaries therefore must continue to assess their compliance with legal requirements in terms of the three areas identified in the releases—notice, access and evidence of delivery. Although we believe that this framework continues to be appropriate, we provide below guidance that will clarify some regulatory issues relating to electronic delivery.[171]

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[164] *"In registration" is a term that refers to the entire registration process under the Securities Act, "at least from the time an issuer reaches an understanding with the broker-dealer which is to act as managing underwriter [before] the filing of a registration statement" until the end of the period during which dealers must deliver a prospectus. See Securities Act Release No. 5180, at n. 1 (Aug. 16, 1971) [36 FR 16506]. An issuer will not be considered to be "in registration" at any particular point in time solely because it has filed one or more registration statements on Form S-8, 17 CFR 239.16b, or it has on file a registration statement for a delayed shelf offering on Form S-3, S-4, F-3 or F-4, 17 CFR 239.13, 239.25, 239.33 or 239.34, and has not commenced or is not in the process of offering or selling securities "off of the shelf."*

[165] *Securities Act Release No. 7233 (Oct. 6, 1995) [60 FR 53458] (the 1995 Release).*

[166] *15 U.S.C. §77a, et seq.*

[167] *15 U.S.C. §78a, et seq.*

[168] *15 U.S.C. §80a-1, et seq.*

[169] *Securities Act Release No. 7288 (May 9, 1996) [61 FR 24644] (the 1996 Release). The 1996 Release also provided additional examples supplementing the guidance in the 1995 Release. Since 1996, we have further addressed the use of electronic media in the context of offshore sales of securities and investment services, see Securities Act Release No. 7516 (Mar. 23, 1998) [63 FR 14806] (the 1998 Release), and cross-border tender offers, see Securities Act Release No. 7759, Section II.G (Oct. 22, 1999) [64 FR 61382].*

[170] *15 U.S.C. §80b-1, et seq.*

[171] *In Section D below, we also request comment on a number of additional issues involving electronic delivery.*

1. Telephonic Consent

As noted above, one of the three elements of satisfactory electronic delivery is obtaining evidence of delivery. The 1995 Release provided that one method for satisfying the evidence-of- delivery element is to obtain an informed consent from an investor to receive information through a particular electronic medium.[172] The 1996 Release stated that informed consent should be made by written or electronic means.[173] Some securities lawyers have concluded that, based on the 1996 Release, telephonic consent generally is not permitted. Others have opined that telephonic consent may be permissible if an issuer or intermediary retains a record of the consent.[174]

In today's markets, where speed is a priority, significant matters often are communicated telephonically. It is common (and increasingly popular), for instance, for security holders to vote proxies and even transfer assets over the telephone where permitted under applicable state law.[175] In addition, investors can place orders to trade securities over the telephone. We believe these practices have developed because business can be transacted as effectively over the telephone today as it can in paper. We are of the view, therefore, that an issuer or market intermediary may obtain an informed consent telephonically, as long as a record of that consent is retained.[176] As with written or electronic consent, telephonic consent must be obtained in a manner that assures its authenticity.[177]

2. Global Consent

The 1995 Release stated that consent to electronic delivery could relate to all documents to be delivered by or on behalf of a single issuer.[178] The 1995 Release also stated that an issuer could rely on consent obtained by a broker-dealer or other market intermediary.[179] Some securities lawyers have questioned the permissible scope of consents that are obtained by broker-dealers or banks (or their agents) from investors who hold securities of multiple issuers in their brokerage, trust or other accounts. Specifically, they have asked whether an investor can consent to electronic delivery of all documents of any issuer in which that investor buys or owns securities through a particular intermediary.

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[172]*See the 1995 Release, n. 11 above, at n. 29 and the accompanying text.*

[173]*See the 1996 Release, n. 15 above, at n. 23.*

[174]*See John R. Hewitt & Richard B. Carlson, Securities Practice and Electronic Technology, Law Journal Seminars-Press (1998), at 3.01[1].*

[175]*See Stephen I. Glover & Lanae Holbrook, Electronic Proxies, Nat. L. J., Mar. 29, 1999, at B5; See also Jennie Blizzard, Investor Relations Gets Tech Updates; Proxy Voting Among the Signs of Change, Rich. Times Dispatch, Mar. 28, 1999, at E1. Similarly, mutual fund shareholders may effect purchases and redemptions of fund shares telephonically, where permitted by the fund and under applicable state law.*

[176]*The record of telephonic consent should contain as much detail as any written consent, including whether the consent obtained is global and what electronic media will be used.*

[177]*See, for example, Ex. 1 and Ex. 2 in Section E below.*

[178]*See the 1995 Release, n. 11 above, at Ex. 3 (consent by investor John Doe to delivery of all future documents by electronic mail) and Ex. 26 (consent by record holder Jane Doe to delivery of all documents via Company XYZ's web site).*

[179]*Id. at Ex. 6. Under this interpretation, we also believe, and we further clarify today, that an issuer or broker-dealer may rely on a consent obtained by a third party document delivery service, but the issuer or broker dealer retains the ultimate responsibility for assuring that the consent is authentic and for the delivery of required documents.*

We believe that an investor may give a global consent to electronic delivery—relating to all documents of any issuer—so long as the consent is informed.[180] Given the broad scope of a global consent and its effect on an investor's ability to receive important documents, we believe intermediaries should take particular care to ensure that the investor understands that he or she is providing a global consent to electronic delivery. For example, a global consent that is merely a provision of an agreement that an investor is required to execute to receive other services may not fully inform the investor. To best inform investors, broker-dealers could obtain consent from a new customer through an account-opening agreement that contains a separate section with a separate electronic delivery authorization, or through a separate document altogether. We believe that a global consent to electronic delivery would not be an informed consent if the opening of a brokerage account were conditioned upon providing the consent.[181] Therefore, absent other evidence of delivery,[182] we believe that if the opening of an account were conditioned upon providing a global consent, evidence of delivery would not be established.

Similarly, because of the broad scope of a global consent, an investor should be advised of his or her right to revoke the consent at any time and receive all covered documents in paper format. We recognize that a system allowing an investor to revoke consent to electronic delivery with respect to some issuers' documents, but not others, may be difficult to administer. An intermediary might be uncertain about whether or not it has complied with its delivery obligations. Thus, intermediaries, if they wish, may require revocation on an "all-or-none" basis, provided that this policy is adequately disclosed when the consent is obtained.

As noted in the 1995 Release, an informed consent must specify the type of electronic media to be used (for example, a limited proprietary system or an Internet web site).[183] This is particularly true for global consents where multiple documents may be delivered through different media. An investor should not be disadvantaged by inadvertently consenting to electronic delivery through a medium that is not compatible with the investor's computer hardware and software.[184]

Although a global consent must identify the various types of electronic media that may be used to constitute an informed consent, it need not specify the medium to be used by any particular issuer. Additionally, the consent need not identify the issuers covered by the consent. If the consent does identify the covered issuers, it also may provide that additional issuers can be

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[180]*Generally, a consent is considered to be informed when an investor is apprised that the document to be provided will be available through a specific electronic medium or source (for example, through a limited proprietary system or at an Internet web site) and that there may be costs associated with delivery (for example, in connection with online time). In addition, for a consent to be informed an investor must be apprised of the time and scope parameters of the consent. For example, an investor should be made aware of whether the consent is indefinite and extends to more than one type of document. See note 29 of the 1995 Release, n. 11 above, for a discussion of the information that must be disclosed in an informed consent.*

[181]*We recognize that some brokerage firms require accounts to be opened online and all account transactions to be initiated and conducted online. In these instances only, the opening of a brokerage account may be conditioned upon providing global consent to electronic delivery.*

[182]*See the 1995 Release, n. 11 above, at Section II.C.*

[183]*See n. 18 above.*

[184]*See, for example, Ex. 3 in Section E below.*

added at a later time without further consent. Investors cannot be required to accept delivery via additional media at a later time without further informed consent.[185]

3. Use of Portable Document Format

The 1995 Release stated that "the use of a particular medium should not be so burdensome that intended recipients cannot effectively access the information provided."[186] Many issuers have interpreted this statement to preclude delivery of PDF documents which cannot be accessed without special software. Instead, those issuers use hypertext markup language, or HTML, which may be viewed without the need for additional software.[187] We believe that issuers and market intermediaries delivering documents electronically may use PDF if it is not so burdensome as effectively to prevent access. For example, PDF could be used if issuers and intermediaries

- inform investors of the requirements necessary to download PDF when obtaining consent to electronic delivery; and
- provide investors with any necessary software and technical assistance at no cost.[188]

4. Clarification of the "Envelope Theory"

The 1995 Release provided a number of examples designed to assist issuers and market intermediaries in meeting their delivery obligations through electronic media. One example provided that documents in close proximity on the same web site menu are considered delivered together.[189] Other examples confirmed the proposition that documents hyperlinked to each other are considered delivered together as if they were in the same paper envelope.[190] The premise underlying these examples has come to be called the "envelope theory."

The purpose of these examples was to provide assurance to issuers and intermediaries that they are delivering multiple documents simultaneously to investors when so required by the federal securities laws. For example, in a registered offering, sales literature cannot be delivered to an investor unless the registration statement has been declared effective and a final prospectus accompanies or precedes the sales literature.[191] It is easy to establish concurrent delivery when multiple documents are included in one paper envelope that is delivered by U.S. postal mail or a private delivery service. When electronic delivery is used, however, it is somewhat more difficult to establish whether multiple documents may be considered delivered together. The guidance provided in the 1995 Release about the use of "virtual" envelopes was intended to alleviate this difficulty.

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[185]*See, for example, Ex. 4 in Section E below.*

[186]*See the 1995 Release, n. 11 above, at n. 24 and the accompanying text.*

[187]*In 1999, we began modernizing the Electronic Data Gathering, Analysis and Retrieval, or EDGAR, system. See Securities Act Release No. 7684 (May 17, 1999) [64 FR 27888]. One effect of the modernization was to allow filings to be submitted in HTML. Filers also were given the option of accompanying their required filings with unofficial copies in PDF.*

[188]*See, for example, Ex. 5 in Section E below. We remind issuers and intermediaries that we will not consider an electronically delivered document to have been preceded or accompanied by another electronic document unless investors are provided with reasonably comparable access to both documents. See the 1996 Release, n. 15 above, at Ex. 4.*

[189]*See the 1995 Release, n. 11 above, at Ex. 14.*

[190]*Id. at Ex. 15 and Ex. 16.*

[191]*See Sections 2(a)(10) and 5(b) of the Securities Act, 15 U.S.C. §§77b(a)(10) and 77e(b).*

Nevertheless, some issuers and intermediaries believe that the envelope theory has created ambiguities as to appropriate web site content when an issuer is in registration.[192] Some securities lawyers have expressed concern that if a Section 10 prospectus is posted on a web site, the operation of the envelope theory causes everything on the web site to become part of that prospectus. They also have raised concerns that information on a web site that is outside of the four corners of the Section 10 prospectus, but in close proximity[193] to it, would be considered free writing.[194]

Information on a web site would be part of a Section 10 prospectus only if an issuer (or person acting on behalf of the issuer, including an intermediary with delivery obligations) acts to make it part of the prospectus. For example, if an issuer includes a hyperlink within a Section 10 prospectus, the hyperlinked information would become a part of that prospectus.[195] When

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[192]*Some securities lawyers have raised similar issues concerning the use of a web site in connection with proxy solicitations, tender offers and other transactions that require documents to be filed or delivered under the federal securities laws. Although the guidance in this section focuses on issues relating to the registration process, it applies by analogy to all documents required to be filed or delivered under the federal securities laws.*

[193]*In Example 14 of the 1995 Release, see n. 11 above, we stated that documents that appear in close proximity to each other on the same web site menu are considered delivered together. Given the layout of a typical web page, which often includes multiple "buttons" spread throughout the page rather than in menu format, issuers may be confused by our reference in the 1995 Release to "menu." Two or more documents will be considered to be delivered together if the buttons are in proximity to each other on the same screen, whether or not they are on the same "menu."*

[194]*By "free writing," we mean communications that would constitute an "offer to sell," "offer for sale" or "offer," including every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value under Section 2(a)(3) of the Securities Act made by means other than a prospectus satisfying the requirements of Section 10 of the Securities Act, 15 U.S.C. §77j. Section 2(a)(10) of the Securities Act defines the term "prospectus."*

[195]*When an issuer includes a hyperlink within a document required to be filed or delivered under the federal securities laws, we believe it is appropriate for the issuer to assume responsibility for the hyperlinked information as if it were part of the document. We believe that the inclusion of a hyperlink to an external web site or document demonstrates the hyperlinking party's intent to make the information part of its communication with investors, security holders and the markets. Additionally, because written offers must be made exclusively through a Section 10 prospectus, when an issuer includes a hyperlink to an external web site or document within a Section 10 prospectus, the issuer expresses its intent to have the hyperlinked information treated as part of this exclusive means of offering its securities. An issuer (or person acting on behalf of the issuer, including an intermediary with delivery obligations) must make it clear to investors where the document from which it is hyperlinking begins and where it ends.*

We are aware that today many standard software programs can automatically convert an inactive uniform resource locator, or URL, into an active hyperlink, either at the time the document including the URL is created or when the document is later accessed. Consequently, as with an embedded hyperlink, an issuer that includes a URL to a web site in a Section 10 prospectus or other document required to be filed or delivered under the federal securities laws is responsible for information on the site that is accessible through the resulting hyperlink. To the extent that the document is required to be filed with the Commission, the hyperlinked information must be filed as part of the document. Inclusion of the URL to the Commission's Internet web site is mandated by some of our disclosure requirements. See, for example, Item 502(a)(2) of Regulation S-K, 17 CFR 229.502(a)(2); Item 12(c)(2)(ii) of Form S-3, 17 CFR 239.13. Additionally, the Division of Corporation Finance has previously indicated that the inclusion of the URL for an issuer's web site in a registration statement, along with the statement "[O]ur SEC filings are also available to the public from our web site," will not, by itself, include or incorporate by reference the information on the site into the registration statement (unless the issuer otherwise acts to incorporate the information by reference). See Division of Corporation Finance interpretive letters Baltimore Gas and Electric Company (Jan. 6, 1997); ITT Corporation (Dec. 6, 1996). In these two situations, we would not consider the presence of the URL to make our web site, or an issuer's web site, as the case may be, part of a document if the party presenting the URL takes reasonable steps to ensure that the URL is inactive (for example, by removing "a>href" tagging) and includes a statement to denote that the URL is an inactive textual reference only.

embedded hyperlinks are used,[196] the hyperlinked information must be filed as part of the prospectus in the effective registration statement and will be subject to liability under Section 11 of the Securities Act.[197] In contrast, a hyperlink from an external document to a Section 10 prospectus would result in both documents being delivered together, but would not result in the non-prospectus document being deemed part of the prospectus. Issuers nevertheless may be subject to liability under Section 12 of the Securities Act[198] for the external document depending on whether the external document is itself a prospectus or part of one.

With respect to the free writing concern, the focus on the location of the posted prospectus is misplaced. Regardless of whether or where the Section 10 prospectus is posted, the web site content must be reviewed in its entirety to determine whether it contains impermissible free writing.[199] The Commission staff will continue to raise questions about information on an issuer's web site that is either inconsistent with the issuer's Section 10 prospectus or that would constitute an "offer to sell," "offer for sale" or "offer" under Section 2(a)(3) of the Securities Act.

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[196] *An issuer may not use embedded hyperlinks exclusively to satisfy the line item disclosure requirements of its filings under the federal securities laws. For example, an issuer filing a registration statement on Form S1, 17 CFR 239.11, could include embedded hyperlinks to its Exchange Act reports so that they are readily available, but only if the issuer otherwise includes full disclosure of all required issuer information within the body of the Section 10 prospectus. This is because the Commission's rules and forms contemplate a single comprehensive, integrated document so that readers can understand the document's content without having to access numerous other documents. We also note that simply embedding a hyperlink within a document does not satisfy the line item disclosure requirement for the incorporation of certain information by reference as provided under the Commission's rules and forms. In order for a document to be incorporated by reference in a filed document, an issuer must include a statement to that effect in the document listing the incorporated documents. See, for example, Item 12(a) of Part I of Form S-3; General Instruction G(4) of Form 10K, 17 CFR 249.310; Exchange Act Rule 12b-23(b), 17 CFR 240.12b-23(b).*

[197] *15 U.S.C. §77k. See, for example, Ex. 6 in Section E below. Of course, other Securities Act and Exchange Act liability provisions also may apply. See, for example, Sections 12(a)(2) and 17(a) of the Securities Act, 15 U.S.C. §§77l(a)(2) and 77q(a), Section 10(b) of the Exchange Act, 15 U.S.C §78j(b), and Rule 10b-5, 17 CFR 240.10b-5. Although a prospectus or other disclosure document on an issuer's web site may contain a hyperlink to an external web site or document under the circumstances described in this section, a hyperlink to an external site or document (including exhibits) currently may not be embedded in any filed EDGAR document. See Rule 105 of Regulation S-T, 17 CFR 232.105; Securities Act Release No. 7684 (May 17, 1999) [64 FR 27888]. However, filers may include hyperlinks to different sections within a single HTML document. Under our recently adopted rules implementing the next phase of EDGAR modernization, the system now permits hyperlinks from an EDGAR filing to its exhibits and to other filings in the EDGAR database on our Internet web site at <http://www.sec.gov>. See Securities Act Release No. 7855 (Apr. 24, 2000) [65 FR 24788]. The new rules address the liability treatment of material hyperlinked from the EDGAR database into EDGAR filings, but do not address broader issues of hyperlinks on issuers' web sites.*

[198] *15 U.S.C. §77l.*

[199] *See n. 40 above. While the proximity of information on an issuer's web site to a Section 10 prospectus posted on the same site will determine whether multiple documents are delivered together, it does not dispose of the issue of whether the information would constitute an "offer to sell," "offer for sale" or "offer" under Section 2(a)(3) of the Securities Act. We provide guidance in Section B below about permissible communications on an issuer's web site when the issuer is in registration.*

Municipal securities market participants involved in offering and selling municipal securities face similar issues under Exchange Act Rule 15c2-12[200] in connection with their use of electronic media. Rule 15c212 requires municipal securities underwriters of primary offerings to, among other things,

- obtain and review an official statement that the municipal securities issuer deems final;
- send the final official statement to any potential customer; and
- in negotiated sales, send the most recent preliminary official statement, if one exists, to any potential customer.

Under Rule 15c2-12, a final official statement can be a single document or set of documents. In a municipal securities offering, if a municipal securities issuer puts its official statement on its web site and also establishes hyperlinks to other web sites, a question arises as to what constitutes the final official statement that a municipal securities underwriter has an obligation to obtain and send to potential customers. For purposes of satisfying its obligations under Rule 15c2-12, a municipal securities underwriter may rely on the municipal securities issuer to identify which of the documents on, or hyperlinked from, the issuer's web site comprise the preliminary, deemed final and final official statements, even if the issuer's web site contains other documents or hyperlinks to other web sites. Hyperlinks embedded within an official statement itself, however, will be considered part of the official statement, even if a municipal securities issuer has not specifically identified the embedded hyperlinked information. For any municipal securities offering subject to Rule 15c2-12, the paper and electronic versions of each of the preliminary, deemed final and final official statements must be the same. Municipal securities issuers are reminded that, whether or not the offering of their securities is exempt from Rule 15c2-12, the anti-fraud provisions of the federal securities laws apply to their official statements and other disclosures.[201]

B. Web Site Content

Issuers have raised a number of questions about their responsibility for the content of their web sites, both when they are in registration and when they are not. It is important for issuers, including municipal securities issuers, to keep in mind that the federal securities laws apply in the same manner to the content of their web sites as to any other statements made by or attributable to them. While many of these questions may be resolved by reference to current law, we recognize that further guidance would be helpful on two fundamental issues affecting web site content. We first consider issuer responsibility for hyperlinked information under the anti-fraud provisions of the federal securities laws. We then discuss the regulation of issuers' web site communications during registered offerings.

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[200]*17 CFR 240.15c2-12.*

[201]*See Exchange Act Release No. 7049 (Mar. 9, 1994) [59 FR 12748]. All issuers, whether offering and selling securities in registered or exempt offerings, are subject to anti-fraud liability. See Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5.*

1. Issuer Responsibility for Hyperlinked Information

Issuers[202] are responsible for the accuracy of their statements that reasonably can be expected to reach investors or the securities markets[203] regardless of the medium through which the statements are made, including the Internet. Some issuers have asked whether they can be held liable under Section 10(b) of the Exchange Act and Rule 10b-5 for third-party information to which they have hyperlinked from their web sites.[204] This concern stems largely from case law[205] and our findings in the 1997 settlement of an enforcement action.[206] These questions focus on the consequences of issuer hyperlinks to analyst research reports, although issuers also have expressed concern about their potential liability for hyperlinks to other information as well.

Whether third-party information is attributable to an issuer depends upon whether the issuer has involved itself in the preparation of the information or explicitly or implicitly endorsed or approved the information. In the case of issuer liability for statements by third parties such as analysts, the courts and we have referred to the first line of inquiry as the "entanglement" theory and the second as the "adoption" theory.

In the case of hyperlinked information, liability under the "entanglement" theory would depend upon an issuer's level of pre-publication involvement in the preparation of the information.[207] In contrast, liability under the "adoption" theory would depend upon whether, after its publication, an issuer, explicitly or implicitly, endorses or approves the hyperlinked information.[208]

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[202] *While our guidance in this section addresses the responsibilities of issuers, broker-dealers and investment advisers also should carefully consider their responsibilities for hyperlinked information.*

[203] *See Securities Act Release No. 6504 (Jan. 20, 1984) [49 FR 2468]. Where a statement is materially misleading, an issuer and any persons responsible for the statement would be liable under the anti-fraud provisions of the federal securities laws. See, for example, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied sub nom., Coates v. SEC, 394 U.S. 976 (1969).*

[204] *When an issuer is offering or selling securities, similar questions arise under Section 17(a) of the Securities Act. Although our discussion is framed in terms of Section 10(b) of the Exchange Act and Rule 10b-5, it applies equally to questions arising under Section 17(a).*

[205] *See n. 54 below.*

[206] *See In the Matter of Presstek, Inc., Exchange Act Release No. 39472 (Dec. 22, 1997), n. 54 below.*

[207] *See, for example, Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980); In the Matter of Syntex Corp. Sec. Litig., 855 F.Supp. 1086 (N.D. Cal. 1993); In the Matter of Caere Corp. Sec. Litig., 837 F. Supp. 1054 (N.D. Cal. 1993).*

[208] *See, for example, In the Matter of Cypress Semiconductor Sec. Litig., 891 F. Supp. 1369, 1377 (N.D. Cal. 1995), aff'd sub nom. Eisenstadt v. Allen, 113 F.3d 1240 (9th Cir. 1997) ("distributing analysts' reports to potential investors may, depending on the circumstances, amount to an implied representation that the reports are accurate"); In the Matter of RasterOps Corporation Sec. Litig., [1994-95 Tr. Binder] Fed.Sec.L.Rep. (CCH) 98,467 (N.D. Cal. 1994) ("act of circulating the reports amounts to an implied representation that the information contained in the reports is accurate or reflects the company's views"). See also Presstek, n. 52 above. In Presstek, we stated that "in the Commission's view, under certain circumstances, an issuer that disseminates false third-party reports may adopt the contents of those reports and be fully liable for the misstatements contained in them, even if it had no role whatsoever in the preparation of the report." Id. at 32.*

—misrepresentation of a material fact or omission of a material fact necessary to make a statement, in light of the circumstances under which it was made, not misleading,

—in the sale, or in connection with the purchase or sale, of a security,

—with the requisite state of mind, or scienter. Liability to a private plaintiff also requires proof that the plaintiff justifiably relied on the statement containing the material misrepresentation or omission and was injured as a result. See, for example, Robbins v. Koger Properties, Inc., 116 F.3d 1441, 1447 (11th Cir. 1997). Investor reliance on a material misrepresentation or omission need not be shown in a Commission enforcement action. See Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). Under certain circumstances, there may be a rebuttable presumption of reliance. See, for example, Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (discussing the "fraud on the market" theory). Similarly, where materiality is established, reliance in an omissions case is presumed. See Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972).

Below we discuss factors that we believe are relevant in deciding whether an issuer has adopted information on a third-party web site to which it has established a hyperlink.[209] While the factors we discuss below form a useful framework of analysis, we caution that they are neither exclusive nor exhaustive. We are not establishing a "bright line" mechanical test. We do not mean to suggest that any single factor, standing alone, would or would not dictate the outcome of the analysis.

a. Context of the Hyperlink

Whether third-party information to which an issuer has established a hyperlink is attributable to the issuer is likely to be influenced by what the issuer says about the hyperlink or what is implied by the context in which the issuer places the hyperlink. An issuer might explicitly endorse the hyperlinked information. For example, a hyperlink might be incorporated in or accompany a statement such as "XYZ's web site contains the best description of our business that is currently available." Likewise, a hyperlink might be used to suggest that the hyperlinked information supports a particular assertion on an issuer's web site. For example, the hyperlink may be incorporated in or accompany a statement such as, "As reported in Today's Widget, our company is the leading producer of widgets worldwide." Moreover, even when an issuer remains silent about the hyperlink, the context nevertheless may imply that the hyperlinked information is attributable to the issuer.[210]

In the context of a document required to be filed or delivered under the federal securities laws, we believe that when an issuer embeds a hyperlink to a web site within the document, the issuer should always be deemed to be adopting the hyperlinked information.[211] In addition, when an issuer is in registration, if the issuer establishes a hyperlink (that is not embedded within a disclosure document) from its web site to information that meets the definition of an "offer to sell," "offer for sale" or "offer" under Section 2(a)(3) of the Securities Act, a strong inference arises that the issuer has adopted that information for purposes of Section 10(b) of the Exchange Act and Rule 10b-5.[212]

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[209] *We do not discuss the application of the "entanglement" theory to hyperlinked information on third party web sites. We recognize that the "entanglement" and "adoption" theories often overlap and that some of the factors relating to an adoption analysis also may apply to an entanglement analysis. Once the threshold issue of whether hyperlinked third-party information has been adopted by an issuer has been answered, a trier of fact would then turn to the issue of whether a claim has been established under Section 10(b) of the Exchange Act and Rule 10b-5. A claim under Section 10(b) and Rule 10b-5 generally includes the following elements:*

—misrepresentation of a material fact or omission of a material fact necessary to make a statement, in light of the circumstances under which it was made, not misleading,

—in the sale, or in connection with the purchase or sale, of a security,

—with the requisite state of mind, or scienter. Liability to a private plaintiff also requires proof that the plaintiff justifiably relied on the statement containing the material misrepresentation or omission and was injured as a result. See, for example, Robbins v. Koger Properties, Inc., 116 F.3d 1441, 1447 (11th Cir. 1997). Investor reliance on a material misrepresentation or omission need not be shown in a Commission enforcement action. See Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). Under certain circumstances, there may be a rebuttable presumption of reliance. See, for example, Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (discussing the "fraud on the market" theory). Similarly, where materiality is established, reliance in an omissions case is presumed. See Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972).

[210] *See Section B.1.c below.*

[211] *See Section A. 4 above.*

[212] *See Section B.2 below for a discussion of the effect of an issuer hyperlink to information on a third party web site for purposes of Section 5 of the Securities Act.*

b. Risk of Confusion

Another factor we would consider in determining whether an issuer has adopted hyperlinked information is the presence or absence of precautions against investor confusion about the source of the information. Hyperlinked information on a third-party web site may be less likely to be attributed to an issuer if the issuer makes the information accessible only after a visitor to its web site has been presented with an intermediate screen that clearly and prominently indicates that the visitor is leaving the issuer's web site and that the information subsequently viewed is not the issuer's. Similarly, there may be less likelihood of confusion about whether an issuer has adopted hyperlinked information if the issuer ensures that access to the information is preceded or accompanied by a clear and prominent statement from the issuer disclaiming responsibility for, or endorsement of, the information. In contrast, the risk of investor confusion is higher when information on a third-party web site is framed[213] or inlined.[214] We are not suggesting, however, that statements and disclaimers will insulate an issuer from liability for hyperlinked information when the relevant facts and circumstances otherwise indicate that the issuer has adopted the information.[215]

c. Presentation of the Hyperlinked Information

The presentation of the hyperlinked information by an issuer is relevant in determining whether the issuer has adopted the information. For example, an issuer's efforts to direct an investor's attention to particular information by selectively providing hyperlinks is a relevant consideration in determining whether the information so hyperlinked has been adopted by the issuer. Where a wealth of information as to a particular matter is available, and where the information accessed by the hyperlink is not representative of the available information, an issuer's creation and maintenance of the hyperlink could be an endorsement of the selected information. Similarly, an issuer that selectively establishes and terminates hyperlinks to third-party web sites depending upon the nature of the information about the issuer on a particular site or sites may be viewed as attempting to control the flow of information to investors. Again, this suggests that the issuer has adopted the information during the periods that the hyperlink is operative.

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[213] *"Framing" involves a form of hyperlinking. Upon clicking highlighted text, graphics or a button, information from a separate web site is imported into the web site that is being used and is displayed within a constant on-screen border, or frame. In this case, information from an issuer's web site and the hyperlinked web site would be visible at the same time. The user may not be aware that the displayed material is actually from a different web site.*

[214] *"Inclining" is similar to framing but does not result in a visible border. As with framing, information from an issuer's web site and the hyperlinked web site would be visible at the same time. Also, as with framing, a web site user may not be aware that the displayed material is actually from a different web site.*

[215] *Some of our prior statements may have created the erroneous impression that the use of a disclaimer, in and of itself, may be effective to shield an issuer from adoption of, and liability under Section 10(b) of the Exchange Act and Rule 10b-5 in connection with, information on a third party web site to which the issuer has established a hyperlink. See, for example, the 1998 Release, n. 15 above, in which we addressed when the posting of offering or solicitation materials on a web site would not be considered activity taking place in the United States. The 1998 Release did not address the anti-fraud provisions of the federal securities laws, however, which continue to reach all Internet activities that satisfy the relevant jurisdictional tests. We do not view a disclaimer alone as sufficient to insulate an issuer from responsibility for information that it makes available to investors whether through a hyperlink or otherwise. To conclude otherwise would permit unscrupulous issuers to make false or misleading statements available to investors without fear of liability as long as the information is accompanied by a disclaimer. Further, we remind issuers that specific disclaimers of anti-fraud liability are contrary to the policies underpinning the federal securities laws. See Section 14 of the Securities Act, 15 U.S.C. §77n, Section 29(a) of the Exchange Act, 15 U.S.C. §78cc(a), Section 47(a) of the Investment Company Act, 15 U.S.C. §80a-46(a), and Section 215(a) of the Investment Advisers Act, 15 U.S.C. §80b-15(a).*

Finally, the layout of the screen containing a hyperlink is relevant in determining whether an issuer will be deemed to have adopted hyperlinked information. Any action to differentiate a particular hyperlink from other hyperlinks on an issuer's web site, through its prominence, size or location, or to draw an investor's attention to the hyperlink, may suggest that the issuer favors the hyperlinked information over other information available to the investor on or through the site. For example, a particular hyperlink might be presented in a different color, type font or size from other hyperlinks on an issuer's web site. Where the method of presenting the hyperlink influences disproportionately an investor's decision to view third-party information, the hyperlinked information is more likely attributable to an issuer.

2. Issuer Communications During a Registered Offering

Because of the increasing use by issuers of web sites to communicate in the ordinary course of business with their security holders, customers, suppliers and others, issuers have asked us for guidance on the permissible content of their Internet communications when they are in registration.[216] An issuer in registration must consider the application of Section 5 of the Secu-rities Act[217] to all of its communications with the public.[218] In our view, this includes information on an issuer's web site as well as information on a third-party web site to which the issuer has established a hyperlink. The Securities Act and accompanying regulations currently limit information about an offering that issuers and persons acting on their behalf may provide to investors to the content of the Section 10 prospectus and any permissible communications under available Securities Act safe harbors.[219] Thus, information on a third-party web site to which an issuer has established a hyperlink that meets the definition of an "offer to sell," "offer for sale" or "offer" under Section 2(a)(3) of the Securities Act raises a strong inference that the

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[216]*In Securities Act Release No. 7606A (Nov. 13, 1998) [63 FR 67174], we proposed exemptions to address many of the issues in this area. We will continue to consider these proposals as part of a broader regulatory review of restrictions on communications. We also have adopted rules relaxing restrictions on communications in the business combination context. If a registered offering involves a merger or other business combination, new Securities Act Rules 165 and 166, 17 CFR 230.165 and 230.166, enable the parties to the transaction or persons acting on their behalf to communicate information about the transaction and the parties to it outside of the Section 10 prospectus. See Securities Act Release No. 7760 (Oct. 22, 1999) [64 FR 61408]. Thus, information relating to a business combination may remain on an issuer's web site provided it is filed in accordance with Securities Act Rule 425, 17 CFR 230.425.*

[217]*15 U.S.C. §77e.*

[218]*Except with respect to business combinations, no offers of any kind may be made before filing a registration statement. Section 5(c) of the Securities Act, 15 U.S.C. §77e(c). During the period between filing and delivery of the final prospectus, written offers and offers transmitted by radio or television must conform to the requirements of Section 10 of the Securities Act. See Sections 2(a)(10) and 5(b) of the Securities Act.*

[219]*See n. 68 below. From a policy standpoint, regulating communications during the offering process can be justified as a reasonable balancing of the incentives that the process creates for participants to stimulate interest in an issuer's securities. During the offering process "the increased compensation to distributors and the compressed period of the selling effort, as well as the issuer's interest in obtaining funds, set up a situation in which potential conflicts of interest between investors and sellers are enhanced." See Reforming the Securities Act of 1933—A Conceptual Framework, an Address by Linda C. Quinn, Director, Division of Corporation Finance, Securities and Exchange Commission, to the American Bar Association, Section of Business Law, Committee on Federal Regulation of Securities, Fall Meeting, Nov. 11, 1995, at 6.*

hyper-linked information is attributable to the issuer for purposes of a Section 5 analysis.[220] To ensure compliance with Section 5, an issuer in registration should carefully review its web site and any information on third-party web sites to which it hyperlinks.

An issuer that is in registration should maintain communications with the public as long as the subject matter of the communications is limited to ordinary-course business and financial information, which may include the following:

- advertisements concerning the issuer's products and services;
- Exchange Act reports required to be filed with the Commission;
- proxy statements, annual reports to security holders and dividend notices;
- press announcements concerning business and financial developments;
- answers to unsolicited telephone inquiries concerning business matters from securities analysts, financial analysts, security holders and participants in the communications field who have a legitimate interest in the issuer's affairs; and
- security holders' meetings and responses to security holder inquiries relating to these matters.[221]

Statements containing information falling within any of the foregoing categories, or an available Securities Act safe harbor,[222] may be posted on an issuer's web site when in registration, either directly or indirectly through a hyperlink to a third-party web site, including the web site of a broker-dealer that is participating in the registered offering.

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[220]*See Section B.1.a above for a discussion of the effect of an issuer hyperlink to information on a third party web site for purposes of the anti-fraud provisions of the federal securities laws. We note that the "safe harbor" from Section 5 of the Securities Act contained in Securities Act Rule 137, 17 CFR 230.137, that permits broker-dealers not participating in a distribution to publish or distribute research without the research being deemed to be an "offer" for purposes of Sections 2(a)(11) of the Securities Act, 15 U.S.C. §77b(a)(11), and the "safe harbors" from Section 5 contained in Securities Act Rules 138 and 139, 17 CFR 230.138 and 230.139, that permit broker-dealers to publish or distribute research without the research being deemed to be an "offer to sell" or "offer for sale" for purposes of Sections 2(a)(10) and 5(c) of the Securities Act, do not extend to permit issuers to publish or distribute the same information. See the 1995 Release, n. 11 above, at Ex. 16.*

[221]*See, for example, the information guidelines contained in Securities Act Release No. 5180 (Aug. 16, 1971) [36 FR 16506]; Securities Act Release No. 5009 (Oct. 7, 1969) [34 FR 16870]; Securities Act Release No. 4697 (May 28, 1964) [29 FR 7317]; and Securities Act Release No. 3844 (Oct. 8, 1957) [22 FR 8359].*

[222]*Limited issuer statements about an offering may be made (electronically or otherwise) before the filing of a registration statement. Securities Act Rule 135, 17 CFR 230.135, permits an issuer to notify the public of a proposed offering of securities during the pre-filing period as long as the contents of the notice do not exceed the items specified in the rule. Securities Act Rule 135c, 17 CFR 230.135c, permits issuers subject to the reporting requirements of the Exchange Act, and certain exempt foreign issuers, to make public announcements of proposed private offerings of securities without any such announcement being deemed an "offer" for purposes of Section 5 of Securities Act, as long as it is not used to condition the market and is limited to the factual items specified in the rule. These safe harbors also may be invoked after the filing of a registration statement. Once a registration statement has been filed, an issuer may publish (electronically or otherwise) a brief description of its business and limited additional information on the securities being offered.*

Although our original guidance was directed at communications by reporting issuers when in registration, it also should be observed by non-reporting issuers preparing to offer securities to the public for the first time. A nonreporting issuer that has established a history of ordinary course business communications through its web site should be able to continue to provide business and financial information on its site consistent with our original guidance. A non-reporting issuer preparing for its first registered public offering that contemporaneously establishes a web site, however, may need to apply this guidance more strictly when evaluating its web site content because it may not have established a history of ordinary course business communications with the marketplace. Thus, its web site content may condition the market for the offering and, due to the unfamiliarity of the marketplace with the issuer or its business, investors may be unable to view the issuer's communications in an appropriate context while the issuer is in registration. In other words, investors may be less able to distinguish offers to sell an issuer's securities in a registered offering from product or service promotional activities or other business or financial information.

C. Online Offerings

1. Online Public Offerings

Increasingly, issuers and broker-dealers are conducting public securities offerings online, using the Internet, electronic mail and other electronic media to solicit prospective investors. Examples of these electronic communications include investor questionnaires on investment qualifications, broker-dealer account-opening procedures and directives on how to submit indications of interest or offers to buy in the context of a specific public offering.[223] These developments present both potential benefits and dangers to investors.[224] On the positive side, numerous "online brokers" appear to have begun to give individual investors more access to

Securities Act Rule 134, 17 CFR 230.134, permits an issuer to make limited offering communications following the filing of a registration statement as long as the contents of the communications are limited to the items specified in the rule and the other conditions of the rule are met. Securities Act Rule 135e, 17 CFR 230.135e, permits a foreign private issuer and other offering participants to provide journalists with access to offshore press activities that discuss a present or proposed offering of securities. Rule 135e requires that press-related materials be released only outside the United States and that press conferences be held outside the United States. As a result, we believe that dissemination through the Internet by the issuer or other person covered by Rule 135e of these materials or press conferences will not comply with Rule 135e unless procedures are implemented to assure that only permitted recipients under the rules are able to access the information.

We also have adopted special safe harbor rules for mutual funds, which, unlike typical corporate issuers, continuously offer and sell their shares to the public and, therefore, are continuously subject to the limitations on issuer communications under the Securities Act. Securities Act Rule 482, 17 CFR 230.482, permits a mutual fund to advertise performance and other information about the fund, provided that the advertisement contains only information the substance of which is included in the fund's prospectus. Securities Act Rule 134 contains special provisions for mutual funds, permitting funds to advertise a broad range of information, other than performance information.

[223]*See Division of Corporation Finance no action letter Wit Capital Corporation (July 14, 1999).*

[224]*We are aware that municipal securities issuers and municipal securities underwriters have begun to evaluate the online offering process and that a limited number of offerings have been conducted over the Internet. At this time, we are not addressing the implications of online municipal securities offerings, but we encourage comment on this topic. We remind municipal securities issuers and other municipal securities market participants, however, of the potential issue that arises if the municipal securities offering also involves an offering of a separate security that is not being sold pursuant to the exemption from registration contained in Section 3(a)(2) of the Securities Act, 15 U.S.C. §77c(a)(2). If the municipal securities offering involves an offering of a separate security that is being sold in reliance on an exemption from registration contained in Section 4(2) of the Securities Act, 15 U.S.C. §77d(2), or Regulation D, 17 CFR 230.501, et seq., or in a registered offering, our discussion in Section C.2 below applies. We, therefore, caution municipal securities offering participants wishing to offer municipal securities online to evaluate carefully whether any separate security is being sold.*

public offerings, including initial public offerings, or IPOs.[225] Still, dangers accompany these expanded online investment opportunities. Retail investors often are unfamiliar with the public offering process generally, and, in particular, with new marketing practices that have evolved in connection with online public offerings. We are concerned that there may be insufficient information available to investors to enable them to understand fully the online public offering process. We also are concerned that investors are being solicited to make hasty, and perhaps uninformed, investment decisions.[226]

Two fundamental legal principles should guide issuers, underwriters and other offering participants in online public offerings. First, offering participants can neither sell, nor make contracts to sell, a security before effectiveness of the related Securities Act registration statement.[227] A corollary to this principle dictates that "[n]o offer to buy can be accepted and no part of the purchase price can be received until the registration statement has become effective."[228]

Second, until delivery of the final prospectus has been completed, written offers and offers transmitted by radio and television cannot be made outside of a Section 10 prospectus except in connection with business combinations.[229] After filing the registration statement, two limited exceptions provide some flexibility to offering participants to publish notices of the offering.[230] Following effectiveness, offering participants may disseminate sales literature and other writings so long as these materials are accompanied or preceded by a final prospectus.[231] Oral offers, in contrast, are permissible as soon as the registration statement has been filed. Offering participants may use any combination of electronic and more traditional media, such as paper or the telephone, to communicate with prospective investors, provided that use of these media is in compliance with the Securities Act.

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[225]*See Joseph Weber & Peter Elstrom, Transforming the Art of the Deal, Bus. Wk., July 26, 1999, at 96; Shawn Tully, Will the Web Eat Wall Street?, Fortune, Aug. 2, 1999, at 112.*

[226]*There also have been numerous reports where investors complained that they did not receive shares in an online IPO. See Randall Smith, So Far, "EUnderwriting" Gets a Slow Start, Wall St. J., Aug. 16, 1999, at C1. See also Randall Smith, Online Brokers to Form Bank in Bid for IPOs, Wall St. J., Nov. 15, 1999, at C1; Randall Smith & Lee Gomes, How Get Rich Hopes of Linux Techies Went Up in Flames, Wall St. J., Aug. 18, 1999, at A1.*

[227]*Section 5(a) of the Securities Act, 15 U.S.C. §77e(a).*

[228]*Securities Act Rule 134(d), 17 CFR 230.134(d).*

[229]*See Sections 2(a)(10) and 5(b) of the Securities Act. Section 5(c) of the Securities Act also proscribes both oral and written offers before the filing of a registration statement or while the registration statement is subject to a refusal order, stop order or, before effectiveness, any other public proceeding or examination under Section 8 of the Securities Act, 15 U.S.C. §77h. For a description of the new rules regarding communications in a business combination context, see n. 62 above.*

Mutual funds are permitted to make written offers before delivery of the final prospectus under Securities Act Rule 482 (permitting advertisements containing only information "the substance of which" is included in the fund's prospectus) and Securities Act Rule 498, 17 CFR 230.498 (permitting the use of a "profile," a summary disclosure document). Both Rule 482 advertisements and fund profiles are prospectuses under Section 10(b) of the Securities Act, which permits a prospectus that omits in part or summarizes information to be used to make offers before delivery of the final prospectus.

[230]*See Securities Act Rules 134 and 135, n. 68 above.*

[231]*See Sections 2(a)(10) and 5(b) of the Securities Act. A confirmation of sale is not deemed a nonconforming prospectus when sent or given after the effective date of a registration statement if a prospectus satisfying the requirements of Section 10(a) of the Securities Act is sent or given before or with the confirmation.*

These key legal principles must underpin the development of appropriate procedures for online offerings. To date, the Division of Corporation Finance has reviewed numerous procedures in connection with online distributions of IPOs. The Division also has issued a no-action letter regarding permissible procedures for the use of the Internet in IPOs.[232] We understand, however, that a number of online brokers have urged that we make additional regulatory accommodations to facilitate online offerings. We appreciate the benefits that technology brings to the offering process and fully support the need to craft a regulatory system that maximizes these benefits. We also are mindful of our investor protection mandate and the fundamental principles established by the Securities Act for the offer and sale of securities. Many of the procedures urged upon us by online brokers may be properly the subject of regulatory action. Accordingly, in this release, we do not prescribe any specific procedures that must be followed. Instead, we will continue to analyze this area as practice, procedures and technology evolve, with a view to possible regulatory action in the future. Additionally, the Commission staff will continue to review procedures submitted in connection with online offerings.

2. Online Private Offerings under Regulation D

Broad use of the Internet for exempt securities offerings under Regulation D is problematic because of the requirement that these offerings not involve a general solicitation or advertising.[233] When we first considered whether exempt offerings could be conducted over the Internet, we concluded that an issuer's unrestricted, and therefore publicly available, Internet web site would not be consistent with the restriction on general solicitation and advertising. Specifically, the 1995 Release included an example indicating that an issuer's use of an Internet web site in connection with a purported private offering would constitute a "general solicitation" and therefore disqualify the offering as "private."[234]

Subsequently, the Divisions of Corporation Finance and Market Regulation issued interpretive guidance to a registered broker-dealer and its affiliate, IPONET,[235] that planned to invite previously unknown prospective investors to complete a questionnaire posted on the affiliate's Internet web site "as a means of building a customer base and database of accredited and sophisticated investors" for the broker/dealer.[236] A password-restricted web page permitting access to private offerings would become available to a prospective investor only after the affiliated

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[232]*See Wit Capital Corporation, n. 69 above.*

[233]*See Rule 502(c) of Regulation D, 17 CFR 230.502(c). General solicitation or advertising is prohibited in offerings under Rules 504, 505 and 506 of Regulation D, 17 CFR 230.504, 230.505 and 230.506. An exception to the prohibition against general solicitation applies to some limited offerings under Rule 504(b)(1), 17 CFR 230.504(b)(1), when an issuer has satisfied state securities laws of specified types. See Securities Act Release No. 7644 (Feb. 25, 1999) [64 FR 11090]. The discussion in this section presumably also would apply to private offerings conducted in reliance on the exemption from registration contained in Section 4(2) of the Securities Act.*

Municipal securities issuers and other municipal securities market participants conducting online offerings are directed to our discussion in n. 70 above of the issue that arises if the municipal securities offering also involves an offering of a separate security that is not being sold pursuant to the exemption from registration contained in Section 3(a)(2) of the Securities Act.

[234]*See the 1995 Release, n. 11 above, at Ex. 20.*

[235]*Divisions of Corporation Finance and Market Regulation interpretive letter IPONET (July 26, 1996).*

[236]*Id.*

broker-dealer determined that the investor was "accredited" or "sophisticated" within the meaning of Regulation D.[237] Additionally, a prospective investor could purchase securities only in offerings that were posted on the restricted web site after the investor had been qualified by the affiliated broker-dealer as an accredited or sophisticated investor and had opened an account with the broker-dealer. The Divisions' interpretive letter was based on an important and well-known principle established over a decade ago: a general solicitation is not present when there is a preexisting, substantive relationship between an issuer, or its broker-dealer, and the offerees.[238]

We understand that some entities have engaged in practices that deviate substantially from the facts in the IPONET interpretive letter. Specifically, third-party service providers who are neither registered broker-dealers nor affiliated with registered broker-dealers have established web sites that generally invite prospective investors to qualify as accredited or sophisticated as a prelude to participation, on an access-restricted basis, in limited or private offerings transmitted on those web sites. Moreover, some non-broker-dealer web site operators are not even requiring prospective investors to complete questionnaires providing information needed to form a reasonable belief regarding their accreditation or sophistication. Instead, these web sites permit interested persons to certify themselves as accredited or sophisticated merely by checking a box.

These web sites, particularly those allowing for self accreditation, raise significant concerns as to whether the offerings that they facilitate involve general solicitations.[239] In these instances, one method of ensuring that a general solicitation is not involved is to establish the existence of a "pre-existing, substantive relationship."[240] Generally, staff interpretations of whether a "pre-existing, substantive relationship" exists have been limited to procedures established by broker-dealers in connection with their customers. This is because traditional broker-dealer relationships require that a broker-dealer deal fairly with, and make suitable recommendations to, customers, and, thus, implies that a substantive relationship exists between the broker-dealer and its customers. We have long stated, however, that the presence or absence of a general solicitation is always dependent on the facts and circumstances of each particular case.[241] Thus, there

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[237]*See Rules 501(a) and 506(b)(2)(ii) of Regulation D, 17 CFR 230.501(a) and 230.506(b)(2)(ii).*

[238]*See Division of Corporation Finance interpretive letters Woodtrails-Seattle, Ltd. (Aug. 9, 1982) (providing that no general solicitation exists when an issuer or any person acting on its behalf made offers to investors in prior limited partnerships sponsored by the general partner of the issuer); E.F. Hutton Co. (Dec. 3, 1985) (providing that no general solicitation exists when an offer is made to customers of a broker-dealer because of the broker's pre-existing, substantive relationship with its customers; further, providing that the requisite relationship could be established through a questionnaire providing the broker-dealer with sufficient information to evaluate the offeree's sophistication and financial situation). See also Division of Corporation Finance interpretive letters H.B. Shaine & Co., Inc. (May 1, 1987); Bateman Eichler, Hill Richards, Inc. (Dec. 3, 1985).*

[239]*These web sites would also call into question the ability of an issuer to form a reasonable belief, before sale, as to the qualification of the purchaser, which may be necessary depending on the nature of the exemption. See, for example, Rule 506(b)(2)(ii) of Regulation D. See also Section 3(c)(7) of the Investment Company Act, 15 U.S.C. §80a-3(c)(7).*

[240]*See Securities Act Release No. 6825 (Mar. 15, 1989) [54 FR 11369] at n. 12 ("the staff has never suggested, and it is not the case, that prior relationship is the only way to show the absence of a general solicitation").*

[241]*Id.*

may be facts and circumstances in which a third party, other than a registered broker-dealer, could establish a "pre-existing, substantive relationship" sufficient to avoid a "general solicitation."[242]

Notwithstanding the analysis for purposes of Section 5 of the Securities Act, web site operators need to consider whether the activities that they are undertaking require them to register as broker-dealers. Section 15 of the Exchange Act[243] 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.[244] The "exempted securities" for which broker-dealer registration is not required under Section 15 are strictly limited.[245] They do not include, for example, securities issued under Regulations A, D or S[246] or privately placed securities that would be "restricted" securities under Securities Act Rule 144.[247] Thus, broker-dealer registration generally is required to effect transactions in securities that are exempt from registration under the Securities Act.[248] In other words, third-party service providers that act as brokers in connection with securities offerings are required to register as broker-dealers, even when the securities are exempt from registration under the Securities Act.[249]

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[242] *We encourage web site operators offering these services to work with the Commission staff to resolve any securities law issues raised by their activities. We understand that securities lawyers may have interpreted staff responses to Lamp Technologies, Inc. as extending the "pre-existing, substantive relationship" doctrine to solicitations conducted by third parties other than a registered broker-dealer. See Divisions of Investment Management and Corporation Finance no-action letters Lamp Technologies, Inc. (May 29, 1998) and Lamp Technologies, Inc. (May 29, 1997). We disagree. In the Lamp Technologies no-action letters, the staff of the Divisions of Investment Management and Corporation Finance recognized a separate means to satisfy the "no general solicitation" requirement solely in the context of offerings by private hedge funds that are excluded from regulation as investment companies pursuant to Sections 3(c)(1) and 3(c)(7) of the Investment Company Act, 15 U.S.C. §§80a-3(c)(1) and 80a-3(c)(7).*

[243] *15 U.S.C. §78o.*

[244] *See Section 15(a)(1) of the Exchange Act, 15 U.S.C. §78o(a)(1).*

[245] *See Section 3(a)(12) of the Exchange Act, 15 U.S.C. §78c(a)(12). These "exempted securities" include instruments such as interests or participations in any common trust fund or similar fund maintained by a bank, or certain interests or participations in a single or collective trust fund or securities arising out of a contract issued by an insurance company issued in connection with qualified plans (see Section 3(a)(12)(A)(iii) and (iv) of the Exchange Act, 15 U.S.C. §§78c(a)(12)(A)(iii) and (iv)), as well as mortgage securities (see Exchange Act Rule 3a12-4, 17 CFR 240.3a12-4) and certain designated foreign government securities (see Exchange Act Rule 3a12-8, 17 CFR 240.3a12-8).*

[246] *17 CFR 230.251, et seq., 230.501, et seq. and 230.901, et seq.*

[247] *17 CFR 230.144. The term "exempted securities" for broker-dealer registration purposes under the Exchange Act also does not include securities issued by religious, educational or charitable organizations that are exempt from registration under Section 3(a)(4) of the Securities Act, 15 U.S.C. §§77c(a)(4), or securities that are exempted from registration by means of one of the transactional exemptions found in Section 4 of the Securities Act, 15 U.S.C. §77d.*

[248] *See the IPONET interpretive letter, n. 81 above. The Division of Market Regulation's response in this interpretive letter required that a registered broker dealer maintain overall supervision of IPONET's activities; otherwise, IPONET would have been required to registered as a broker-dealer under Section 15(a) of the Exchange Act. The Commission requests the Division of Market Regulation to consider whether the activities of a web site operator, such as described in the no-action letters to Lamp Technologies, Inc., see n. 88 above, require the web site operator to register with the Commission as a broker-dealer.*

[249] *Staff guidance is available regarding whether a person is a broker-dealer subject to registration with the Commission. Questions on this subject should be addressed to the Office of Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-1001, (202) 942-0073.*

3. Broker-Dealer Capacity

We have noted before that broker-dealers must have adequate facilities and personnel to promptly execute and consummate all of their securities transactions.[250] As broker-dealers increasingly rely on electronic facilities, such as electronic mail and Internet web sites, to handle communications and transactions with their customers, they must have the facilities to handle the expected user volume.[251] Broker-dealers should consider taking steps to maintain their operational capability during high-volume usage (such as when investors transmit electronic indications of interest to purchase securities in online IPOs), and high-volume and high-volatility trading days (such as the immediate aftermarket trading following an IPO).[252]

D. Technology Concepts

Each technological advance brings changes to the structure of the capital markets and the securities industry. While we believe that the guidance provided in this release will be useful in the near term, we also recognize that we will need to reexamine our regulatory system and interpretive guidance as technology evolves. We will continue to examine and consider the removal of regulations that pose unnecessary barriers to electronic commerce and maintain those regulations that are essential to protect investors. In that regard, we request comment below on specific issues that may arise in the future in several areas. We also solicit comment on whether there are issues involving electronic media under the federal securities laws that we have not identified.

1. Access Equals Delivery

Various commentators have suggested that additional regulatory changes may be warranted in the use of electronic media for delivery purposes. The 1995 Release stated that issuers and market intermediaries with delivery obligations would need to continue to make information available in paper form until such time as electronic media became more universally accessible and accepted.[253] Some believe that this time has come and, therefore, that we should shift from the present delivery model to an "access equals-delivery" model. Under the latter model, investors would be assumed to have access to the Internet, thereby allowing delivery to be accomplished solely by an issuer posting a document on the issuer's or a third-party's web site.

We believe that the time for an "access-equals-delivery" model has not arrived yet. Internet access is more prevalent than in 1995, but many people in this country still do not enjoy the benefits of ready access to electronic media.[254] Moreover, even investors who are online are unlikely to rely on the Internet as their sole means of obtaining information from issuers or intermediaries

[250]*See Exchange Act Release No. 8363 (July 29, 1968) [33 FR 11150]. See also Exchange Act Release No. 15194 (Sept. 28, 1978) [43 FR 46397]; Exchange Act Release No. 6778 (Apr. 16, 1962) [27 FR 3991].*

[251]*See In the Matter of Lowell H. Listrom, 50 SEC 883, 887 n. 7 (1992).*

[252]*See Division of Market Regulation Staff Legal Bulletin No. 8 (Sept. 9, 1998), available on our Internet web site at <http://www.sec.gov/rules/othern/slbmr8.htm>.*

[253]*See the 1995 Release, n. 11 above, at n. 16 and the accompanying text.*

[254]*See, for example, Richard S. Dunham, Across America, A Troubling "Digital Divide," Bus. Wk., Aug. 2, 1999, at 40; Michelle Singletary, "Digital Divide" Isn't Just about Internet Access, The Wash. Post, Aug. 22, 1999, at H-1.*

with delivery obligations.[255] Some investors decline electronic delivery because they do not wish to review a large document on their computer screens. Others decline electronic delivery because of the time that it takes to download and print a document.

We request comment, however, as to whether there are circumstances in which, consistent with investor protection, an "access-equals-delivery" model might be appropriate. How many U.S. households currently have Internet access? Is there data supporting the conclusion that most investors have access to the Internet? Similarly, is there data supporting the belief that investors who are online will rely on the Internet as their sole means of obtaining information from issuers or intermediaries? Assuming that this data exists, how will investors know when disclosure information has been posted on an issuer's web site? If we were to adopt an "access-equals-delivery" model, would we be creating a system that requires ownership of a late-model, sophisticated computer to participate in the securities markets?

We also request comment on whether the disadvantages of electronic delivery, such as lengthy downloading time and system capacity limitations, are likely to be reduced or eliminated in the near future. Also, will documents delivered online be more readable in the future?

2. Electronic Notice

The 1995 and 1996 Releases stated that notice of the availability of electronically delivered disclosure documents must be delivered directly to each investor. The 1995 Release further stated that notice on an Internet web site and otherwise by publication in a newspaper is insufficient to alert a consenting investor of the availability on a web site of a disclosure document.[256]

We continue to believe that direct notice of the availability of electronic disclosure documents is necessary unless an issuer or market intermediary can otherwise establish that delivery has been made. For example, a broker/dealer cannot meet its confirmation obligation under Exchange Act Rule 10b-10[257] by simply placing a notice on its web site that a customer must "pull" down to access. Rather, a Rule 10b-10 confirmation must be sent directly to the broker-dealer's customer. Additionally, messages posted to an investor's account at his or her broker-dealer's web site regarding the availability of electronic disclosure documents are insufficient, unless they are promptly forwarded directly to the investor. We request comment, however, as to whether changes in the sophistication and expectations of Internet users as well as advances in

[255]*See Andy Serwer, A Nation of Traders, Fortune, Oct. 11, 1999, at 116, 120 (quoting Charles Schwab CEO David S. Pottruck as saying `[c]ustomers want a variety of [information] distribution channels . . . . face to face, the mail, the telephone and the Web.'"). Additionally, the National Association of Securities Dealers, Inc. has recognized that the Internet is not sufficient to serve as the sole means of disseminating material corporate information. In January 1999, we issued an order granting approval of a rule change by the NASD that stipulated that the Internet may not be a substitute for the dissemination of corporate news to security holders through traditional news services. See Exchange Act Release No. 40988 (Jan. 28, 1999) [64 FR 5331]. In that release, we explained that "[w]hile Nasdaq believes that it is generally in the public interest to encourage widespread dissemination of information to investors through the Internet, it also believes that it must maintain a level playing field for all investors, including those who do not have Internet access or who may not generally rely on the Internet as their primary source of material corporate news."*

[256]*See the 1995 Release, n. 11 above, at Ex. 24.*

[257]*17 CFR 240.10b-10.*

Internet technology warrant re-evaluation of our position on whether account messages on an Internet web site provide sufficient notice. Were we to adopt such an approach, would it result in shifting the burden from issuers to notify security holders of the availability of electronic disclosure documents to security holders to search for material information? Would a burden shift be consistent with our investor protection mandate?

3. Implied Consent

In lieu of "access-equals-delivery," some commentators have argued for changes to our electronic delivery scheme, particularly with respect to investor consent to electronic delivery. We understand that obtaining investor consent poses the most significant barrier to the use of electronic delivery by issuers and market intermediaries.[258] Some have suggested that electronic delivery would be more common if issuers and intermediaries with delivery obligations were permitted to use a form of implied consent to evidence satisfaction of delivery. Under an implied consent model, an issuer could rely on electronic delivery if investors do not affirmatively object when notified of the issuer's or intermediary's intention to deliver documents in an electronic format. Proponents of implied consent argue that the difficulties in obtaining investors' consents to electronic delivery result not from the unwillingness of investors to use an electronic medium, but rather from investors' inattention to requests for affirmative consent.

We are concerned that investors would be significantly and adversely affected by implied consent through their inadvertent failure to object. We understand that in many circumstances investors are not inattentive to requests for consent to electronic delivery, but rather, purposely do not consent.[259] Thus, we generally believe that it would not be appropriate for issuers or intermediaries to rely on implied consent.[260] We request comment, however, as to whether there are particular circumstances under which an implied consent model would be appropriate.[261] For example, would it be appropriate where investors previously have provided an electronic mail

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[258] *See Alexander C. Gavis & Scott Maylander, Mutual Funds and Electronic Delivery: Promise Versus Reality, wallstreetlawyer.com, Feb. 1999, at 1.*

[259] *For a discussion of the impediments to electronic delivery, see n. 101 above and the accompanying text.*

[260] *We set forth alternative procedures in the 1995 Release enabling an issuer to satisfy the evidence-of delivery element without obtaining informed consent, but only where there is some other indication that the document was in fact received. See the 1995 Release, n. 11 above. None of these procedures, however, permits an issuer or intermediary with delivery obligations to assume consent based upon an investor's inaction. In contrast, the 1996 Release provided that an issuer could presume consent to electronic delivery by employee-security holders who use the electronic mail system "in the ordinary course of performing their duties and ordinarily are expected to log-on to electronic mail routinely to receive mail and communications." See the 1996 Release, n. 15 above, Ex. 1. This interpretation still stands, but we do not extend it to other situations.*

[261] *We recently adopted rules that allow issuers and broker-dealers to rely on implied consent to "householding" of prospectuses and security holder reports; that is, delivery of a single prospectus or report to two or more investors that are members of the same family and share the same residential address. See Securities Act Release No. 7766 (Nov. 4, 1999) [64 FR 62540]. Under these rules, consent to householding can be implied only if adequate advance notice is given to the investors and they do not object. Due to concerns expressed by commentators, our rules permit householding to a shared electronic address only if the investors consent in writing. Id. We have proposed similar rules for delivery of proxy and information statements to households. See Securities Act Release No. 7767 (Nov. 4, 1999) [64 FR 62548].*

address to an issuer or intermediary and have indicated that electronic mail is one of their methods of communication for investing purposes? How would the fact that investors sometimes change their electronic mail addresses affect an implied consent model?

4. Electronic-Only Offerings

The 1995 Release stated that, as a matter of policy, issuers and market intermediaries with delivery obligations would need to continue to deliver paper copies of documents that are required to be delivered until such time as electronic media becomes more universally accessible and accepted.[262] This policy, however, does not preclude "electronic-only" offerings. In an "electronic only" offering, investors are permitted to participate only if they agree to accept electronic delivery of all documents in connection with the offering. The 1995 Release provided that an issuer could structure its offering as one that would be effected entirely through electronic media.[263] Even in these offerings, however, an issuer or intermediary must provide the required documents in paper form if an investor revokes his or her consent before valid delivery is made. Additionally, the 1995 and 1996 Releases both provided that a paper copy of information previously delivered electronically should be delivered whenever an investor so requests, even when the revocation is made after electronic delivery or there has been no revocation at all.[264]

Should the paper back-up system be required for offerings where participation is conditioned upon consent to electronic-only delivery?[265] If not, would there be any adverse effects? Would we be creating a two tiered system with access to some offerings available only to investors with Internet access? Should an issuer be permitted to require investors to pay for paper delivery when they have consented to electronic-only delivery? If the paper back-up system were no longer required, how should investors be advised of any payment requirement and any attendant risks? In the event of technical difficulties, how would issuers and intermediaries comply with their delivery obligations, other than by providing paper delivery? Should there be an exception to paper delivery where technological difficulties would prevent electronic delivery in a timely manner? What disclosures should be included in the notice to investors? If the paper back-up system were no longer required generally, are there any particular types of offerings, such as dividend reinvestment and direct stock purchase plans, or DRSPPs, where the paper back-up system should be retained?

If the paper back-up system were no longer required for public offerings, how would issuers meet their prospectus delivery requirements for secondary market trading?[266] Should an issuer be permitted to condition participation in offerings upon consent to electronic delivery of all

[262] *See the 1995 Release, n. 11 above, at n. 16 and the accompanying text.*

[263] *Id. at n. 27. Companies conducting public offerings must consider prospectus delivery requirements for secondary market trading under Securities Act Rule 174, 17 CFR 230.174. Id.*

[264] *See the 1995 Release, n. 11 above, at n. 27 and the accompanying text and the 1996 Release, n. 15 above, at n. 17 and the accompanying text.*

[265] *This could arise either when an issuer is conducting an electronic-only offering, or when an issuer is conducting a traditional offering, but certain members of the underwriting syndicate that are online brokers offer only electronic delivery.*

[266] *See Securities Act Rule 174.*

required Exchange Act reports? If not, should an issuer be required to obtain a separate consent from security holders in the newly public issuer in order to permit electronic-only delivery of required Exchange Act reports?

For a mutual fund, would there be any potential adverse effects of limiting electronic-only offerings to investors who provide an irrevocable consent to electronic delivery of all future disclosure documents, including shareholder reports, proxy solicitation materials and prospectuses provided in connection with the purchase of additional fund shares?

5. Access to Historical Information

One of the unique characteristics of the Internet is the continuous availability of information once it is posted on a web site. For example, a press release disseminated over a wire service or through other customary means is considered to have been "issued" once, and thereafter is not recirculated to the marketplace. The same press release posted on an issuer's web site potentially has a longer life because it provides a record that can be accessed by investors at any time and upon which investors potentially could rely when making an investment decision without independent verification. In effect, a statement may be considered to be "republished" each time that it is accessed by an investor or, for that matter, each day that it appears on the web site.

Commentators have suggested that if a statement is deemed to be republished, it may potentially give rise to liability under Section 10(b) of the Exchange Act and Rule 10b-5.[267] We request comment on how to facilitate the availability of historical information on the Internet consistent with the federal securities laws. Additionally, how can technology help minimize investor confusion while providing for the accessibility of potentially useful information?

6. Communications When in Registration

Although we believe that our long-standing guidance on permissible communications is adequate to address many of the questions applicable to an issuer's web site content when in registration, we recognize that the Internet has spawned new types of businesses that do not easily fit within the existing disclosure framework. For example, many issuers not only use their web sites to conduct business through the Internet, their web sites are their businesses. In this instance, when an issuer is in registration, how should the issuer segregate its business activities from its offering activities? In other words, how can an issuer comply with its obligations under Section 5 of the Securities Act while maintaining communications to the marketplace related solely to its legitimate business activities?

Are there special considerations for mutual funds because they continuously offer and sell their shares to the public and, therefore, always maintain effective registration statements? For a mutual fund that continuously offers its shares, what, if any, facts and circumstances should

[267] *See, for example, Mary Lou Peters, Avoiding Securities Law Liability for a Company's Web Site, Insights, April 1999, at 16; Steven E. Bochner & Anita S. Presser, Corporate Disclosure in the Electronic Age: The Web Site—Opportunities and Pitfalls, wallstreetlawyer.com, Apr. 1998, at 1.*

overcome the strong inference[268] that hyperlinked information on a third-party web site that meets the definition of an "offer to sell," "offer for sale" or "offer" under Section 2(a)(3) of the Securities Act is attributable to an issuer for purposes of anti-fraud liability?

7. Internet Discussion Forums

Another distinguishing characteristic of the Internet is its facility for interactive discussion. This discussion can, and does, cover virtually any subject, including issuers and their securities. In the corporate context, at least three different means of Internet "discussions" have evolved. First, many web sites offer moderated discussion forums, typically led by a real-time moderator and featuring a guest "expert." Other web sites contain "bulletin boards," cyberspace message centers where comments concerning issuers, securities or industries can be posted and saved for viewing over an extended period of time. Finally, numerous web sites host discussion groups, or "chat rooms," with real-time postings and viewing by participants on a wide variety of topics.

These discussion forums present unique and often difficult problems for issuers.[269] We request comment on any issues relating to Internet discussion forums. In particular, what effect, if any, do discussion group communications have on an issuer's stock price? In addition, should issuers or broker-dealers that host online discussion forums adopt and maintain "best practices" for participation in these forums? If so, who should establish these best practices, and what should be included in them?

Another area of significant concern involves the use of Internet discussion forums by an issuer's employees. Are issuers currently using specific procedures covering the use of electronic forms of communications by their employees? If so, what are these "best practices"?

E. Examples

A series of examples is provided below to illustrate various applications of the interpretations outlined in this release and to provide guidance in applying them to specific facts and circumstances. We note, however, that these examples are non-exclusive methods of ways to comply with the above interpretations. Additionally, the analysis required to determine compliance with the federal securities laws is fact-specific, and any different or additional facts might require a different conclusion. We request comment on whether other examples might be appropriate for publication.

(1) Investor John Doe gives XYZ Delivery Service his informed consent over the telephone using automated touch tone instructions (after accessing the service using a personal identification number).[270] The automated instructions informed John Doe of the manner, costs and risks of electronic delivery. The consent related to electronic delivery of documents. Before deliv

[268] *See n. 66 above and the accompanying text.*

[269] *See the Unger Report, n. 2 above, at 75.*

[270] *This example and Example 2 represent alternative ways of recording a telephonic consent. These examples are not the only ways to comply with the interpretation.*

ering any electronic documents to Investor John Doe, XYZ Delivery Service sends Investor John Doe a letter confirming that he had consented to electronic delivery.

The confirming letter sent by XYZ Delivery Service provides assurance that John Doe consented to the same extent as if he had provided a written or electronic consent. Thus, XYZ Delivery Service's procedures would evidence satisfaction of delivery. We also note that XYZ Delivery Service has reason to be assured of the authenticity of John Doe's telephonic consent because of his use of a personal identification number.

(2) In speaking with Broker DEF over the telephone, Investor Jane Doe (a long-term customer of Broker DEF) consents to electronic delivery to all future documents of Company XYZ on Company XYZ's Internet web site. Broker DEF agrees to notify Jane Doe by electronic mail (or other acceptable means of notification) that Company XYZ has posted the documents on its web site when the posting occurs. Before obtaining Jane Doe's consent, Broker DEF advises Jane Doe that she may incur certain costs associated with delivery in this manner (for example, online time and printing) and possible risks (for example, system outages). Broker DEF also advises Jane Doe that the term of the consent is indefinite but that the consent can be revoked at any time. Broker DEF maintains a signed and dated memorandum in its files regarding the details of the conversation.

In this situation, Jane Doe's consent would be informed regarding the manner, costs and risks of electronic delivery. We also note that Broker DEF has reason to be assured of the authenticity of Jane Doe's telephonic consent because Jane Doe is well known to Broker DEF.

(3) In seeking a global consent to electronic delivery from Investor John Doe, Broker DEF specifies that the electronic media that may be used to deliver documents will be CD-ROM, an Internet web site, electronic mail or facsimile transmission, and further advises John Doe that if he does not have access to all of these media he should not consent to electronic delivery. John Doe consents to electronic delivery from Broker DEF.

In this situation, John Doe's consent would be informed regarding the manner of electronic delivery. The consent need not specify which form of media a specific issuer may use.

(4) Investor Jane Doe consents to delivery via a third-party delivery service's Internet web site of all future documents of Company ABC, Company XYZ and any additional companies in which she invests in the future. Jane Doe subsequently purchases securities of Company DEF. Thereafter, Company XYZ and Company DEF post their final prospectuses on the third party web site and notify Jane Doe by electronic mail (or other acceptable means of notification) of the availability of the prospectuses. Company ABC does not post its prospectus on the third-party web site but delivers a CD-ROM version of its prospectus.

Company XYZ has satisfied its delivery obligations. Additionally, although not specifically identified in the consent, Company DEF has satisfied its delivery obligations because the consent covered delivery by companies added at a later date. Absent other factors indicating that Jane

Doe actually accessed Company ABC's CD-ROM prospectus, however, Company ABC's procedure would not satisfy its delivery obligations because Jane Doe consented to delivery only by an Internet web site. If consent is to be relied upon, the consent must cover the specific electronic medium or media that may be used for delivery.

(5) Investor John Doe consents to delivery of all future documents of Company XYZ electronically via Company XYZ's Internet web site, including documents delivered in PDF. The form of consent advises John Doe of the system requirements necessary for receipt of documents in PDF and cautions that downloading time may be slow. Company XYZ places its proxy soliciting materials and annual report to security holders in PDF on its Internet web site, with a hyperlink on the same screen enabling users to download a free copy of Adobe Acrobat (software permitting PDF viewing) and a toll-free telephone number that investors can use to contact someone during Company XYZ's business hours for technical assistance or to request a paper copy of a document.

Company XYZ has satisfied its delivery obligations. Under these circumstances, John Doe can effectively access the information provided.

(6) Company XYZ, which is engaged in a public offering of its securities, places its preliminary prospectus on its Internet web site. In the Business section of the prospectus, Company XYZ has placed a hyperlink to a report by a marketing research firm located on a third-party web site regarding Company XYZ's industry.

Because the hyperlink is embedded within the prospectus, the report becomes a part of the prospectus and must be filed with the Commission. In addition, Company XYZ must obtain a written consent from the person preparing the report in accordance with Securities Act Rule 436. This consent also must be filed with the Commission. Moreover, the report will be subject to liability under Section 11 of the Securities Act, as well as other antifraud provisions of the federal securities laws.

(7) Company XYZ, which is engaged in a public offering of its securities, places its preliminary prospectus on its Internet web site. Each of the topics in the Table of Contents is a hyperlink, allowing investors to pick a topic and immediately be hyperlinked to the section in the prospectus relating to that topic.

The hyperlinks present no federal securities law issues. The hyperlinks do no more than allow investors to turn electronically to a specific page in the prospectus.

(8) Company XYZ, which is engaged in a public offering of its securities, places its preliminary prospectus on its Internet web site. Immediately following the button for the prospectus on the web site, Company XYZ offers investors the ability to download its financial statements in spreadsheet format. This financial information is not modified in any way from that contained in the filed document.

The provision of financial statements in spreadsheet format would be permissible when the download results only in a mere difference in format without any difference in text. The completeness of the financial statements must not be compromised by any difference in the electronic version from the paper version.

III. Solicitation of Comment

We invite anyone who is interested to submit written comments on this release. We request comment not only on the specific issues discussed in this release, but also on any other approaches or issues involved in facilitating the use of electronic media to further the disclosure purposes of the federal securities laws. We request comment from the point of view of both parties providing the disclosure, such as issuers and those acting on behalf of issuers, and parties receiving and using the disclosure, such as investors and security holders.

By the Commission.

Jonathan G. Katz
Secretary

Dated: April 28, 2000

COMMISSION GUIDANCE ON THE USE OF COMPANY WEB SITES

[Release Nos. 34-58288, IC-28351]

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation; solicitation of comment.

SUMMARY: We are publishing this interpretive release to provide guidance regarding the use of company web sites under the Exchange Act and the antifraud provisions of the federal securities laws. We are soliciting comment on issues relating to company use of technology generally in providing information to investors.

DATES: Effective Date: August 7. 2008.

Comment Date: Comments should be received on or before November 5. 2008.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/interp.html); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-23-08 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Secretary. Securities and Exchange Commission, 100 F Street, NE, Washington. DC 20549-1090.

All submissions should refer to File Number S7-23-08. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's web site (http://www.sec.gov/rules/interp.html). Comments are also available for public inspection and copying in the Commission's Public Reference Room. 100 F Street, NE. Washington. DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change: we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Jeffrey Cohan. Kim McManus or Mark Vilardo. Special Counsels in the Office of Chief Counsel, Division of Corporation Finance, at (202) 551-3500. 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

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I. Introduction and Overview

A. Introduction

In its February 2008 Progress Report, the Federal Advisory Committee on Improvements to Financial Reporting recommended that we provide more guidance as to how companies can use their web sites to provide information to investors in compliance with the federal securities laws, particularly with respect to the Securities Exchange Act of 1934 (the "Exchange Act").[271] Prompted, in part, by this report, we believe that to encourage the continued development of company web sites as a significant vehicle for the dissemination to investors of important company information, it is an appropriate time to provide additional Commission guidance specifically addressing company web sites.[272] While we addressed certain discrete Internet issues relating to the Securities Act of 1933 (the "Securities Act") in 2005,[273] we last provided guidance in 2000 on the electronic delivery of disclosure documents, company liability for web site content, as well as other matters.[274] We noted then that, given the speed at which technological advances are developing, and the translation of those technologies into investor tools, we expected to revisit the guidance provided at that time in order to update and supplement it as appropriate.[275]

Given the development and proliferation of company web sites since 2000, and our expectation that continued technological advances will further enhance the quality, not just the quantity, of information delivered and available to investors on such web sites, as well as the speed at which such information reaches the market, we are issuing this interpretive release[276] to provide additional guidance on the use of company web sites with respect to the antifraud provisions and certain relevant Exchange Act provisions of the federal securities laws.[277] Our guidance focuses principally on:[278]

- When information posted on a company web site is "public" for purposes of the applicability of Regulation FD;

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[271] *See Progress Report of the SEC Advisory Committee on Improvements to Financial Reporting. Release No. 33-8896 (Feb. 14. 2008)("CIFiR Progress Report"), available at http://www.sec.gov/rules/other/2008/33-8896.pdf.*

[272] *In this release the term "company web site" and the use of the term "web site" in the context of companies refer to public (Internet) company sites, as distinguished from private (intranet) sites. A company web site is maintained by or for the company and contains information about the company.*

[273] *See Securities Offering Reform. Release No. 33-8591 (Aug. 3. 2005) [70 FR 44721] ("Securities Offering Reform Release").*

[274] *See Use of Electronic Media. Release No. 33-7856 (Apr. 28. 2000) [65 FR 25843] ("2000 Electronics Release").*

[275] *See id. At Section II.D.*

[276] *We do not view the guidance in this release as a delineation of the outer limits of how technology can or should be used on company web sites.*

[277] *In addition to the Exchange Act. companies must also consider whether their web sites may involve issues under the Securities Act. which we discussed in our 2000 Electronics Release. For example, a company in registration must consider the application of Section 5 of the Securities Act to all of its communications with the public including information on a company's web site. See 2000 Electronics Release, supra note 4. This consideration is important with regard to any company engaged in offering and selling its securities, including companies engaged in continuous offerings of their securities, such as mutual funds. Because our rules adopted as part of Securities Offering Reform in 2005 answered many of the key issues relating to company web site use under the Securities Act. this release will focus on the antifraud provisions and certain Exchange Act provisions only. See Securities Offering Reform Release, supra note 3: Securities Act Rule 433 [17 CFR 230.433].*

[278] *For purposes of this release generally, we are using the term "company" to refer to entities that are corporations, partnerships and other types of registrants subject to the periodic reporting and antifraud provisions of the Exchange Act, including registered investment companies.*

- Company liability for information on company web sites—including previously posted information, hyperlinks to third-party information, summary information and the content of interactive web sites;
- The types of controls and procedures advisable with respect to such information; and
- The format of information presented on a company web site, with the focus on readability, not printability.

We have long recognized the vital role of the Internet and electronic communications in modernizing the disclosure system under the federal securities laws and in promoting transparency, liquidity and efficiency in our trading markets.[279] Central to the effective operation of our trading markets is the ongoing dissemination of information by companies about themselves and their securities. A reporting company's reports that it files under the Exchange Act and other publicly available information form the basis for the market's evaluation of the company and the pricing of its securities, and investors in the secondary market use that information in making their investment decisions.

Ongoing technological advances in electronic communications have increased both the markets' and investors' demand for more timely company disclosure and the ability of companies to capture, process and disseminate this information to market participants. Indeed, one of the key benefits of the Internet is that companies can make information available to investors quickly and in a cost-effective manner. Recently, we noted that approximately 80% of investors in mutual funds in the United States have access to the Internet in their homes.[280] Investors are turning increasingly to electronic media and to company and third-party web sites as sources of information to aid in their investment decisions, particularly since many types of investment- re-

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[279] *See, e.g. The Impact of Recent Technological Advances on the Securities Markets (Sept. 1997) (available at* ***http://www.sec.gov/news/studies/techrp97.html****). In this report, we stated that we were mindful of the benefits of increasing use of new technologies for investors and the markets, and have encouraged experimentation and innovation by adopting flexible interpretations of the federal securities laws. We noted that our approach has balanced the goals of promoting the benefits of electronic media, with the need to protect investors and the integrity of the markets from fraud and abuse. We also emphasized the importance of continued coordination with market participants and federal, state and international regulators as technological advances develop. See also Securities Offering Reform Release, supra note 3.*

[280] *See Internet Availability of Proxy Materials. Release No. 34-55146. at Section I (Jan. 22, 2007) [72 FR 4147] ("Internet Proxy Release"). The Investment Company Institute reported that, in 2006. 92% of mutual fund shareholders had Internet access. See Sandra West & Victoria Leonard-Chambers. Ownership of Mutual Funds and Use of the Internet. 2006. Investment Company Institute Research Fundamentals (Oct. 2006). available at* ***http://ici.org/stats/res/fm-vl5n6.pdf****. In 2005. that figure was at 88%. Additionally, the Investment Company Institute reported that 79% of all U.S. adults had Internet access in 2005. See Sandra West & Victoria Leonard-Chambers. Mutual Fund Shareholders' Use of the Internet. 2005. Investment Company Institute Research Fundamentals (Feb. 2006). available at* ***http://www.ici.org/pdf/fm-vl5n2.pdf****. According to the Pew Internet & American Life Project, as of an October-December 2007 survey. 75% of adults use the Internet See* ***http://www.pewinternet.org/trends/User Demo_2.t5.08.htm.***

lated company information are available only in electronic form. We believe that the Internet has helped to transform the trading markets by enabling many retail investors to have ready access to company information.[281]

Through the years, we have taken a number of steps to encourage the dissemination of information electronically via the Internet, as we believe that widespread access to company information is a key component of our integrated disclosure scheme, the efficient functioning of the markets, and investor protection. Today, all companies must make their Commission filings electronically through our Electronic Data Gathering. Analysis and Retrieval ("EDGAR") system,[282] and we provide free access to EDGAR on a real-time basis through our Internet web site. www.sec.gov.[283] In addition to our ongoing efforts to improve and modernize EDGAR, we have encouraged, and recently proposed requiring,[284] companies to provide financial information on EDGAR in interactive data files, which would make financial information easier for investors to analyze, as well as help automate regulatory filings and business information processing. We also proposed rule amendments requiring mutual funds to provide certain key information from their prospectuses in interactive data format.[285] Interactive data has the potential to increase the speed, accuracy and usability of financial and other disclosure, and eventually to reduce costs.[286]

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[281] *See, e.g. Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports. Release No. 3.1-8128. at Section II.D.1 (Sept. 5.2002) [67 FR 58480] ("Accelerated Periodic Report Filing Release") ("Online access to Internet information also helps to democratize the capital markets by enabling many small investors to access corporate information.").*

[282] *A limited number of forms continue to be permitted to be filed in paper. For example, we permit paper filing of Form 1-A [17 CFR 239.90] and Form 144 [17 CFR 239.144]. In addition. SEC registered investment advisers make some of their filings electronically through the Investment Adviser Registration Depository.*

[283] *Since 1983, when the Commission first began to develop an electronic disclosure system, we have been continually improving and modernizing electronic access to companies' Commission filings, as well as requiring more forms to be filed electronically rather than in paper. The pilot program for EDGAR was established in the early 1980s pursuant to a Congressional mandate and the system was fully implemented, effective January 30. 1995. For a summary of the development of EDGAR, see the staff's report. "Electronic Filing and the EDGAR System: A Regulatory Overview." (Oct. 3. 2006). available at http://www.sec.gov/info/edgar/regoverview.htm.*

[284] *On May 30, 2008, we published proposed rule amendments requiring companies to provide their financial statements, including financial statement footnotes and schedules, in interactive data format on EDGAR. The proposed rules would require a company to provide such interactive data in its annual and quarterly reports, transition reports, and Securities Act registration statements. Companies that maintain web sites also would be required to post this new interactive data on their web sites. See Interactive Data to Improve financial Reporting. Release No. 33-8924 (May 30, 2008) [73 PR 32794] ("Interactive Data Proposing Release").*

[285] *See Interactive Data For Mutual Fund Risk/Return Summary. Release No. 33-8929 (June 10, 2008) [73 FR 35442] ("Mutual Fund Interactive Data Proposing Release." together with the Interactive Data Proposing Release supra note 14, the "Interactive Data Proposing Releases").*

[286] *Companies create interactive data files by defining or "tagging"—their financial statements using elements and labels from a standard list of interactive data tags. Data tagging provides a format for enhancing financial and other reporting data using electronic formats such as eXtensive Mark-Up Language (XML) and its derivatives, such as eXtensive Business Reporting Language (XBRL). General information concerning interactive data is available on our web site at http://www.sec.gov/spotlight/xbrl.shtml. See also XBRL Voluntary Financial Reporting Program on the EDGAR System, Release No. 33-8529 (Feb. 3. 20051 [70 FR 6556]; and Extension of Interactive Data Voluntary Reporting Program on the EDGAR System to Include Mutual Fund Risk/Return Summary Information, Release No. 33-8823 (July 11. 2007) [72 FR 39290].*

As we have developed EDGAR to facilitate and promote electronic availability of information, we also have encouraged companies to make their Commission filings and other company information available on their web sites. We believe that company disclosure should be more readily available to investors in a variety of locations and formats to facilitate investor access to that information. Although our rules do not require reporting companies to establish or maintain web sites, our rules do promote and. in some cases require, companies to use web sites to make required disclosures.[287]

A company's web site is an obvious place for investors to find information about the company,[288] and a substantial majority of large public companies already provide access to their Commission filings through their web sites.[289] Technological advances, and the reduced costs associated with the implementation of technologies over time, now allow companies to include more "interactive" and current information on their web sites than was the case previously, thereby moving web sites away from the filing cabinet or "static" paradigm to a "dynamic" paradigm, one shaped by the market's desire for more current, searchable and interactive information.[290] We recognize that allowing companies to present data in formats different from those dictated by our forms or more technologically advanced than EDGAR may be beneficial to investors.[291] Indeed, because we recognize the enormous potential for the Internet to promote the

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[287]*See Section I.B. infra. See also Exchange Act Section l6(a)(4)(C) [15 U.S.C. 78(p)(a)(4)(C)]. This section was enacted pursuant to the Sarbanes-Oxley Act of 2002 [Pub. L. No. 107-204, 116 Stat. 745 (2002)] and requires that companies post Section 16 reports on their web site if they maintain one. Section 16(a)(4)(C) evidences Congress's recognition of the informational utility of company web sites. While our rules do not require companies to establish web sites, the New York Stock Exchange does require its listed companies, with certain exceptions, to establish and maintain their own web sites. See NYSE Listed Company Manual. Section 303A.14.*

[288]*Since their first appearance on the World Wide Web, company web sites typically have included copies of Commission filings or a hyperlink to the Commission's EDGAR database, along with certain other previously posted historical information, such as earnings releases. Some companies also have provided limited "real-time" information, such as stock data links, for a discussion of the content of company web sites in 1998 and prior years, see generally Robert Prentice et al. Corporate Website Disclosure and Rule 10b-5: An Empirical Evaluation, 36 Am. Bus. L.J.531 ("Prentice"); Howard M. Friedman, Securities Regulation in Cyberspace §10.01 (3rd ed. Supp. 2006) ("Friedman").*

[289]*A 2002 study by our Office of Economic Analysis revealed that approximately 83% of companies with a public float of at least $75 million (other than registered investment companies! provide some form of access to their Commission filings through their web sites, either via a hyperlink with a third-party service providing real-time access to the filings (45%). by posting the filings directly on their web sites (29%) or via a hyperlink to our EDGAR database (15%). See Accelerated Periodic Report Filing Release, supra note 11.*

[290]*For example, web pages created in a "dynamic" format, such as "active server page," are database driven, permitting automatic updating of the content. This differs from the traditional, "static" HTML pages that can only be altered by the webmaster. "Push" technology, such as e-mail alerts or "RSS" feeds, enables the automatic, electronic dissemination of new information on the site to subscribers. "Interactive" investor-related tools and functionality, such as "blogs" and electronic shareholder forums, promote direct communications with companies, their officers and other representatives.*

[291]*As we noted in a recent release. Shareholder Choice Regarding Proxy Materials, Release No. 34-56135. at Section VI.C.1 (Jul. 26.2007) [73 FR 42221) ("Shareholder Choice Release"): "Information in electronic documents is often more easily searchable than information in paper documents. Shareholders will be better able to go directly to any section of the document that they are particularly interested in. The amendments also will permit shareholders to more easily evaluate data and transfer data using analytical tools such as spreadsheet programs. Such tools enable users to compare relevant data about several companies more easily."*

goals of the federal securities laws,[292] we wish to continue to encourage companies to develop their web sites in compliance with the federal securities laws so that they can serve as effective information and analytical tools for investors.[293] Enhanced company web site presentation of information can benefit investors of all types by enabling them to gather information about a company at a level of detail they believe is satisfactory for their purposes.[294]

B. Overview of Exchange Act Rules on the Use of Company Web Sites

We have issued a series of interpretive releases and rules that promote the use of company web sites as a means for companies to communicate and provide information to investors under the Securities Act and the Exchange Act.[295] A fundamental principle underlying these interpretations and rules is that, where access is freely available to all, use of electronic media is at least equal to other methods of delivering information or making it available to investors and the market. Further, we have recognized that, in some cases, allowing companies to provide information on their web sites has advantages for investors over mandating that EDGAR serve as the exclusive venue and format for company disclosures.[296] Indeed, today we have reached a point where the availability of information in electronic form—whether on EDGAR or a company web site—is the superior method of providing company information to most investors, as compared to other methods.

Our rules and interpretations that promote the use of web sites generally work in two different respects. First, when delivery of documents is required under the federal securities laws, we have encouraged the delivery in electronic format or recognized that electronic access can satisfy delivery—hence, prospectuses and proxy materials can be delivered or otherwise made available

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[292] *See, e.g., SEC v. Capital Gains Research Bureau. Inc., 37S U.S. 180, 186 (1963) (explaining that the purpose common to the securities laws was to "substitute a philosophy of full disclosure for the philosophy of caveat emptor").*

[293] *While EDGAR and the Commission's web site continue to serve as the core source of companies' securities-related information online, we recognize that the technological capacities of company web sites may allow for presentation and manipulation of large quantities of data in ways that exceed EDGAR's current capacities. For example, while the recently introduced RSS feed on the Commission's web site allows access to documents in interactive data format in the pilot program, some commercial and company web sites enable users to receive the filings of companies of their choice.*

[294] *In discussing the use of company web sites to provide information in a tiered formal, the Federal Advisory Committee on Improvements to Financial Reporting recently observed in its February 2008 Progress Report: "A valuable element of many of such [company] web site presentations is that they present the most important general information about a company on the opening page, with embedded links that enable the reader to drill down to more detail by clicking on the links. In this way. viewers can follow a path into, and thereby obtain increasingly greater details about, the financial statements, a company's strategy and products, its management and corporate governance, and its many other areas in which investors and others may have an interest." See CIFiR Progress Report, supra note I.*

[295] *See generally 2000 Electronics Release, supra note 4; Use of Electronic Media for Delivery Purposes, Release No. 33-7233 (Oct. 6. 1995) [60 FR 53458] ("1995 Electronics Release"): Use of Electronic Media by Broker-Dealers, Release No. 33-7288 (May 9. 1996) [61 FR 24643] ("1996 Electronics Release").*

[296] *See, e.g., Regulation G [17 CFR 244.100]; Instruction 2 to Item 407(b)(2) of Regulation S-K [17 CFR 229.407(b)(2)]; Exchange Act Rule 12d-2(c)(2)(iii) [17 CFR 240. 12d-2(c)(2)(ii)]. See generally Accelerated Periodic Report Filing Release, supra note 11, at Section IV.B.1.*

using electronic communications and the Internet in certain circumstances.[297] Indeed with respect to proxy materials, certain companies are required to post their proxy materials on a specified, publicly accessible Internet web site (other than EDGAR) and provide record holders with a notice informing them that the materials are available and explaining how to access those materials.[298] Second, where disclosure of information is required under the Exchange Act, we have allowed companies to make such information available to investors on their web sites with their web sites serving, depending on the circumstance, as a supplement to EDGAR, as an alternative to EDGAR, or as a stand-alone method of providing information to investors independent of EDGAR.

When a company web site serves as a supplement to EDGAR, company information is available both on EDGAR and on the company's web site. We have promoted this supplemental use of web sites by requiring, for example, that:

- Companies disclose their web site addresses in annual reports on Form 10-K and state whether their Exchange Act reports are available on their web sites;[299]
- Mutual funds disclose in their prospectuses whether shareholder reports are available on their web sites, and if not. why not;[300]

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[297]*See Securities Act Rule 172 [17 CFR 230.172]; Securities Offering Reform Release, supra note 3; Internet Proxy Release, supra note 10; Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Release No. 33-8861 (Nov. 30, 2007([72 FR 67790] ("Mutual Fund Summary Prospectus Proposing Release") (proposing to permit funds to satisfy their prospectus delivery obligations by sending or giving key information directly to investors in the form of a summary prospectus and providing the statutory prospectus on an Internet web site).*

[298]*See Shareholder Choice Release, supra note 21. While large accelerated filers, not including registered investment companies, are currently required to comply with these rules, starting January I. 2009, these rules will apply to all filers and other soliciting parties. Perhaps the most significant change effected by this rulemaking is the shift whereby electronic availability can serve as the default means of delivery, with shareholders having to "opt out" to receive paper delivery. The requirement that any shareholder lacking Internet access, or preferring delivery of a paper copy of the proxy materials, can make a permanent request to receive a paper copy of the proxy materials (and all future proxy materials) at no charge mitigates concerns about Internet access. In adopting these notice and access model rules, we recognized that "\a]s technology continues to progress, accessing the proxy materials on the Internet should increase the utility of our disclosure requirements to shareholders. Information in electronic documents is often more easily searchable than information in paper documents. Shareholders will be better able to go directly to any section of the document that they are particularly interested in." Id. at Section VI.C.1. It is significant to note that these rules neither require, nor permit, solicitations pursuant to the notice and access model with respect to business combination transactions. Based on statistics compiled by Broadridge, a proxy distribution service provider . beneficial owner (which include retail investors) participation in proxy voting has diminished since the adoption of the notice and access model rules. See Broadridge, Notice & Access: Statistical Overview of Use with Beneficial Shareholders as of May 31. 2008, available at http://broadridge.com/notice-and-access/NAStatsStory.pdf.*

[299]*Accelerated filers and large accelerated filers are required to disclose this information. Non-accelerated filers are encouraged to do so. See Item 101(e) of Regulation S-K [17 CFR 229.101(e)].*

[300]*See Item 1(b) of Form N-l A. See also Item 1.1.d. of Form N-2 (providing a similar requirement for closed-end funds).*

- Companies make their Exchange Act reports available on their web sites as a condition to incorporating by reference previously filed reports into prospectuses filed as part of registration statements on Form S-l or Form S-11;[301]
- Companies post on their web sites, if they have one. all beneficial ownership reports filed by officers, directors and principal security holders under Section 16(a) of the Exchange Act;[302] and
- Companies post on their web sites, if they have one, notice of their intent to delist or deregister their securities.[303]

In addition, we have proposed in the Interactive Data Proposing Releases that companies that maintain web sites be required to post their interactive data files on their web sites.[304]

In some situations, we have given companies the choice and flexibility of satisfying an Exchange Act disclosure requirement either by filing the disclosure on EDGAR or by making it available on the company's web site, thereby using company web sites as an alternative to EDGAR. For example:

- A company may disclose non-GAAP financial measures and Regulation G required information on its web site;[305]

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[301] *See Form S-l. General Instruction VII.F [17 CFR 239.11]; Form S-l I, General Instruction H.6 [17 CFR 239.18], In the adopting release for the Form S-11 amendments, we noted that companies could satisfy this requirement by "including hyperlinks directly to the reports or other materials filed on EDGAR or on another third-party web site where the reports or other materials are made available in the appropriate timeframe and access to the reports or other materials is free of charge to the user." See Revisions to Form S-l1 to Permit Historical Incorporation by Reference, Release No. 33-8909, at Section I.B.1(a) (Apr. 10,2008) [73 FR 20512].*

[302] *See Exchange Act Section 16(a)(4)(C) and Rule 16a-3(k) [17 CFR 240.16a-3(k)]. See also Mandated Electronic Filing and Website Posting for Forms 3. 4 and 5, Release No. 33-8230 (May 7, 2003) [68 FR 25787].*

[303] *See Exchange Act Rule 12d2-2(c)(2)(iii)(17 CFR 240.12d2-2(c)(2)(iii)]- See also Exchange Act Rule 12d2-2(c)(3) [17 CFR 240.12d2-2(c)(3)] (imposing a similar requirement on a national securities exchange to post on its web site any notice it receives from a company indicating the company has determined to withdraw a class of securities from listing and/or registration on the exchange).*

[304] *See Interactive Data Proposing Release, supra note 14; and Mutual Fund Interactive Data Proposing Release, supra note 15.*

[305] *See Conditions for Use of Non-GAAP Financial Measures, Release No. 33-8176 (Jan. 22, 2003) [68 FR 4819]. In that release, we recommended that companies provide ongoing web site access to this information for a period of at least 12 months. Although we understand that some companies may be reducing such web site access to a single quarter, we continue to believe that companies should retain the information on their web sites for 12 months. We believe such a retention time period is appropriate to enable quarter-to-quarter comparisons. Financial information disclosed on web sites is still subject to the limitations on disclosure of non-GAAP financial information set forth in Regulation G. See id.*

- An asset-backed issuer may post disclosure of static pool data on its web site rather than filing it on EDGAR;[306]
- A company may provide its audit, nominating or compensation committee charters on its web site as an alternative to providing them in its proxy or information statement;[307]
- A company may disclose a material amendment to its code of ethics, or a material waiver of a provision of its code of ethics, by posting the information on its web site rather than filing a Form 8-K;[308] and
- A company may provide information regarding board member attendance at the annual shareholder meeting on its web site rather than in its proxy statement.[309]

Finally, we have recently recognized that, in very limited circumstances, a company's web site can even serve as a standalone method of providing information to investors wholly independent of EDGAR. We have permitted certain foreign private issuers to use their web sites as the primary or stand-alone source of information about the company as a basis for maintaining an exemption from Exchange Act registration and reporting requirements, under certain circumstances.[310]

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[306] *See Asset-Backed Securities, Release No. 33-8518. at Section III.B.4.b. (Dec. 22.2004) [70 FR 1505] (""Asset-Backed Release") (discussing the ability to post disclosure of static pool data that is required in registered sales of asset-backed securities on web sites rather than filing it on EDGAR, subject to certain conditions). In this context, we resolved the potential conflict between the need to include material information in a prospectus offering asset-backed securities and the technical limitations of EDGAR that may have limited the ability of asset-backed issuers to provide that information in the formal most useful for investors by adopting an alternative accommodation via which the information posted on a web site will be deemed to be included in the prospectus when done incompliance with Item 312 of Regulation S-T [17 CFR 232.312].*

[307] *See Instruction 2 to Item 407(b)(2) of Regulation S-K [17 CFR 229.407(b)(2)]. As we noted above, the New York Stock Exchange has also implemented rules that recognize the value of company web sites as an important source of corporate governance information. See, e.g., NYSE Listed Company Manual. Sections 303A.10 and 303A.14 and note 17 supra.*

[308] *See Item 406(d) of Regulation S-K [17 CFR 229.406(d)]; Item 5.05(e) of Form 8-K [17 CFR 249.308].*

[309] *See Instruction to Item 407(b)(2) of Regulation S-K.*

[310] *We recently adopted new Exchange Act Rule 12h-6 [17 CFR 240.12h-6] and accompanying rule amendments to extend the Exchange Act Rule 12g3-2(b) 117 CFR 240.12g3-2(b)] exemption to a foreign private issuer and prior Form 15 filer immediately upon its termination of reporting under Rule 12h-6. To maintain that exemption, the company must publish specified home country documents in English on its Internet web site or through an electronic information delivery system generally available to the public in its primary trading markets. See Termination of a Foreign Private Issuer's Registration of a Class of Securities under Section 12(g) and Duty to File Reports Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Release No. 34-55540 (Mar. 27. 2007) [72 FR 16933]. The purpose of these provisions, and the additional changes that have been proposed to the availability of the exemption from registration pursuant to Rule 12g3-2(b), is to provide U.S. investors with Internet access to ongoing material information about a foreign private issuer that is required by its home country following its termination of reporting under Rule 12h-6. See Exemption from Registration under Section 12(g) of the Securities Exchange Act of 1934 for Foreign Private Issuers, Release No. 34-57350 (Feb. 19,2008) [73 FR 10101]. We also recently proposed rules that would permit exchange-traded funds to be actively managed provided certain conditions are met, including that fund composition information is maintained every business day on a publicly accessible web site, with such web site posting being the standalone method of providing such information to the public. See Exchange-Traded Funds, Release No. 33-8901 (Mar. 11. 2008) [73 FR 14618].*

II. Application of Certain Provisions of the Federal Securities Laws to Information Presented on Company Web Sites

A. Evaluation of "Public" Nature of Information on Company Web Sites

As we note above, there has been a dramatic increase in the use of company web sites since our 2000 Electronics Release and the adoption of Regulation FD.[311] Companies are providing greater amounts and types of information on their web sites, which, as a result, are increasingly viewed by investors as key sources of information about the company.[312] As companies use their web sites to a greater extent to provide comprehensive information about themselves, some have raised questions as to the treatment of information posted on a company web site under the federal securities laws.[313] We note that such questions have numerous implications under the federal securities laws.[314]

Although we have not addressed the question of whether and when information on a company's web site is considered public for purposes of determining if a subsequent selective disclosure of such information may implicate Regulation FD, we believe that in view of the significant technological advances and the pervasive use of the Internet by companies, investors and other market participants since 2000. it is now an appropriate time to provide additional guidance regarding the public nature of disclosures on company web sites for purposes of Regulation FD. Accordingly, we are providing guidance as to the circumstances under which information posted on a company web site (whether by or on behalf of such company) would be considered "public" for purposes of evaluating the (1) applicability of Regulation FD to subsequent private discussions or disclosure of the posted information and (2) satisfaction of Regulation FD's "public disclosure" requirement.[315]

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[311] *Sec Selective Disclosure and Insider Trading, Release No. 33-7881, at Section II.B.2 (Aug. 15. 2000) (65 FR 51715] ("Regulation FD Adopting Release").*

[312] *See Section I. supra. There also has been significant growth in the use of (he Internet by the public. As noted in the Internet Proxy Release, research submitted to the Commission during the comment period indicated that approximately S0% of mutual fund investors in the United States have access to the Internet in their homes. See Internet Proxy Release, supra note 10, at Section I.*

[313] *The Federal Advisory Committee on Improvements to Financial Reporting requested that the Commission clarify this point in its CIFiR Progress Report. See CIFiR Progress Report, supra note 1, at Chapter 4. Section III.*

[314] *See 2000 Electronics Release, supra note 4.*

[315] *We are not addressing issues relating to insider trading that may be implicated by disclosures on company web sites. In addition, our guidance is not intended to modify' the positions we have expressed regarding the Securities Act implications of disclosures on company web sites, including when such disclosures may constitute offers or the implications for private offerings. For example, in the 2000 Electronics Release, we discussed the extent to which a company 's use of an Internet web site could constitute a "general solicitation." See 2000 Electronics Release, supra note 4, at Section II.C.2.*

Our guidance also is not intended to address issues under Securities Act Rule 144(c) [17 CFR 2.10.144(c)l. We note, for example, that the concept of "public information" for non-reporting companies contained in Rule 144(c)(2) is based on access. We believe that non-reporting companies should focus on the availability of information required by Rule 144 rather than on dissemination of that information as further discussed in this section. Likewise, under Rule l44A(d)(1)(i) [17 CFR 230.144A(d)(1)(i)], sellers and persons acting on their behalf may look to publicly available financial statements for a prospective purchaser: and under Rule 144A(d)(4)(i). certain companies are required to provide access to specified company information to security holders and prospective purchasers. As with Rule 144. the concept of dissemination as we discuss in this section is not a condition to reliance on Rule 144A.

Regulation FD applies to closed-end investment companies but does not apply to other investment companies. Exchange Act Rule 101(b) [17 CFR.243.101(b)(definition of issuer for purposes of Regulation FD).

1. Whether and When Information Is "Public" for Purposes of the Applicability of Regulation FD

Evaluating whether and when information posted on a company web site is public so that a subsequent disclosure of that information to an enumerated person in Regulation FD is not a disclosure of non-public information implicates many of the same issues that Regulation FD itself was adopted to address.[316] In particular. Regulation FD was adopted to address the problem of selective disclosure of material information by companies, in which "a privileged few gain an informational edge—and the ability to use that edge to profit—from their superior access to corporate insiders, rather than from their skill, acumen, or diligence."[317] We must, therefore, keep that in mind when providing guidance on when information is considered public for purposes of assessing whether a subsequent selective disclosure may implicate Regulation FD.

"In order to make information public, it must be disseminated in a manner calculated to reach the securities market place in general through recognized channels of distribution, and public investors must be afforded a reasonable waiting period to react to the information."[318] Thus, in evaluating whether information is public for purposes of our guidance, companies must consider whether and when: (1) a company web site is a recognized channel of distribution, (2) posting of information on a company web site disseminates the information in a manner making it available to the securities marketplace in general, and (3) there has been a reasonable waiting period for investors and the market to react to the posted information.

With respect to the first element of this analysis, as we have noted above, we believe that a company's web site can be a valuable channel of distribution for information about a company, its business, financial condition and operations.[319] As we discuss below, whether a company's web site is a recognized channel of distribution of information will depend on the steps that the company has taken to alert the market to its web site and its disclosure practices, as well as the use by investors and the market of the company's web site.

With respect to the second element of the analysis, the question of what "disseminated" means in the context of web site disclosure, we recognize that, today, news is disseminated in an electronic world—one in which the accessibility to the information is not limited to reading a newspaper or the "broad tape." There are now many different channels of distribution of news and other information which account for the rapid dissemination of news today (and also the corresponding capacity for rapid trading based on such information). Because companies of all sizes now have the capacity to present information on their web sites to all investors on a broadly accessible basis, and because investors correspondingly have the capability to easily find and retrieve information about companies by searching the World Wide Web, we now analyze

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[316] *See Regulation FD [17 CFR 243.100 et seq.].*

[317] *See Regulation FD Adopting Release, supra note 41 at Section II.A. In the Regulation FD Adopting Release, we stated our belief that Regulation FD struck an appropriate balance. It established a clear rule prohibiting unfair selective disclosure and encouraged broad public disclosure. We also believed that Regulation FD should not impede ordinary course business communications. See id. at Section 11.A.4.*

[318] *Faberge, Inc., 45 S.E.C. 249, 255 (1973). See also Regulation FD Adopting Release, supra note 41, at Section II.B ("Information is nonpublic if it has not been disseminated in a manner making it available to investors generally.").*

[319] *See Section I.B. supra. See Interactive Data Proposing Release, supra note 14.*

the concept of dissemination" through a changed lens. Consequently, we believe that, in the context of a company web site that is known by investors as a location of company information, the appropriate approach to analyzing the concept of "dissemination" for purposes of the "public" test as it relates to the applicability of Regulation FD to a subsequent disclosure should be to focus on (1) the manner in which information is posted on a company web site and (2) the timely and ready accessibility of such information to investors and the markets.[320]

Some factors, though certainly non-exclusive ones, for companies to consider in evaluating whether their company web site is a recognized channel of distribution and whether the company information on such site is "posted and accessible" and therefore "disseminated." include:

- Whether and how companies let investors and the markets know that the company has a web site and that they should look at the company's web site for information. For example, does the company include disclosure in its periodic reports (and in its press releases) of its web site address and that it routinely posts important information on its web site?
- Whether the company has made investors and the markets aware that it will post important information on its web site and whether it has a pattern or practice of posting such information on its web site;
- Whether the company's web site is designed to lead investors and the market efficiently to information about the company, including information specifically addressed to investors, whether the information is prominently disclosed on the web site in the location known and routinely used for such disclosures, and whether the information is presented in a format readily accessible to the general public;
- The extent to which information posted on the web site is regularly picked up by the market and readily available media, and reported in. such media or the extent to which the company has advised newswires or the media about such information and the size and market following of the company involved. For example, in evaluating accessibility to the posted information, companies that are well-followed by the market and the media may know that the market and the media will pick up and further distribute the disclosures they make on their web sites. On the other hand, companies with less of a market following, which may include many companies with smaller market capitalizations, may need to take more affirmative steps so that investors and others know that information is or has been posted on the company's web site and that they should look at the company web site for current information about the company;

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[320]*In our recent proposals regarding interactive data, we stated that we believed that "web site availability of the interactive data would encourage its widespread dissemination." Interactive Data Proposing Release, supra note 14, at Section II.B.5. In that release, we recognized the increasing role that company web sites perform in supplementing the information filed electronically with the Commission by delivering financial and other disclosure directly to investors. Id.*

- The steps the company has taken to make its web site and the information accessible, including the use of "push" technology,[321] such as RSS feeds, or releases through other distribution channels either to widely distribute such information or advise the market of its availability. We do not believe, however, that it is necessary that push technology be used in order for the information to be disseminated, although that may be one factor to consider in evaluating the accessibility to the information;[322]
- Whether the company keeps its web site current and accurate;
- Whether the company uses other methods in addition to its web site posting to disseminate the information and whether and to what extent those other methods are the predominant methods the company uses to disseminate information; and
- The nature of the information.

The third element in evaluating whether and when information posted on a company's web site would be public for purposes of evaluating whether a subsequent selective disclosure may implicate Regulation FD is whether investors and the market have been afforded a reasonable waiting period to react to the information. What constitutes a reasonable waiting period depends on the circumstances of the dissemination, which, in the context of company web sites, may include:

- the size and market following of the company;
- the extent to which investor oriented information on the company web site is regularly accessed;
- the steps the company has taken to make investors and the market aware that it uses its company web site as a key source of important information about the company, including the location of the posted information;
- whether the company has taken steps to actively disseminate the information or the availability of the information posted on the web site, including using other channels of distribution of information; and
- the nature and complexity of the information.[323]

We emphasize that companies must look at the particular facts and circumstances in determining whether the reasonable waiting period element is satisfied. What may be a reasonable waiting period after posting information on a company web site for a particular company and a particular type of information may not be one for other companies or other types of information. For example, a large company that frequently uses its web site as a key resource for

[321] *Push technology, or server push, describes a type of Internet-based communication where the request for the transmission of information originates with the publisher or central server. It is contrasted with pull technology, where the request for the transmission of information originates with the receiver or client.*

[322] *Companies should also consider the extent to which their Internet infrastructure can accommodate spikes in traffic volume that may accompany a major company development.*

[323] *See Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F.2d 833, 854 (2d Cir. 1968) (noting that "where the news is of a sort which is not readily translatable into investment action, insiders may not take advantage of their advance opportunity to evaluate the information by acting immediately upon dissemination").*

providing information, has taken steps to make investors and the market aware of this, and reasonably believes that its web site is well-followed by investors and other market participants, may get comfortable with a waiting period that is shorter than a waiting period for a company that is not in the same situation.

If the information is important, companies should consider taking additional steps to alert investors and the market to the fact that important information will be posted—for example, prior to such posting, filing or furnishing such information to us or issuing a press release with the information. Adequate advance notice of the particular posting, including the date and time of the anticipated posting and the other steps the company intends to take to provide the information, will help make investors and the market aware of the future posting of information, and will thereby facilitate the broad dissemination of the information.

The question of what constitutes a reasonable waiting period has been frequently litigated in the context of insider trading.[324] While we are not addressing when information is "public" for purposes of insider trading, the cases in this area may provide guidance to companies for purposes of Regulation FD. As we have noted, what constitutes a reasonable waiting period is a facts and circumstances determination.

Hence, under the foregoing analysis, if information on a company's web site is public, then subsequent selective disclosure of that information—such as to an analyst in a private conversation—would not trigger Regulation FD because such information, even if material, would not be non-public.[325] It is important to note that, although posting information on a company 's web site in a location and format readily accessible to the general public would not be "selective" disclosure, the information may not be "public" for purposes of determining whether a subsequent selective disclosure implicates Regulation FD. If, however, under the foregoing analysis, information on a company's web site is not public, then subsequent selective disclosure of that information, if material, may trigger the application of Regulation FD.

2. Satisfaction of Public Disclosure Requirement of Regulation FD.

Rule 101(e) of Regulation FD requires that once a selective disclosure has been made, the company must file or furnish a Form 8-K or use an alternative method or methods of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to

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[324]See SEC v. Ingoldsby, No. 88-1001-MA. 1990 U.S. Dist. LEXIS 11383 (D. Mass. May 15. 1990); SEC v. MacDonald. 568 F.Supp. 111, 113 (D.R.I. 1983), aff'd, 725 F.2d 9 (1st Cir. 1984); SEC v. Materia, No. 82 Civ. 6225, 1983 U.S. Dist. LEXIS 11130 (S.D.N.Y. Dec. 5. 1983); DuPont Glore Forgan. Inc. v. Arnold Bernhard & Co. Inc., No. 73 Cov. 3071, 1978 U.S. Dist. LEXIS 20385 (S.D.N.Y. Mar. 6. 1978). See also In re Apollo Group Inc. Sec. Litig., 509 F.Supp. 2d 837. 846 (D. Ariz. 2007) (In this securities-fraud class action, the Court declined to adopt a bright-line rule presuming an immediate market reaction, based on the efficient market theory, and instead focused on the specific facts of each case.); In re Crossroads Sys., Inc. 2002 U.S. Dist. LEXIS 26716. (W.D. Tex. Nov. 22. 2002), aff'd, Greenberg v. Crossroads Sys. Inc. 364 F.3d 657, 660-661 (5th Cir. 2004) (In this securities-fraud class action, the Court employed a two-day window, concluding that an efficient market will digest unexpected new information within two days of its release.).

[325]The standard to satisfy "public disclosure" in Regulation FD following a selective disclosure is governed by Rule 101(e).

the public—simultaneously, in the case of an intentional disclosure, or promptly, in the case of an unintentional disclosure.[326] In adopting Regulation FD in 2000, we discussed the role of company web sites in satisfying the alternative public disclosure provisions of the regulation. At the time, we stopped short of concluding that disclosure on a company web site would, itself, be an acceptable method of "public disclosure" of material non-public information for purposes of compliance with Regulation FD, but we recognized that web site disclosure and webcasting could constitute integral parts of a model method of disclosure in satisfaction of the regulation. With regard to disclosure solely via a company web site, we stated that "[a]s technology evolves and as more investors have access to and use the Internet.we believe that some companies, whose web sites are widely followed by the investment community, could use such a method."[327]

As we stated above in the context of whether information posted on a company web site would be "public" so that a subsequent selective disclosure would not implicate Regulation FD, we now believe that technology has evolved and the use of the Internet has grown such that, for some companies in certain circumstances, posting of the information on the company's web site, in and of itself, may be a sufficient method of public disclosure under Rule 101(e) of Regulation FD. Companies will need to consider whether and when postings on their web sites are "reasonably designed to provide broad, non-exclusionary distribution of the information to the public."[328] To do so. companies can look to the factors we have outlined above regarding the first two elements of the analysis—whether the company web site is a recognized channel of distribution and whether the information is "posted and accessible" and. therefore, "disseminated."[329] As part of that evaluation, companies also will need to consider their web sites' capability to meet the simultaneous or prompt timing requirements for public disclosure once a selective disclosure has been made.[330] Because the company has the responsibility for evaluating whether a method or combination of methods of disclosure would satisfy the alternative public disclosure provision of Regulation FD. it remains the company's responsibility to evaluate whether a posting on its web site would satisfy this requirement.[331]

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[326] *See Rules 100(a) and 101(e) of Regulation FD.*

[327] *See Regulation FD Adopting Release, supra note 41. at Section II.B.4.b.*

[328] *See Rule 101(e)(2) of Regulation FD.*

[329] *Under Regulation FD. when an issuer makes a selective disclosure, it must also provide general public disclosure, either simultaneously or promptly. Thus, the third element of the public test we discuss above—whether investors and the market have been afforded a reasonable waiting period to react to the information—does not apply in analyzing whether the general public disclosure requirements of Regulation FD have been satisfied.*

[330] *For purposes of Regulation FD. a posting on a blog,. by or on behalf of the company, would he treated the same as any other posting on a company's web site. The company would have to consider the factors outlined above to determine if the blog posting could be considered "public."*

[331] *We recognized in Regulation FD that "the issuer may use a method 'or combination of methods' of disclosure, in recognition of the fact that it may not always be possible or desirable for an issuer to rely on a single method of disclosure as reasonably designed to effect broad public disclosure." "[A]n issuer's methods of making disclosure in a particular case should be judged with respect to what is 'reasonably designed' to effect broad, non-exclusionary distribution in light of all the relevant facts and circumstances." Regulation FD Adopting Release, supra note 41.*

B. Antifraud and Other Exchange Act Provisions

The antifraud provisions of the federal securities laws apply to company statements made on the Internet in the same way they would apply to any other statement made by, or attributable to. a company.[332] This includes postings on and hyperlinks from company web sites that satisfy the relevant jurisdictional tests.[333] As we noted in the 2000 Electronics Release, companies should be mindful that they "are responsible for the accuracy of their statements that reasonably can be expected to reach investors or the securities markets regardless of the medium through which the statements are made, including the Internet."[334]

Accordingly, a company should keep in mind the applicability of the antifraud provisions of the federal securities laws, including Exchange Act Section 10(b) and Rule 10b-5. to the content of its web site.[335] These provisions contain a general prohibition on making material misstatements and omissions of fact in connection with the purchase or sale of securities.[336]

In the Rule 10b-5 context, to satisfy the materiality requirement, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[337] Whether information posted on a company's web site is considered part of the "total mix" for purposes of analyzing materiality is a facts and circumstances determination. As we discuss below, we believe that companies can take certain steps that affect whether information located on

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[332] *See, e.g., 1995 Electronics Release, supra note 25. at n. 11 ("The liability provisions of the federal securities laws apply equally to electronic and paper-based media. For instance, the antifraud provisions of the federal securities laws as set forth in Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 [17 CFR 240.10b-5] thereunder would apply to any information delivered electronically, as it does to information delivered in paper."); 1996 Electronics Release. supra note 25. at Section I. n. 4 ("The substantive requirements and liability provisions of the federal securities laws apply equally to electronic and paper-based media. For example, the antifraud provisions of the Exchange Act and Rule 10b-5 thereunder... apply to information delivered and communications transmitted electronically. to the same extent as they apply to information delivered in paper form."); 2000 Electronics Release, supra note 4. at Section II.B. ("It is important for companies... to keep in mind that the federal securities laws apply in the same manner to the content of their web sites as to any other statements made by or attributable to them.").*

[333] *See 2000 Electronics Release, supra note 4. at Section II.B.*

[334] *See 2000 Electronics Release, supra note 4, at Section II.B.1.*

[335] *Rule 10b-5 [17 CFR 240.10b-5] makes it unlawful to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading" (emphasis added). See 2000 Electronics Release, supra note 4. In addition. Securities Act Section 17(a) [15 U.S.C. 77q(a)] applies to the offer and sale of securities. See also Prentice, supra note 18. at 542 (noting that the Commission's antifraud legal regime under Section I0(bi and Rule 10b-5 applies to all manner of electronic disclosure).*

[336] *Section 10(b) and Rule 10b-5 have a scienter requirement, unlike some other provisions in the federal securities laws. See, e.g., Securities Act Section I7(a)(2)[l5 U.S.C. 771(a)(2)]. For cases discussing the scienter requirement of Section 10(b)and Rule 10b-5. see, e.g. SEC v. McNulty. 137 F.3d 732 (2d Cir. 1998), cert, denied. 525 U.S. 931 (1998); Lanza v. Drexel & Co. 419 F.2d !277(2d Cir. 1973); Hollinger v. Titan Capital. Inc., 914 F.2d 1564. 1569 (9th Cir. 1990); Aaron v. SEC, 446 U.S. 680(1980).*

[337] *TSC Industries. Inc. v. Northway, Inc., 426 U.S. 438. 448-449 (1976). See also Basic v. Levinson, 485 U.S. 224, 231 (1988). In Basic v. Levinson, the U.S. Supreme Court "expressly adopted] the TSC Industries standard of materiality for the S10(b) and Rule 10b-5 context." Id. at 232.*

or hyperlinked from a company's web site is part of such "total mix" of information.[338] In this release, we are providing guidance regarding certain issues that arise under the antifraud provisions relating to disclosures on company web sites.

In addition, under certain of our rules, companies may disclose information exclusively on their web sites rather than filing such disclosures or materials on EDGAR. While the provisions of Exchange Act Section 13(a) and Exchange Act Rules 13a-1 and 12b-20 apply to Exchange Act filings made by companies with the Commission, such provisions generally do not apply to disclosures on company web sites. However, if a company fails to satisfy a web site disclosure option that is an alternative to filing or furnishing an Exchange Act report, an action could be brought under the Exchange Act reporting provisions based on the company's failure to file the report.[339]

1. Effect of Accessing Previously Posted Materials or Statements on Company Web Sites

In our 2000 Electronics Release, we discussed liability concerns arising from accessing previously posted materials or statements on a company's web site.[340] Since the publication of our 2000 Electronics Release, we understand that some companies continue to be concerned about whether previously posted materials or statements on their web site that are accessed at a later time will be considered "republished" at that later date, with attendant securities law liability.[341] We understand that companies may continue to be concerned that they may have a duty to update the previously posted materials or statements if they are considered to be a new statement by being "republished" each time the materials or statements are accessed on the web site.[342] In 2005. we addressed the treatment of previously posted (which we called historical) information

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[338]*In this regard, we believe the "buried facts" doctrine applies to electronic disclosures. Under this doctrine, a court would consider disclosure to be false and misleading if its overall significance is obscured because material information is "buried." for example, in a footnote or appendix. We have addressed the application of the buried facts doctrine in the context of an introduction or overview section of Item 303 of Regulation S-K—Management's Discussion and Analysis of financial Condition and Results of Operations and summary disclosure in plain English. In addition, in the context of the use of summary information in the electronics disclosure context we discuss in Part II.B.3 below, we note that the failure to include every material disclosure that is being summarized should not automatically trigger the "buried facts" doctrine. See Commission Guidance Regarding Management's Discussion and Analysis. Release No. 33-8350 (Dec. 19, 2003) [68 FR 75056] ("MD&A Release"); Plain English Disclosure, Release No. 33-7497 (Jan. 28, 1998) [63 FR 6370].*

[339]*See, e.g., Exchange Act Section 13(a) [15 U.S.C. 78m] (requiring companies with a class of securities registered under the Exchange Act to file reports prescribed by the Commission) and Exchange Act Rule 13a-1 [17 CFR 240.13a-1] (requiring such companies to file an annual report with the Commission).*

[340]*See 2000 Electronics Release, supra note 4. at Section II.D.*

[341]*See id. at Section II.D.5. As discussed in the 2000 Electronics Release, "a press release disseminated over a wire service or through other customary means is considered to have been "issued" once, and thereafter is not recirculated to the marketplace. The same press release posted on a company's web site potentially has a longer life because it provides a record that can be accessed by investors at any time and upon which investors potentially could rely when making an investment decision without independent verification. In effect, a statement may be considered to be 'republished' each time that it is accessed by an investor or. for that matter, each day that it appears on the web site. Commentators have suggested that if a statement is deemed to be republished, it may potentially give rise to liability under Section 10(b) of the Exchange Act and Rule 10b-5." Id.*

[342]*Specifically, if previously posted information is considered republished, companies may be concerned that even if the information was accurate when initially posted or issued, it may no longer be current or accurate when it is accessed at a later date.*

on a company's web site in the context of registered offerings under the Securities Act.[343] We believe it is now appropriate to provide clarity with respect to the treatment of such previously posted materials or statements under the antifraud provisions of the federal securities laws.

We do not believe that companies maintaining previously posted materials or statements on their web sites are reissuing or republishing such materials or information for purposes of the antifraud provisions of the federal securities laws just because the materials or statements remain accessible to the public. Of course, the antifraud provisions would apply to statements contained in posted materials when such statements were initially made. If a company affirmatively restates or reissues a statement, the antifraud provisions would apply to such statements when the company restates or reissues the statement. This affirmative restatement or reissuance may create a duty to update the statement so that it is accurate as of the date it is restated or reissued. As a general matter, we believe that the fact that investors can access previously posted materials or statements on a company's web site does not in itself mean that such previously posted materials or statements have been reissued or republished for purposes of the antifraud provisions of the federal securities laws, that the company has made a new statement, or that the company has created a duty to update the materials or statements.

In circumstances where it is not apparent to the reasonable person that the posted materials or statements speak as of a certain date or earlier period, then to assure that investors understand that the posted materials or statements speak as of a date or period earlier than when the investor may be accessing the posted materials or statements, we believe that previously posted materials or statements that have been put on a company's web site should be:

- Separately identified as historical or previously posted materials or statements, including, for example, by dating the posted materials or statements: and
- Located in a separate section of the company's web site containing previously posted materials or statements.[344]

2. Hyperlinks to Third-Party Information.

Another area we addressed previously that continues to raise questions involves the use of hyperlinks to third-party information.[345] Companies include on their web sites hyperlinks to third-party information for a variety of reasons, including as part of their ongoing communications to their customers, investors and the markets. In our 2000 Electronics Release, we discussed the implications for the use of hyperlinks from company web sites to third-party information in the context of both the Securities Act and the antifraud provisions of the federal securities laws. While we believe that the treatment of hyperlinks for purposes of the Securities

[343] *See Securities Offering Reform Release, supra note 3, at Section III.D.3.b.iii.(E)(2).*

[344] *These considerations mirror those found in Rule 433(e)(2) under the Securities Act [17 CFR 230.433(e)(2)].*

[345] *A "hypertext link." or "hyperlink." is an electronic path often displayed in the form of highlighted text, graphics or a button that associates an object on a web page with another web page address. It allows the user to connect to the desired web page address immediately by clicking a computer-pointing device on the text, graphics or button. See 2000 Electronics Release, supra note 4. at n. 7 (citing Harvey L. Pitt & Dixie E. Johnson. Avoiding Spiders on the Web: Rules of Thumb fur Companies t sine Web Sites and E-Mail, in Practising Law Institute. Securities Law & the Internet. No. 1127(1999). at 107-118. n. 5).*

Act is clear from our prior interpretation, we understand that companies continue to be concerned about their liability for hyperlinks to third-party information included on their web sites as part of their ongoing communications to the public, including investors and the markets.[346] In light of these concerns, we believe it is appropriate to provide additional guidance to companies as to the circumstances under which they may have liability for posted information outside the context of the offer and sale of securities under the Securities Act.

Under Section 10(h) of the Exchange Act and Rule 10b-5, a company can be held liable for third-party information to which it hyperlinks from its web site and which could be attributable to the company. As we explained in the 2000 Electronics Release, whether third-party information is attributable to a company depends upon whether the company has: (1) involved itself in the preparation of the information, or (2) explicitly or implicitly endorsed or approved the information.[347] In the case of company liability for statements by third parties such as analysts, the courts and we have referred to the first line of inquiry as the "entanglement" theory and the second as the "adoption" theory.[348] While we are addressing the use of hyperlinks to third-party information in the context of the antifraud provisions, this guidance does not affect our interpretation regarding the use of hyperlinks to third-party information in the context of offers and sales of securities under the Securities Act.[349]

Our focus in the 2000 Electronics Release was to help companies understand what factors may be relevant in determining whether they have adopted hyperlinked information.[350] We explained that the following, non-exhaustive list of factors may influence that analysis:

- Context of the hyperlink—what the company says about the hyperlink or what is implied by the context in which the company places the hyperlink;

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[346] *See CIFiR Progress Report, supra note 1. at Chapter 4. Section III.*

[347] *See 2000 Electronics Release, supra note 4. at Section II.B. Of course, as staled in the 2000 Electronics Release, "in the context of a document required to be filed or delivered under the federal securities laws, we believe that when a company embeds a hyperlink to a web site within the document, the company should always be deemed to be adopting the hyperlinked information. In addition, when a company is in registration, if the company establishes a hyperlink (that is not embedded within a disclosure document) from its web site to information that meets the definition of an "offer to sell." "offer for sale" or "offer" under Section 2(a)(3) of the Securities Act. a strong inference arises that the company has adopted that information for purposes of Section 10(b) of the Exchange Act and Rule 10b-5." But see Exemption from Section 101(c)(1) of the Electronic Signatures in Global and National Commerce Act for Registered Investment Companies. Release No. 13-7877 (Jul. 27. 2000) [65 FR 47281] at notes 18-24 and accompanying text (clarifying how this guidance applies to mutual funds).*

[348] *See generally 2000 Electronics Release, supra note 4 at Sections II.A.4. and II.B.1. As we stated in the 2000 Electronics Release, "[i]n the case of hyperlinked information, liability under the "entanglement" theory would depend upon a company's level of pre-publication involvement in the preparation of the information. In contrast, liability under the "adoption" theory would depend upon whether, after its publication, a company, explicitly or implicitly endorses or approves the hyperlinked information."*

[349] *See Securities Offering Reform Release, supra note 3. at Section III.D.3.b.iii.(E); 2000 Electronics Release, supra note 4, at Section II.B.1.; Securities Act Rule 433.*

[350] *Some commenters on the 2000 Electronics Release criticized the '"facts-and-circumstances" approach we adopted, arguing that it leads to uncertainty and could result in companies providing less useful information to investors. See., e.g. comment letters from The Bond Market Association and Fidelity Investments, which are publicly available at Imp: www.sec.gov/rules/interp/s71100.shtml or at our Public Reference Room at 100 F Street. M . Washington DC 20549 in File No. S7-11-00*

- Risk of confusing the investors—the presence or absence of precautions against investor confusion about the source of the information; and
- Presentation of the hyperlinked information—how the hyperlink is presented graphically on the web site, including the layout of the screen containing the hyperlink.[351]

We understand that some companies may still wish for further elaboration of some of the issues addressed regarding the application of the adoption theory. Accordingly, we are providing further guidance on these issues as they relate to the adoption theory.

In evaluating the potential antifraud liability of a company under the adoption theory with respect to third-party information to which the company provides a hyperlink in the context of providing information about the company and its business, we believe the focus should be on whether a company has explicitly or implicitly approved or endorsed the statement of a third-party such that the company should be liable for that statement. Because an explicit approval or endorsement is, by definition, plainly evident, the analytical scrutiny is on the circumstances or conditions under which a company can fairly be said to have implicitly approved or endorsed a third-party statement by hyperlinking to that information. The key question in the hyperlinking context, therefore, is: Does the context of the hyperlink and the hyperlinked information together create a reasonable inference that the company has approved or endorsed the hyperlinked information?

We believe that in evaluating whether a company has implicitly approved or endorsed information on a third-party web site to which it has established a hyperlink, one important factor is what the company says about the hyperlink, including what is implied by the context in which the company places the hyperlink.[352] In considering the context of the hyperlink, we begin with the assumption that providing a hyperlink to a third-party web site indicates that the company believes the information on the third-party web site may be of interest to the users of its web site. Otherwise, it is unclear to us why the company would provide the link. To avoid potential confusion or misunderstanding about what the company's view or opinion is with respect to the information to which the company has provided a hyperlink, the company should consider explaining the context for the hyperlink—and thereby make explicit, rather than implicit, why the hyperlink is being provided. For example, a company might explicitly endorse the hyperlinked information or suggest that the hyperlinked information supports a particular assertion on the company's web site. Alternatively, a company might simply note that the third-party web site contains information that may be of interest or of use to the reader.

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[351] *See 2000 Electronics Release, supra note 4. at Section II.B.1.*

[352] *We note that companies can have different audiences for different pages on their web sites. For example, a consumer products company may have customer-oriented pages, or supplier-oriented pages, on its web site, as well as investor-oriented pages, such as an investor relations page. Because of its context, a third-party hyperlink on a customer-oriented page—for example, the company manufactures laundry detergent and provides a link to a third-party clothing care web site—has different implications from a securities law perspective than a hyperlink to a research analyst's report on an investor-oriented page.*

The nature and content of the hyperlinked information also should be considered in deciding how to explain the context for the hyperlink. The degree to which a company is making a selective choice to hyperlink to a specific piece of third-party information likely will indicate the extent to which the company has a positive view or opinion about that information. For example, a company including a hyperlink to a news article that is highly laudatory of management should consider explanatory language about the source and why the company is providing the hyperlink in order to avoid the inference that the company is commenting on or even approving its accuracy, or was involved in its preparation. Conversely, the more general or broad-based the hyperlinked information is. the company may consider providing a more general explanation. For example, if a company has a media page and simply provides hyperlinks to recent news articles, both positive and negative, about the company, the risk that a company may have liability regarding a particular article or that it endorses or approves of each and every news article may be reduced. In this case, a title such as "Recent News Articles" may be all the explanation that a company may determine is needed to avoid being considered to have adopted the materials.[353]

In addition to an explanation of why a company is including particular hyperlinks on its web site, a company also may determine to use other methods, including "exit notices" or "intermediate screens." to denote that the hyperlink is to third-party information. While the use of "exit notices" or "intermediate screens" helps to avoid confusion as to the source of the third-party information, no one type of "exit notice" or "intermediate screen" will absolve companies from antifraud liability for third-party hyperlinked information.[354] For example, if there is only one analyst report out of many that provides a positive outlook on the company's prospects, and the company provides a hyperlink to the one positive analyst report and to no other, and does not mention the fact that all the other analyst reports are negative on the company's prospects, then even the use of an "exit notice" or "intermediate screen" or explanatory language may not be sufficient to avoid the inference that the company has approved or endorsed the one positive analyst's report.

With regard to the use of disclaimers generally, as we noted in the 2000 Electronics Release, we do not view a disclaimer alone as sufficient to insulate a company from responsibility for information that it makes available to investors whether through a hyperlink or otherwise."[355] Accordingly, a company would not be shielded from antifraud liability for hyperlinking to information it knows, or is reckless in not knowing, is materially false or misleading. This would

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[353]*Of course, a further explanation may be necessary depending on the manner by which a company limits the sources of its recent news articles. For example, if a company only includes recent news articles published by bullish industry journals, the limited nature of the sources should be clear and the company should explain why it selected the sources identified.*

In addition, any SEC-registered investment adviser (or investment adviser that is required to be SEC registered) that includes, in its web site or in other electronic communications, a hyperlink to postings on third-party web sites, should carefully consider the applicability of the advertising provisions of the Investment Advisers Act of 1940 ("Advisers Act"). Under the Advisers Act. it is a fraudulent act for an investment adviser to. among other things, refer to testimonials in its advertisements. See Section 206(4) of the Advisers Act [15 U.S.C. 806-6(4)]; Rule 206(4)-1 (a)(1) [17 CFR 275.206(4)-1(a)(1)].

[354]*We do not believe that the failure to use "exit notices" or "intermediate screens" should automatically result in a determination that a company has adopted third-party information.*

[355]*See 2000 Electronics Release, supra note 4. at Section II.B.1.a. and n. 61.*

be the case even where the company uses a disclaimer and/or other features designed to indicate that it has not adopted the false or misleading information to which it has provided the hyperlink. Our concern is that an alternative approach could result in unscrupulous companies using disclaimers as shields from liability for making false or misleading statements. We again remind companies that specific disclaimers of antifraud liability are contrary to the policies underpinning the federal securities laws.[356]

3. Summary Information

A third area in which we are providing guidance is with respect to companies' use of summaries or overviews to present information, particularly financial information, on their web sites.[357] We understand that some companies may be concerned as to the treatment of summary or overview information contained on their web sites under the antifraud provisions of the federal securities laws.[358] By definition, these summaries or overviews do not. without more, include the more detailed information from which they are derived or on which they are based.

We have encouraged and, in some cases, required the inclusion of summaries or overviews in prospectuses and in Exchange Act reports to highlight important information for investors.[359] We believe that summary information can be particularly appropriate and helpful to investors, such as when it relates to lengthy or complex information. For similar reasons, we believe the use of summaries or overviews on web sites can be helpful to investors. We note, however, that summaries or overviews standing alone and which a reasonable person would not perceive as summary, and which do not provide additional information to alert a reader as to where more detailed information is located, could result in investors not necessarily understanding that the statements should be read in the context of the information being summarized. Consequently,

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[356] *See id.*

[357] *Our discussion is intended to provide guidance generally regarding a company's use of summarized information. This guidance does not supersede more specific requirements covering the use of summaries or their content that are or may be contained in our rules. See e.g., Mutual fund Summary Prospectus Proposing Release, supra note 27.*

[358] *See CIFiR Progress Report, supra note 1, at Chapter 4. Section III.*

[359] *We have encouraged or required summaries or overviews in the following contexts:*

- *We have suggested that Management's Discussion and Analysis disclosures could benefit from an introductory section or overview providing context for the more detailed information following it and thereby facilitating a reader's understanding of the disclosures. See MD&A Release, supra note 68. In that release, we also encouraged companies to consider using other means of providing clearer disclosure, such as tabular presentations and the use of section headings to assist readers in following the flow of the MD&A. We have also encouraged companies to use a "layered" approach in their MD&A disclosures.*
- *We adopted the Compensation Discussion and Analysis section in Regulation S-K Item 402 to provide a narrative, analytical overview to executive compensation disclosure. See Executive Compensation and Related Person Disclosure, Release No. 33-8732A, at Section 1 (Aug. 29, 2006) [71 FR 53158].*
- *We require prospectuses to include a plain English "summary of the information in the prospectus where the length or complexity of the prospectus makes a summary useful." See Item 503(a) of Regulation S-K [17 CFR 229.503(a)].*
- *We recently proposed rules that would require key information to appear in a summary section at the front of mutual fund prospectuses. See Mutual Fund Summary Prospectus Proposing Release, supra note 27.*

when using summaries or overviews on web sites, companies should consider ways to alert readers to the location of the detailed disclosure from which such summary information is derived or upon which such overview is based, as well as to other information about a company on a company's web site.

In presenting information in a summary format or as part of an overview, companies should consider the context in which such information is presented. Just as with hyperlinks to third-party information, companies should consider using appropriate explanatory language to identify summary or overview information. As an example, a summary page on a company web site that is identified and presented in a manner similar to an introductory page in a "glossy" annual report—with graphs and charts illustrating key performance metrics derived from finan cial statements contained in later pages of the same document—would likely be viewed as a summary. Conversely, where summary information is not identified as such, the reader may be confused and fail to appreciate that the information is not complete.

We encourage companies that use summaries or overviews of more complete information located elsewhere on their web sites to consider employing disclosure and other techniques designed to highlight the nature of summaries or overviews in order to help minimize the chance that investors would be confused as to the level of incompleteness inherent in these disclosures. To this end. companies may wish to consider the following techniques that may highlight the nature of summary or overview information:

- Use of appropriate titles. An appropriate title or heading that conveys the summary, overview or abbreviated nature of the information could help to avoid unnecessary confusion;
- Use of additional explanatory language. Companies may consider using additional explanatory language to identify the text as a summary or overview and the location of the more detailed information;
- Use and placement of hyperlinks. Placing a summary or overview section in close proximity to hyperlinks to the more detailed information from which the summary or overview is derived or upon which the overview is based could help an investor understand the appropriate scope of the summary information or overview while making clearer the context in which the summary or overview should be viewed;[360] and
- Use of "layered" or "tiered" format. In addition to providing hyperlinks to more complete information, companies can organize their web site presentations such that they present the most important summary or overview information about a company on the opening page, with embedded links that enable the reader to drill down to more detail

[360] *We believe this approach is analogous to the "envelope" theory, which describes how and when information from different sources may be deemed to have been delivered together. In the 1995 Electronics Release, supra note 25, we explained that documents appearing in close proximity to each other on the same web page and documents hyperlinked together will be considered delivered together, analogizing it to delivery of the information in paper form in the same envelope. Id. at Questions 15 and 16. Similarly, providing hyperlinks to the complete information from which the summary is derived or upon which an overview is based can lead to this information being considered to be provided together or. at a minimum, directing the reader to the location of the more detailed information.*

by clicking on the links."[361] In this way. viewers can follow a logical path into, and thereby obtain increasingly greater details about, the financial statements, a company's strategy and products, its management and corporate governance, and the many other areas in which investors and others ma; have an interest.

4. Interactive Web Site features

We believe that it is important to provide guidance that will promote robust use by companies of their web sites. One example of such robust use is making the company web site interactive. We note that companies are increasingly using their web sites to take advantage of the latest interactive technologies for communicating over the Internet with various stakeholders, from customers to vendors and investors. These communications can take various forms, ranging from "blogs" to "electronic shareholder forums." Since all communications made by or on behalf of a company are subject to the antifraud provisions of the federal securities laws, companies should consider taking steps to put into place controls and procedures to monitor statements made by or on behalf of the company on these types of electronic forums.[362]

Company-sponsored "blogs." which can include CEO blogs and investor relations blogs. among others, are recent additions to company web sites.[363] Companies can use these for a variety of purposes, including allowing for the exchange of opinions and ideas between a company's management or certain other employees and its various stakeholders.[364] The open format of blogs makes them an attractive forum for ongoing communications between and among companies and their clients, customers, suppliers, shareholders and other stakeholders.

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[361] *We have taken a similar approach in our proposed rules regarding prospectus delivery for open-end mutual funds. See the Mutual Fund Summary Prospectus Proposing Release, supra note 27.*

[362] *Whether an individual is acting on behalf of a company will, as always, be a facts and circumstances determination. We note that companies generally have policies on who may speak on behalf of the company and on maintaining the confidentiality of company information for purposes of Regulation FD compliance and insider trading and tipping liability.*

[363] *A "blog" has been defined as "[a] Website (or section of a Website) where users can post a chronological, up-to-date e-journal entry of their thoughts. [I]t is an open forum communication tool that, depending on the Website, is either very individualistic or performs a crucial function for an organization or company. There are three basic varieties of blogs: those that post links to other sources, those that compile news and articles, and those that provide a forum for opinions and commentary." See http://www.netlingo.com/lookup.cfm?term=blog.*

[364] *For example, a manufacturing company could sponsor a blog for its staff tasked with designing, developing and troubleshooting products. Vendors and end-users likely would find such a forum helpful. Shareholders also may welcome the opportunity to view and/or join a discussion of the uses of a company's existing products to better understand one of the means a company derives revenues, especially with the "front-line" employees responsible for those products.*

Similar to blogs, electronic shareholder forums can serve as a means for investors to communicate with companies and each other and to provide investor feedback on various issues in a real-time basis, and we have adopted rules to encourage their use.[365] These forums are designed to promote interactive communication—between and among the company and its various stakeholders and with the public at large.

We acknowledge the utility these interactive web site features afford companies and shareholders alike, and want to promote their growth as important means for companies to maintain a dialogue with their various constituencies. As we noted in the Shareholder Forum Release, companies may find these forums "of use in better gauging shareholder interest with respect to a variety of topics." and the forums "could be used to provide a means for management to communicate with shareholders by posting press releases, notifying shareholders of record dates, and expressing the views of the company's management and board of directors.[366] Accordingly, we are providing the following guidance for companies hosting or participating in blogs or electronic shareholder forums:

- The antifraud provisions of the federal securities laws apply to blogs and to electronic shareholder forums. As stated above, companies are responsible for statements made by the companies, or on their behalf, on their web sites or on third party web sites, and the antifraud provisions of the federal securities laws reach those statements. While blogs or forums can be informal and conversational in nature, statements made there by the company (or by a person acting on behalf of the company) will not be treated differently from other company statements when it comes to the antifraud provisions of the federal securities laws. Employees acting as representatives of the company should be aware of their responsibilities in these forums, which they cannot avoid by purporting to speak in their "individual" capacities.

- Companies cannot require investors to waive protections under the federal securities laws as a condition to entering or participating in a blog or forum. Any term or condition of a blog or shareholder forum requiring users to agree not to make investment decisions based on the blog's or forum's content or disclaiming liability for damages of any kind arising from the use or inability to use the blog or forum is inconsistent with

[365] *See Electronic Shareholder Forums. Release No. 34-57172 (Jan. 18, 2008) [73 FR 4450] ("Shareholder Forum Release"). In this release, we adopted amendments to the proxy rules to clarify that participation in an electronic shareholder forum that could potentially constitute a solicitation subject to the proxy rules is exempt from most of the proxy rules if all of the conditions to the exemption are satisfied. In addition, the amendments state that a shareholder, company, or third party acting on behalf of a shareholder or company that establishes, maintains or operates an electronic shareholder forum will not be liable under the federal securities laws for any statement or information provided by another person participating in the forum. The amendments did not provide an exemption from Rule 14a-9 [17 CFR 240.14a-9]. which prohibits fraud in connection with the solicitation of proxies. The general disclosure obligations under the federal securities laws continue to apply to these forums as well. See id. at n. 88 (referring participants in shareholder forums to the requirements of Regulation FD); and id. at n. 2-1 (reminding participants that the antifraud provisions of Rule 14a-9 may require a participant in a forum that otherwise allows anonymity to identify itself if failure to do so in the circumstance would result in omission of a "material fact necessary in order to make the statements therein not false or misleading.").*

[366] *See id. at Section I.*

the federal securities laws and. we believe, violates the anti-waiver provisions of the federal securities laws.[367] A company is not responsible for the statements that third parties post on a web site the company sponsors, nor is a company obligated to respond to or correct misstatements made by third parties. The company remains responsible for its own statements made (including statements made on its behalf) in a blog or a forum.[368]

C. Disclosure Controls and Procedures

Postings on a company's web site also may implicate Exchange Act rules governing certification requirements relating to disclosure controls and procedures.[369] Under these rules, a company's principal executive officer and principal financial officer must certify that they are responsible for establishing and maintaining disclosure controls and procedures, that such controls and procedures have been designed to ensure that material information relating to the company is made known to them, that they have evaluated the effectiveness of the disclosure controls and procedures as of the end of a reporting period, and that they have disclosed in the company's periodic report for that reporting period their conclusions about the effectiveness of those controls and procedures.[370]

As discussed above in Section I.B. we have adopted rules permitting companies to satisfy certain Exchange Act disclosure obligations by posting that information on their web sites as an alternative to providing that information in an Exchange Act report.[371] If a company elects to satisfy such disclosure obligations by posting the information on its web site, disclosure controls and procedures would apply to such information because it is information required to be disclosed by the company in Exchange Act reports. Failure to make those disclosures on the company's web site would result in an Exchange Act report being incomplete. For example, if the company failed to disclose waivers of its code of ethics on its web site, it would need to file an Item 5.05 Form 8-K: if the company failed to disclose its board policy on director attendance

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[367]*See Securities Act Section 14 [15 U.S.C. 77n]; Exchange Act Section 29(a) (15 U.S.C. 78cc]; Section 47(a) of the Investment Company Act of 1940 ("'Investment Company Act") [15 U.S.C. 80a-46(a)] and Section 215(a) of the Advisers Act [15 U.S.C. 806-15].*

[368]*See, e.g., Rule !4a-17(b) [17 CFR 240.14a-17(b)]. Of course, the company may be held responsible under the "adoption theory" or "entanglement theory" if the company adopts, endorses, or approves the statement. See generally Section II.B.2., supra.*

[369]*Exchange Act Rules 13a-15(e) [17 CFR 240.13a-15(e)) and 15d-15(e) [17 CFR 240.15d-15(e)] and Investment Company Act Rule 30a-3(c) [17 CFR 270.30a-3(c)] define "disclosure controls and procedures" as those controls and procedures designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is:*

(1)'"recorded, processed, summarized and reported, within [he time periods specified in the Commission's rules and forms." and

(2)"accumulated and communicated to the company's management... as appropriate to allow timely decisions regarding required disclosure."

[370]*See Exchange Act Rule 13a-14(a) [17 CFR 240.13a-14(a)]; Exchange Act Rule 15d-14(a) [17 CFR 240.15d-14(a)]; Item 60l(b)(31)(i) of Regulation S-K [17 CFR 229.60l(b)(31)(i)]; Investment Company Act Rule 30a-2(a) [17 CFR 270.30a-2(a)].*

[371]*See Section I.B, supra.*

at the annual meeting of security holders on its web site, it would need to do so in its proxy statement.[372] Hence, companies must make sure that their disclosure controls and procedures are designed to address the disclosure of such information on their web sites.

On the other hand, disclosure controls and procedures do not apply to other disclosures of information on a company's web site. This means that the principal executive officer and principal financial officer will not be disclosing their conclusions regarding the effectiveness of any controls that a company may have in place regarding its web site disclosure of information, other than those controls with respect to information that is posted as an alternative to being provided in an Exchange Act report. That said, other disclosures on a company's web site are subject to antifraud liability, and companies also need to consider whether such disclosures are in compliance with Regulation FD, the Securities Act, and the federal proxy rules, among others.

D. Formal of Information and Readability

The nature of online information is increasingly interactive, not static. The inability to print a particular browser screen or presentation, particularly one designed for interactive viewing and not for reading outside the electronic context, is not inherently detrimental to its readability. We do not think it is necessary that information appearing on company web sites satisfy a printer-friendly standard[373] unless our rules explicitly require it.[374] For example, our notice and access model requires that electronically posted proxy materials be presented in a format "convenient for both reading online and printing on paper."[375] Hence, all other information on a company's web site need not be made available in a format comparable to paper-based information.[376]

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[372]*See Instruction to Item 407(b)(2) of Regulation S-K [17 CFR 229.407(b)(2)].*

[373]*See 1996 Electronics Release, supra note 25 at Section II.A.2. We use the term "printer-friendly" to describe a version of a web page that is formatted for printing. For example, if a web page includes advertising and navigation, those items may be removed to format the relevant content for printing on standard size paper.*

[374]*For example, Exchange Act Rule 14a-16(c) [17 CFR 240.14a-16(c)] requires proxy materials to be presented in a format convenient for both reading online and printing in paper when delivered electronically. See the text accompanying note [97] supra. See Shareholder Choice Release, supra note 21, at n. 35: "We believe that requiring readable and printable formats is important so that shareholders have meaningful access to the proxy materials." Similarly, proposed Rule 498 under the Securities Act would permit the obligation to deliver a statutory prospectus relating to a mutual fund to be satisfied by sending or giving a summary prospectus and providing the statutory prospectus online. If provided online, proposed Securities Act Rule 498(f)(2)(i) would require that the statutory prospectus be presented in a format that is "convenient for both reading online and printing on paper." See Mutual fund Summary Prospectus Proposing Release, supra note 27, at Section II.B.3. and n. 113.*

[375]*See Exchange Act Rule 14a-16(c); Internet Proxy Release, supra note 10. at n. 82.*

[376]*See 1996 Electronics Release, supra note 25. at Section II.A.2. As we noted in the 2000 Electronics Release, if special software is required in order to view information aimed at investors that a company puts on its web site, we believe the company should make a free, downloadable version of the software available on the web site or the site should contain information on the location where the required software may be downloaded free of charge so that all investors can effectively access the information provided. In the case of interactive data, we have taken a different approach. We have proposed that companies that maintain web sites post on their web sites the same interactive data they file or furnish with certain Exchange Act reports and Securities Act registration statements. We have not proposed, however, that registrants also provide interactive data viewers (or information on how to obtain viewers] on their web sites. Instead, we have determined to allow third parties to develop viewers, anticipating that these viewers will, over time, become more readily accessible at a little or no cost to investors. The Commission makes several interactive data viewers available through its web site at http://www.sec.gov/spotlight/xbrl/xbrlwebapp.shtml. See Interactive Data Proposing Releases, supra note 14, at Section II.A. and supra note 15.*

III. Request for Comment

We invite interested parties to submit written comment on any other approaches or issues involved in facilitating the use of electronic media, including as a result of technological developments, to further the disclosure purposes of the federal securities laws.

List of Subjects in 17 CFR Parts 241 and 271

Securities

Amendment (if the Code of Federal Regulations

For the reasons set out in the preamble. Title 17 Chapter II of the Code of Federal Regulations is amended as set forth below:

PART 241—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

Part 241 is amended by adding Release No. 34-58288 and the release date of August 1, 2008, to the list of interpretive releases.

PART 271—INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT COMPANY ACT OF 1940 AND GENERAL RULES AND REGULATIONS THEREUNDER

Part 271 is amended by adding Release No. IC-28351 and the release date of August 1, 2008, to the list of interpretive releases.

By the Commission.

Florence E. Harmon
Acting Secretary

Dated: August 1, 2008

IM Guidance Update

MARCH 2013 | No. 2013-01

FILING REQUIREMENTS FOR CERTAIN ELECTRONIC COMMUNICATIONS

The staff has received inquiries regarding whether certain interactive content posted in a real-time electronic forum (*i.e.*, chat rooms or other social media) ("interactive content") should be filed under the filing requirements of Section 24(b) of the Investment Company Act of 1940 ("1940 Act") or Rule 497 under the Securities Act of 1933 ("1933 Act") if it is not required to be filed under Financial Industry Regulatory Authority ("FINRA") Rule 2210.[1] The staff believes that certain interactive content need not be filed. Whether a communication need be filed depends on the content, context, and presentation of the particular communication or set of communications and requires an examination of the underlying substantive information transmitted to the social media user and consideration of any other facts and circumstances, such as whether the interactive communication is merely a response to a request or inquiry from the social media user or is forwarding previously-filed content. The following examples of interactive communications are intended to provide more guidance.

The staff would view the following as examples of interactive communications that generally need not be filed:

- An incidental mention of a specific investment company or family of funds not related to a discussion of the investment merits of the fund.
    - "Fund X Family of Funds invites you to their annual benefit for XYZ Charity."
    - "More than 100 Fund X employees volunteered for our Annual Day of Caring!"
    - "Consumer Reports has written an article in which it mentions our Brand X Rewards Card. Are you a card member?"
- The incidental use of the word "performance" in connection with a discussion of an investment company or family of funds, without specific mention of some or all of the elements of a fund's return (*e.g.*, 1, 5 and 10 year performance).[2]
    - "We update the performance of our funds every month and publish the results on <website url>."
    - "Click on this link <website url> where we provide full details of our yearly performance since inception."
    - "When reviewing a mutual fund's historical performance it's important to consider the following:
        - Total return
        - Performance against benchmark index
        - Performance against peers

- Past performance is not a guarantee of future returns."

- A factual introductory statement forwarding or including a hyperlink to a fund prospectus or to information that is filed pursuant to Section 24(b) or Rule 497:[3]
  - "The new ABC ETF Strategy Report is now available through this link: <website url>."
  - "We launched two new emerging market funds this week. More info about them is available here <website url>."
  - "John Doe is the new portfolio manager for ABC fund. <website url>."
- An introductory statement not related to a discussion of the investment merits of a fund that forwards or includes a hyperlink to general financial and investment information such as discussions of basic investment concepts or commentaries on economic, political or market conditions:
  - "The 'low volatility anomaly' is explained in our latest white paper: <website url>."
  - "Our data shows the average 401(k) balance is the highest it's been in more than 10 years! This is partly due to increasing employer and employee contributions. <website url>."
  - "The election is over, what is next for our economy? See our report analyzing the elections. <website url>."
  - "Here's a Q&A with our Portfolio Manager, John Doe, regarding his views on the economy for 2013. <website url>."
  - "Gold and silver have provided a relatively low correlation to stocks and bonds over the last few years. <website url>."
- A response to an inquiry by a social media user that provides discrete factual information that is not related to a discussion of the investment merits of the fund. The response may direct the social media user to the fund prospectus or to access information filed with FINRA pursuant to Section 24(b) or Rule 497 or to contact the issuer through a different medium (*e.g.*, phone, e-mail).

  INQUIRY: "Why are your funds such a large investor in ABC Manufacturer's stock?"

  Fund's posted response: "We respect your thoughts. As you know, ABC Manufacturer is found in many broad-market indices that our index funds are obligated to track so some of our index funds hold those shares as a result."

  INQUIRY: "Can you add a page to your website providing personalized information on year-end distribution dates, estimated distributions, and total estimated distributions?"

  Fund's posted response: "Here's a link to our website that may provide the information you're interested in: <website url>"

INQUIRY: "What is a better investment, buying real estate or buying a REIT?"

Fund's posted response: "There are a lot of things to consider when choosing between the two options. The answer depends on your goals and risk tolerance and whether you want to invest in a REIT, a fund that invests in REITs, or real property. While we can't talk about specific funds on [social media] please give us a call at 1-800-***-**** and we'll be happy to talk to you in more detail about this."

INQUIRY: "With companies paying dividends in December to avoid concerns with 2013, are you anticipating paying larger than usual capital gains and dividends in December 2012?"

Fund's posted response: "According to a lead analyst in our Investment Strategy Group, our published capital gains and dividends estimates are not that different this year than in recent years. Here's a link to our estimates: <website url>."

INQUIRY: "What was the NAV for ABC fund on Friday?"

Fund's posted response: "$xx.xx"

INQUIRY: "What are the fees and expenses for ABC Fund?"

Fund's posted response: "Information on the fund's fees and expenses is available at <website url>. Feel free to contact us at 1-800-***-**** for more information about this fund."

INQUIRY: "How can I exchange shares from one fund to another?"

Fund's posted response: "Information about exchanging fund shares is available on our website at <website url>. Feel free to call us at 1-800***-**** to assist you with this process."

The staff would view the following as examples of interactive communications that generally should be filed pursuant to Section 24(b) or Rule 482, as appropriate:

- A discussion of fund performance that provides specific mention of some or all of the elements of a fund's return (*e.g.*, 1, 5 and 10 year performance) or promotes a fund's returns.
    - "Our quarter-end returns have exceeded our expectations!"
    - "Please keep in mind the fund's high double-digit returns were primarily achieved during favorable market conditions."
    - "Fund performance rebounded strongly during the third quarter of 2012."
    - "The fund slightly underperformed its benchmark, the S&P 500 Index, during the quarter that ended September 30, 2012.
- A communication initiated by the issuer that discusses the investment merits of the fund.
    - "Looking for dividends? Think global and consider our new Global Equity Fund. <website url>."

- "What's your favorite technology to invest in? Read our portfolio manager's views regarding Fund X as an investment opportunity in this space. <website url>."
- "As you plan for retirement, consider our new lifecycle fund <website url>."
- "Our ABC Fund was included in the list of best new funds recently published by Morningstar. <website url>"

Endnotes

[1]In particular, Section 24(b) of the 1940 Act prohibits certain investment companies from transmitting any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors ("24(b) ads") through U.S. jurisdictional means unless the 24(b) ads have been filed with the Commission or are filed within 10 days of the transmission. Further, Rule 497 under the 1933 Act requires registered investment company performance advertisements subject to Rule 482 ("482 ads") to be filed with the Commission. 24(b) ads and 482 ads are considered filed with the Commission if filed with FINRA.

In the past, FINRA deemed real-time, interactive content on social networking as a public appearance, exempt from FINRA Rule 2210's filing requirement (the current category is "retail communications"). *See* "Blogs and Bulletin Boards," Guide to the Web for Registered Representatives available at http://www.finra.org/Industry/Issues/Advertising/p006118; and "Ask the Analyst-Electronic Communications," NASD Regulation, Regulatory & Compliance Alert (Mar. 1999) available at https://www.finra.org/industry/Regulation/Guidance/RCA/p015326. FINRA clarified to its members in 2010 that even if FINRA considers interactive content to be a public appearance exempt from Rule 2210's filing requirement, the SEC could still conclude that Rule 482 under the 1933 Act and the filing requirements of Section 24(b) of the Act apply to the communication. *See* Regulatory Notice 10-06, Social Media Web Sites: Guidance on Blogs and Social Networking Web Sites (January 2010) available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120779.pdf.

[2]In these examples, the performance discussion in the attached hyperlink "<website url>" is filed with FINRA pursuant to Rule 497.

[3]In other words, in these examples, the content of the hyperlink "<website url>" is filed with FINRA pursuant to Section 24(b) or Rule 497. An issuer cannot avoid the filing requirements of Section 24(b) or Rule 497 by posting an interactive communication that hyperlinks to or attaches material that should be, but has not been, filed (*e.g.*, a fund fact sheet).

This *IM Guidance Update* summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This *IM Guidance Update* is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this *IM Guidance Update*.

SHAREHOLDER NOTICES OF THE SOURCES OF FUND DISTRIBUTIONS - ELECTRONIC DELIVERY

The staff has been asked whether management investment companies (funds) registered under the Investment Company Act of 1940 (1940 Act) that make certain types of distributions to their shareholders may electronically deliver to their shareholders the required "written statement" describing the sources of those distributions. Electronic media may be a more efficient, effective and timely means of delivering the required information to fund shareholders. The staff's view is that funds may electronically deliver to their shareholders the required "written statement" describing the sources of their distributions.

Background

Section 19(a) of the 1940 Act generally prohibits a fund from making a distribution from any source other than the fund's net income, unless that payment is accompanied by a written statement that adequately discloses the source or sources of the payment.[1] Rule 19a-1 under the 1940 Act specifies the information required to be disclosed in the written statement (Rule 19a-1 Notice).[2] Rule 19a-1(a) also states that every written statement "shall be made on a separate paper."

As innovations and advances in technology have facilitated the expanding use of electronic media, the Commission has periodically issued interpretive guidance on how registrants may use electronic media to deliver information to investors.[3] This Commission guidance, however, has not focused specifically on Rule 19a-1, and the rule was last amended in 1973, before document delivery through electronic media was possible.

Electronic Delivery of Rule 19a-1 Notices

Notwithstanding the rule's provision referencing "a separate paper," the staff believes that electronic delivery of a Rule 19a-1 Notice, consistent with the Commission's guidance, would satisfy the purposes and policies underlying Rule 19a-1.[4] Moreover, electronic delivery may be a more efficient, effective and timely means of providing fund shareholders with the required information.[5] The staff's view reflects the framework established by the Commission for satisfactory electronic delivery: notice, access and evidence of delivery.[6] The staff's view is predicated on compliance with all applicable Commission guidance on electronic delivery, including, without limitation: (i) electronic delivery of a Rule 19a-1 Notice in the form of an e-mail message to the fund shareholder containing the Rule 19a-1 Notice or a document link to the Rule 19a-1 Notice; (ii) the fund (or its intermediary) having obtained prior consent of the shareholder to receive fund shareholder communications through electronic means (Consent); and (iii) electronic delivery of Rule 19a-1 Notices only to fund shareholders that provided the Consent, and cessation of electronic delivery of Rule 19a-1 Notices to any fund shareholder who withdraws or revokes the Consent.

Endnotes

[1]Section 19(a) was intended to prevent funds from creating a false impression of gains. *See* Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3rd Sess., 275, 278 (1940). *See also* In the Matter of Gabelli Funds, LLC, Investment Company Act Release No. 28580 (Jan. 12, 2009) (settlement) ("The purpose of Section 19(a) and Rule 19a-1 is to afford shareholders adequate disclosure of the sources from which the payments are made so shareholders will not believe that a fund portfolio is generating investment income when, in fact, distributions are paid from other sources, such as shareholder capital or capital gains." (footnote omitted)); Investment Company Institute, SEC Staff No-Action Letter (July 22, 1996) (1996 Letter) (addressing how the requirements of Rule 19a-1 may be satisfied when a fund offers shareholders the option of automatically reinvesting dividends, directing dividend payments, or receiving dividend payments by check).

[2]Rule 19a-1(g) provides, in relevant part, that "[t]he purpose of this rule, in the light of which it shall be construed, is to afford security holders adequate disclosure of the sources from which dividend payments are made." In adopting Rule 19a-1, the Commission stated that "[a]n important feature of the rule is the extent to which it requires explicit and affirmative disclosure whenever a dividend is being paid from a capital source." Letter of the Director of the Investment Company Division Relating to Section 19 and Rule N-19-1, Investment Company Act Release No. 71 (Feb. 21,1941).

[3]Use of Electronic Media for Delivery Purposes, Investment Company Act Release No. 21399 (Oct. 6,1995) ("The extent to which required disclosure is made, as opposed to the medium for providing it, should be most important to the analysis of whether sufficient disclosure has occurred under the securities laws."); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Investment Company Act Release No. 21945 (May 9, 1996); Use of Electronic Media, Investment Company Act Release No. 24426 (Apr. 28, 2000) ("2000 Release").

[4]The staff's view also extends to funds delivering Rule 19a-1 Notices pursuant to the 1996 Letter.

[5]For example, a fund shareholder who has requested electronic delivery by a fund of shareholder documents and communications may overlook a Rule 19a-1 Notice delivered in another medium, *i.e.*, paper.

[6]See note 3, *supra*. "Issuers and market intermediaries . . . must . . . assess their compliance with legal requirements in terms of . . . notice, access and evidence of delivery." 2000 Release.

This *IM Guidance Update* summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This *IM Guidance Update* is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this *IM Guidance Update*.

APPENDIX V

SELECTED SECTIONS FROM REGULATION C UNDER THE SECURITIES ACT OF 1933 —REGISTRATION

Rule 134b Statements of additional information.

For the purpose only of Section 5(b) of the Act the term "prospectus" as defined in Section 2(a)(10) of the Act does not include a Statement of Additional Information filed as part of a registration statement on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter) transmitted prior to the effective date of the registration statement if it is accompanied or preceded by a preliminary prospectus meeting the requirements of Rule 430.

Rule 154. Delivery of prospectuses to investors at the same address

(a) Delivery of a single prospectus. If you must deliver a prospectus under the federal securities laws, for purposes of sections 5(b) and 2(a)(10) of the Act or Rule 15c2-8(b) of this chapter, you will be considered to have delivered a prospectus to investors who share an address if:

(1) You deliver a prospectus to the shared address;

(2) You address the prospectus to the investors as a group (for example, "ABC Fund [or Corporation] Shareholders," "Jane Doe and Household," "The Smith Family") or to each of the investors individually (for example, "John Doe and Richard Jones"); and

(3) The investors consent in writing to delivery of one prospectus.

(b) Implied consent. You do not need to obtain written consent from an investor under paragraph (a)(3) of this section if all of the following conditions are met:

(1) The investor has the same last name as the other investors, or you reasonably believe that the investors are members of the same family;

(2) You have sent the investor a notice at least 60 days before you begin to rely on this section concerning delivery of prospectuses to that investor. The notice must be a separate written statement and:

(i) State that only one prospectus will be delivered to the shared address unless you receive contrary instructions;

(ii) Include a toll-free telephone number or be accompanied by a reply form that is preaddressed with postage provided, that the investor can use to notify you that he or she wishes to receive a separate prospectus;

(iii) State the duration of the consent;

(iv) Explain how an investor can revoke consent;

(v) State that you will begin sending individual copies to an investor within 30 days after you receive revocation of the investor's consent; and

(vi) Contain the following prominent statement, or similar clear and understandable statement, in bold-face type: "Important Notice Regarding Delivery of Shareholder Documents." This statement also must appear on the envelope in which the notice is delivered. Alternatively, if the notice is delivered separately from other communications to investors, this statement may appear either on the notice or on the envelope in which the notice is delivered;

NOTE Rule 154(b)(2): The notice should be written in plain English. See Rule 421(d)(2) for a discussion of plain English principles.

(3) You have not received the reply form or other notification indicating that the investor wishes to continue to receive an individual copy of the prospectus, within 60 days after you sent the notice; and

(4) You deliver the prospectus to a post office box or to a residential street address. You can assume a street address is a residence unless you have information that indicates it is a business.

(c) Revocation of consent. If an investor, orally or in writing, revokes consent to delivery of one prospectus to a shared address (provided under paragraphs (a)(3) or (b) of this section), you must begin sending individual copies to that investor within 30 days after you receive the revocation. If the individual's consent concerns delivery of the prospectus of a registered open-end management investment company, at least once a year you must explain to investors who have consented how they can revoke their consent. The explanation must be reasonably designed to reach these investors.

(d) Definition of address. For purposes of this section, address means a street address, a post office box number, an electronic mail address, a facsimile telephone number, or other similar destination to which paper or electronic documents are delivered, unless otherwise provided in this section. If you have reason to believe that an address is the street address of a multi-unit building, the address must include the unit number.

REGULATION C—REGISTRATION

Rule 400. Application of §230.400 to §230.494, Inclusive.

Sections 230.400 to 230.494 shall govern every registration of securities under the Act, except that any provision in a form, or an item of Regulation S-K (17 CFR 229.001 et seq.) referred to in such form, covering the same subject matter as any such rule shall be controlling unless otherwise specifically provided in §§230.400 to 230.494.

General Requirements

Rule 401. Requirement as to Proper Form.

(a) The form and contents of a registration statement and prospectus shall conform to the applicable rules and forms as in effect on the initial filing date of such registration statement and prospectus.

(b) If an amendment to a registration statement and prospectus is filed for the purpose of meeting the requirements of section 10(a)(3) of the Act or pursuant to the provisions of section 24(e) or 24(f) of the Investment Company Act of 1940, the form and contents of such an amendment shall conform to the applicable rules and forms as in effect on the filing date of such amendment.

(c) An amendment to a registration statement and prospectus, other than an amendment described in paragraph (b) of this section, may be filed on any shorter Securities Act registration form for which it is eligible on the filing date of the amendment. At the issuer's option, the amendment also may be filed on the same Securities Act registration form used for the most recent amendment described in paragraph (b) of this section or, if no such amendment has been filed, the initial registration statement and prospectus.

(d) The form and contents of a prospectus forming part of a registration statement which is the subject of a stop order entered under section 8(d) of the Act, if used after the date such stop order ceases to be effective, shall conform to the applicable rules and forms as in effect on the date such stop order ceases to be effective.

(e) A prospectus filed as part of an amendment to an effective registration statement, or other amendment to such registration statement, on any form may be prepared in accordance with the requirements of any other form which would then be appropriate for the registration of securities to which the prospectus or other amendment relates, provided that all of the other requirements of such other form and applicable rules (including any required undertakings) are met.

(f) Notwithstanding the provisions of this section, a registrant (1) shall comply with the rules and forms as in effect at a date different from those specified in paragraphs (a), (b), (c) and (d) of this section if the rules or forms or amendments thereto specifically so provide; and (2) may comply voluntarily with the rules and forms as in effect at dates subsequent to those speci-

fied in paragraphs (a), (b), (c) and (d) of this section, provided that all of the requirements of the particular rules and forms in effect at such dates (including any required undertakings) are met.

(g)(1) Subject to paragraphs (g)(2), (g)(3) and (g)(4) of this section, except for registration statements and post-effective amendments that become effective immediately pursuant to Rule 462 and Rule 464 (§230.462 and §230.464), a registration statement or any amendment thereto is deemed filed on the proper registration form unless the Commission objects to the registration form before the effective date.

(2) An automatic shelf registration statement as defined in Rule 405 (§230.405) and any post-effective amendment thereto are deemed filed on the proper registration form unless and until the Commission notifies the issuer of its objection to the use of such form. Following any such notification, the issuer must amend its automatic shelf registration statement onto the registration form it is then eligible to use, *provided*, *however,* that any continuous offering of securities pursuant to Rule 415 (§230.415) that the issuer has commenced pursuant to the registration statement before the Commission has notified the issuer of its objection to the use of such form may continue until the effective date of a new registration statement or post-effective amendment to the registration statement that the issuer has filed on the proper registration form, if the issuer files promptly after notification the new registration statement or post-effective amendment and if the offering is permitted to be made under the new registration statement or post-effective amendment.

(3) Violations of General Instruction I.B.6. of Form S-3 or General Instruction I.B.5. of Form F-3 will also violate the requirements as to proper form under this section notwithstanding that the registration statement may have been declared effective previously.

(4) Notwithstanding that the registration statement may have become effective previously, requirements as to proper form under this section will have been violated for any offering of securities where the requirements of General Instruction I.A. of Form SF-3 (§239.45 of this chapter) have not been met as of ninety days after the end of the depositor's fiscal year end prior to such offering.

Rule 401a. Requirements as to proper form.

With regard to issuers eligible to rely on Release No. 34-45589 (March 18, 2002) (which may be viewed on the Commission's website at www.sec.gov), the filing of reports in accordance with the provisions of that Release shall result in those reports being "timely filed" for purposes of all form eligibility standards in registration statement forms under the Securities Act of 1933.

Rule 402. Number of Copies; Binding; Signatures.

(a) Three copies of the complete registration statement, including exhibits and all other papers and documents filed as a part of the statement, shall be filed with the Commission. Each copy shall be bound, in one or more parts, without stiff covers. The binding shall be made on the side or stitching margin in such manner as to leave the reading matter legible. At least one such copy of every registration shall be signed by the persons specified in section 6(a) of the Act. Unsigned copies shall be conformed.

(b) Ten additional copies of the registration statement, similarly bound, shall be furnished for use in the examination of the registration statement, public inspection, copying and other purposes. Where a registration statement incorporates into the prospectus documents which are required to be delivered with the prospectus in lieu of prospectus presentation, the ten additional copies of the registration statement shall be accompanied by ten copies of such documents. No other exhibits are required to accompany such additional copies.

(c) Notwithstanding any other provision of this section, if a registration statement is filed on Form S-8 (§239.16b of this chapter), three copies of the complete registration statement, including exhibits and all other papers and documents filed as a part of the statement, shall be filed with the Commission. Each copy shall be bound, in one or more parts, without stiff covers. The binding shall be made on the side or stitching margin in such manner as to leave the reading matter legible. At least one such copy shall be signed by the persons specified in section 6(a) of the Act. Unsigned copies shall be conformed. Three additional copies of the registration statement, similarly bound, also shall be furnished to the Commission for use in the examination of the registration statement, public inspection, copying and other purposes. No exhibits are required to accompany the additional copies of registration statements filed on Form S-8.

(d) Notwithstanding any other provision of this section, if a registration statement is filed pursuant to Rule 462(b) (§230.462(b)) and Rule 110(d) (§230.110(d)), one copy of the complete registration statement, including exhibits and all other papers and documents filed as a part thereof shall be filed with the Commission. Such copy should not be bound and may contain facsimile versions of manual signatures in accordance with paragraph (e) of this section.

(e) ***Signatures***. Where the Act or the rules thereunder, including paragraphs (a) and (c) of this section, require a document filed with or furnished to the Commission to be signed, such document shall be manually signed, or signed using either typed signatures or duplicated or facsimile versions of manual signatures. Where typed, duplicated or facsimile signatures are used, each signatory to the filing shall manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in the filing. Such document shall be executed before or at the time the filing is made and shall be retained by the registrant for a period of five years. Upon request, the registrant shall furnish to the Commission or its staff a copy of any or all documents retained pursuant to this section.

Rule 403. Requirements as to Paper, Printing, Language and Pagination.

(a) Registration statements, applications and reports shall be filed on good quality, unglazed, white paper no larger than 8½ x 11 inches in size, insofar as practicable. To the extent that the reduction of larger documents would render them illegible, such documents may be filed on paper larger than 8½ x 11 inches in size.

(b) The registration statement and, insofar as practicable, all papers and documents filed as a part thereof shall be printed, lithographed, mimeographed or typewritten. However, the statement or any portion thereof may be prepared by any similar process which, in the opinion of the

Commission, produces copies suitable for a permanent record. Irrespective of the process used, all copies of any such material shall be clear, easily readable and suitable for repeated photocopying. Debits in credit categories and credits in debit categories shall be designated so as to be clearly distinguishable as such on photocopies.

(c)(1) All Securities Act filings and submissions must be in the English language, except as otherwise provided by this section. If a registration statement or other filing requires the inclusion of a document that is in a foreign language, the filer must submit instead a fair and accurate English translation of the entire foreign language document, except as provided by paragraph (c)(3) of this section.

(2) If a registration statement or other filing or submission subject to review by the Division of Corporation Finance requires the inclusion of a foreign language document as an exhibit or attachment, the filer must submit a fair and accurate English translation of the foreign language document if consisting of any of the following, or an amendment of any of the following:

(i) Articles of incorporation, memoranda of association, bylaws, and other comparable documents, whether original or restated;

(ii) Instruments defining the rights of security holders, including indentures qualified or to be qualified under the Trust Indenture Act of 1939;

(iii) Voting agreements, including voting trust agreements;

(iv) Contracts to which directors, officers, promoters, voting trustees or security holders named in a registration statement are parties;

(v) Contracts upon which a filer's business is substantially dependent;

(vi) Audited annual and interim consolidated financial information; and

(vii) Any document that is or will be the subject of a confidential treatment request under §230.406 or §240.24b-2 of this chapter.

(3)(i) A filer may submit an English summary instead of an English translation of a foreign language document as an exhibit or attachment to a filing subject to review by the Division of Corporation Finance as long as:

(A) The foreign language document does not consist of any of the subject matter enumerated in paragraph (c)(2) of this section; or

(B) The applicable form permits the use of an English summary.

(ii) Any English summary submitted under paragraph (c)(3) of this section must:

(A) Fairly and accurately summarize the terms of each material provision of the foreign language document; and

(B) Fairly and accurately describe the terms that have been omitted or abridged.

(4) When submitting an English summary or English translation of a foreign language document under this section, a filer must identify the submission as either an English summary or English translation. A filer may submit a copy of the unabridged foreign language document when including an English summary or English translation of a foreign language document in a filing. A filer must provide a copy of any foreign language document upon the request of Commission staff.

(5) A Canadian issuer may file an exhibit or other part of a registration statement on Form F-7, F-8, F-9, F-10, or F-80 (§§239.37, 239.38, 239.39, 239.40, or 239.41 of this chapter), that contains text in both French and English if the issuer included the French text to comply with the requirements of the Canadian securities administrator or other Canadian authority and, for an electronic filing, if the filing is an HTML document, as defined in Regulation S-T Rule 11(§232.11).

(d) The manually signed original (or in the case of duplicate originals, one duplicate original) of all registrations, applications, statements, reports or other documents filed under the Act shall be numbered sequentially (in addition to any internal numbering which otherwise may be present) by handwritten, typed, printed or other legible form of notation from the first page of the document through the last page of that document and any exhibits or attachments thereto. Further, the total number of pages contained in a numbered original shall be set forth on the first page of the document.

Rule 404. Preparation of Registration Statement.

(a) A registration statement shall consist of the facing sheet of the applicable form; a prospectus containing the information called for by Part I of such form; the information, list of exhibits, undertakings and signatures required to be set forth in Part II of such form; financial statements and schedules; exhibits; any other information or documents filed as part of the registration statement; and all documents or information incorporated by reference in the foregoing (whether or not required to be filed).

(b) All general instructions, instructions to items of the form, and instructions as to financial statements, exhibits, or prospectuses are to be omitted from the registration statement in all cases.

(c) The prospectus shall contain the information called for by all of the items of Part I of the applicable form, except that unless otherwise specified, no reference need be made to inapplicable items, and negative answers to any item in Part I may be omitted. A copy of the prospectus may be filed as a part of the registration statement in lieu of furnishing the information in item-and-answer form. Wherever a copy of the prospectus is filed in lieu of information in item-and-answer form, the text of the items of the form is to be omitted from the registration statement, as well as from the prospectus, except to the extent provided in paragraph (d) of this rule.

(d) Where any items of a form call for information not required to be included in the prospectus, generally Part II of such form, the text of such items, including the numbers and captions thereof, together with the answers thereto shall be filed with the prospectus under cover of the facing sheet of the form as a part of the registration statement. However, the text of such items may be omitted provided the answers are so prepared as to indicate the coverage of the item without the necessity of reference to the text of the item. If any such item is inapplicable, or the answer thereto is in the negative, a statement to that effect shall be made. Any financial statements not required to be included in the prospectus shall also be filed as a part of the registration statement proper, unless incorporated by reference pursuant to Rule 411 (§230.411).

Rule 405. Definitions of Terms.

Unless the context otherwise requires, all terms used in §§230.400 to 230.494, inclusive, or in the forms for registration have the same meanings as in the Act and in the general rules and regulations. In addition, the following definitions apply, unless the context otherwise requires:

Affiliate. An "affiliate" of, or person "affiliated" with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.

Amount. The term "amount," when used in regard to securities, means the principal amount if relating to evidences of indebtedness, the number of shares if relating to shares, and the number of units if relating to any other kind of security.

Associate. The term "associate," when used to indicate a relationship with any person, means (1) a corporation or organization (other than the registrant or a majority-owned subsidiary of the registrant) of which such person is an officer or partner or is, directly or indirectly, the beneficial owner of 10 percent or more of any class of equity securities, (2) any trust or other estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar capacity, and (3) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of the registrant or any of its parents or subsidiaries.

Automatic shelf registration statement. The term *automatic shelf registration statement* means a registration statement filed on Form S-3 or Form F-3 (§239.13 or §239.33 of this chapter) by a well-known seasoned issuer pursuant to General Instruction I.D. or I.C. of such forms, respectively.

Business combination related shell company. The term *business combination related shell company* means a shell company (as defined in §230.405) that is:

(1) Formed by an entity that is not a shell company solely for the purpose of changing the corporate domicile of that entity solely within the United States; or

(2) Formed by an entity that is not a shell company solely for the purpose of completing a business combination transaction (as defined in §230.165(f) of this chapter) among one or more entities other than the shell company, none of which is a shell company.

Business development company. The term "business development company" refers to a company which has elected to be regulated as a business development company under sections 55 through 65 of the Investment Company Act of 1940.

Certified. The term "certified," when used in regard to financial statements, means examined and reported upon with an opinion expressed by an independent public or certified public accountant.

Charter. The term "charter" includes articles of incorporation, declarations of trust, articles of association or partnership, or any similar instrument, as amended, affecting (either with or without filing with any governmental agency) the organization or creation of an incorporated or unincorporated person.

Common equity. The term "common equity" means any class of common stock, or an equivalent interest, including but not limited to a unit of beneficial interest in a trust or a limited partnership interest.

Commission. The term "Commission" means the Securities and Exchange Commission.

Control. The term "control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

Depositary share. The term "depositary share" means a security, evidenced by an American Depositary Receipt, that represents a foreign security or a multiple of or fraction thereof deposited with a depositary.

Director. The term "director" means any director of a corporation or any person performing similar functions with respect to any organization whether incorporated or unincorporated.

Dividend or interest reinvestment plan. The term "dividend or interest reinvestment plan" means a plan which is offered solely to the existing security holders of the registrant, which allows such persons to reinvest dividends or interest paid to them on securities issued by the registrant, and also may allow additional cash amounts to be contributed by the participants in the plan, provided the securities to be registered are newly issued, or are purchased for the account of plan participants, at prices not in excess of current market prices at the time of purchase, or at prices not in excess of an amount determined in accordance with a pricing formula specified in the plan and based upon average or current market prices at the time of purchase.

Electronic filer. The term "electronic filer" means a person or an entity that submits filings electronically pursuant to Rules 100 and 101 of Regulation S-T (§§232.100 and 232.101 of this chapter, respectively).

Electronic filing. The term "electronic filing" means a document under the federal securities laws that is transmitted or delivered to the Commission in electronic format.

Employee. The term "employee" does not include a director, trustee, or officer.

Employee benefit plan. The term employee benefit plan means any written purchase, savings, option, bonus, appreciation, profit sharing, thrift, incentive, pension or similar plan or written compensation contract solely for employees, directors, general partners, trustees (where the registrant is a business trust), officers, or consultants or advisors. However, consultants or advisors may participate in an employee benefit plan only if:

(1) They are natural persons;

(2) They provide bona fide services to the registrant; and

(3) The services are not in connection with the offer or sale of securities in a capital-raising transaction, and do not directly or indirectly promote or maintain a market for the registrant's securities.

Equity security. The term *equity security* means any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.

Executive officer. The term "executive officer," when used with reference to a registrant, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant. Executive officers of subsidiaries may be deemed executive officers of the registrant if they perform such policy making functions for the registrant.

Fiscal year. The term "fiscal year" means the annual accounting period or, if no closing date has been adopted, the calendar year ending on December 31.

Foreign government. The term "foreign government" means the government of any foreign country or of any political subdivision of a foreign country.

Foreign issuer. The term "foreign issuer" means any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country.

Foreign private issuer. (1) The term foreign private issuer means any foreign issuer other than a foreign government except an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter:

(i) More than 50 percent of the outstanding voting securities of such issuer are directly or indirectly owned of record by residents of the United States; and

(ii) Any of the following:

(A) The majority of the executive officers or directors are United States citizens or residents;

(B) More than 50 percent of the assets of the issuer are located in the United States; or

(C) The business of the issuer is administered principally in the United States.

Note to paragraph (1) of the definition of *Foreign private issuer*: To determine the percentage of outstanding voting securities held by U.S. residents:

A. Use the method of calculating record ownership in §240.12g3-2(a) of this chapter, except that:

(1) The inquiry as to the amount of shares represented by accounts of customers resident in the United States may be limited to brokers, dealers, banks and other nominees located in:

(i) The United States,

(ii) The issuer's jurisdiction of incorporation, and

(iii) The jurisdiction that is the primary trading market for the issuer's voting securities, if different than the issuer's jurisdiction of incorporation; and

(2) Notwithstanding §240.12g5-1(a)(8) of this chapter, the issuer shall not exclude securities held by persons who received the securities pursuant to an employee compensation plan.

B. If, after reasonable inquiry, the issuer is unable to obtain information about the amount of shares represented by accounts of customers resident in the United States, the issuer may assume, for purposes of this definition, that the customers are residents of the jurisdiction in which the nominee has its principal place of business.

C. Count shares of voting securities beneficially owned by residents of the United States as reported on reports of beneficial ownership provided to the issuer or filed publicly and based on information otherwise provided to the issuer.

(2) In the case of a new registrant with the Commission, the determination of whether an issuer is a foreign private issuer shall be made as of a date within 30 days prior to the issuer's filing of an initial registration statement under either the Act or the Securities Exchange Act of 1934.

(3) Once an issuer qualifies as a foreign private issuer, it will immediately be able to use the forms and rules designated for foreign private issuers until it fails to qualify for this status at the end of its most recently completed second fiscal quarter. An issuer's determination that it fails to qualify as a foreign private issuer governs its eligibility to use the forms and rules designated for foreign private issuers beginning on the first day of the fiscal year following the determination date. Once an issuer fails to qualify for foreign private issuer status, it will remain unqualified unless it meets the requirements for foreign private issuer status as of the last business day of its second fiscal quarter.

Free writing prospectus. Except as otherwise specifically provided or the context otherwise requires, a *free writing prospectus* is any written communication as defined in this section that constitutes an offer to sell or a solicitation of an offer to buy the securities relating to a registered offering that is used after the registration statement in respect of the offering is filed (or, in the case of a well-known seasoned issuer, whether or not such registration statement is filed) and is made by means other than:

(1) A prospectus satisfying the requirements of section 10(a) of the Act, Rule 430 (§230.430), Rule 430A (§230.430A), Rule 430B (§230.430B), Rule 430C (§230.430C), Rule 430D (§230.430D) or Rule 431 (§230.431);

(2) A written communication used in reliance on Rule 167 and Rule 426 (§230.167 and §230.426); or

(3) A written communication that constitutes an offer to sell or solicitation of an offer to buy such securities that falls within the exception from the definition of prospectus in clause (a) of section 2(a)(10) of the Act.

Graphic communication. The term *graphic communication*, which appears in the definition of "write, written" in section 2(a)(9) of the Act and in the definition of written communication in this section, shall include all forms of electronic media, including, but not limited to, audiotapes, videotapes, facsimiles, CD-ROM, electronic mail, Internet Web sites, substantially similar messages widely distributed (rather than individually distributed) on telephone answering or voice mail systems, computers, computer networks and other forms of computer data compilation. Graphic communication shall not include a communication that, at the time of the communication, originates live, in real-time to a live audience and does not originate in recorded form or otherwise as a graphic communication, although it is transmitted through graphic means.

Ineligible issuer. (1) An *ineligible issuer* is an issuer with respect to which any of the following is true as of the relevant date of determination:

(i) Any issuer that is required to file reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) that has not filed all reports and other materials required to be filed during the preceding 12 months (or for such shorter period that the issuer was required to file such reports pursuant to sections 13 or 15(d) of the Securities Exchange Act of 1934), other than reports on Form 8-K (§249.308 of this chapter) required solely pursuant to an item specified in General Instruction I.A.3(b) of Form S-3 (§239.13 of this chapter) (or in the case of an asset-backed issuer, to the extent the depositor or any issuing entity previously established, directly or indirectly, by the depositor (as such terms are defined in Item 1101 of Regulation AB (§229.1101 of this chapter) are or were at any time during the preceding 12 calendar months required to file reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 with respect to a class of asset-backed securities involving the same asset class, such depositor and each such issuing entity must have filed all reports and other material required to be filed for such period (or such shorter period that each such entity was required to file such reports), other than reports on Form 8-K required solely pursuant to an item specified in General Instruction I.A.2 of Form SF-3);

(ii) The issuer is, or during the past three years the issuer or any of its predecessors was:

(A) A blank check company as defined in Rule 419(a)(2) (§230.419(a)(2));

(B) A shell company, other than a business combination related shell company, each as defined in this section;

(C) An issuer in an offering of penny stock as defined in Rule 3a51-1 of the Securities Exchange Act of 1934 (§240.3a51-1 of this chapter);

(iii) The issuer is a limited partnership that is offering and selling its securities other than through a firm commitment underwriting;

(iv) Within the past three years, a petition under the federal bankruptcy laws or any state insolvency law was filed by or against the issuer, or a court appointed a receiver, fiscal agent or similar officer with respect to the business or property of the issuer subject to the following:

(A) In the case of an involuntary bankruptcy in which a petition was filed against the issuer, ineligibility will occur upon the earlier to occur of:

(1) 90 days following the date of the filing of the involuntary petition (if the case has not been earlier dismissed); or

(2) The conversion of the case to a voluntary proceeding under federal bankruptcy or state insolvency laws; and

(B) Ineligibility will terminate under this paragraph (1)(iv) if an issuer has filed an annual report with audited financial statements subsequent to its emergence from that bankruptcy, insolvency, or receivership process;

(v) Within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of section 15(b)(4)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(4)(B)(i) through (iv));

(vi) Within the past three years (but in the case of a decree or order agreed to in a settlement, not before December 1, 2005), the issuer or any entity that at the time was a subsidiary of the issuer was made the subject of any judicial or administrative decree or order arising out of a governmental action that:

(A) Prohibits certain conduct or activities regarding, including future violations of, the anti-fraud provisions of the federal securities laws;

(B) Requires that the person cease and desist from violating the anti-fraud provisions of the federal securities laws; or

(C) Determines that the person violated the anti-fraud provisions of the federal securities laws;

(vii) The issuer has filed a registration statement that is the subject of any pending proceeding or examination under section 8 of the Act or has been the subject of any refusal order or stop order under section 8 of the Act within the past three years; or

(viii) The issuer is the subject of any pending proceeding under section 8A of the Act in connection with an offering.

(2) An issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer. Any such determination shall be without prejudice to any other action by the Commission in any other proceeding or matter with respect to the issuer or any other person.

(3) The date of determination of whether an issuer is an ineligible issuer is as follows:

(i) For purposes of determining whether an issuer is a well-known seasoned issuer, at the date specified for purposes of such determination in paragraph (2) of the definition of well-known seasoned issuer in this section; and

(ii) For purposes of determining whether an issuer or offering participant may use free writing prospectuses in respect of an offering in accordance with the provisions of Rules 164 and 433 (§230.164 and §230.433), at the date in respect of the offering specified in paragraph (h) of Rule 164.

Majority-owned subsidiary. The term "majority-owned subsidiary" means a subsidiary more than 50 percent of whose outstanding securities representing the right, other than as affected by events of default, to vote for the election of directors, is owned by the subsidiary's parent and/or one or more of the parent's other majority-owned subsidiaries.

Material. The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.

Officer. The term "officer" means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated.

Parent. A "parent" of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries.

Predecessor. The term "predecessor" means a person the major portion of the business and assets of which another person acquired in a single succession, or in a series of related successions in each of which the acquiring person acquired the major portion of the business and assets of the acquired person.

Principal underwriter. The term "principal underwriter" means an underwriter in privity of contract with the issuer of the securities as to which he is underwriter, the term "issuer" having the meaning given in sections 2(4) and 2(11) of the Act.

Promoter. (1) The term "promoter" includes—

(i) Any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes initiative in founding and organizing the business or enterprise of an issuer; or

(ii) Any person who, in connection with the founding and organizing of the business or enterprise of an issuer, directly or indirectly receives in consideration of services or property, or both services and property, 10 percent or more of any class of securities of the issuer or 10 percent or more of the proceeds from the sale of any class of such securities. However, a person who receives such securities or proceeds either solely as underwriting commissions or solely in consideration of property shall not be deemed a promoter within the meaning of this paragraph if such person does not otherwise take part in founding and organizing the enterprise.

(2) All persons coming within the definition of "promoter" in paragraph (1) of this definition may be referred to as "founders" or "organizers" or by another term provided that such term is reasonably descriptive of those persons' activities with respect to the issuer.

Prospectus. Unless otherwise specified or the context otherwise requires, the term "prospectus" means a prospectus meeting the requirements of section 10(a) of the Act.

Registrant. The term "registrant" means the issuer of the securities for which the registration statement is filed.

Share. The term "share" means a share of stock in a corporation or unit of interest in an unincorporated person.

Shell company. The term *shell company* means a registrant, other than an asset-backed issuer as defined in Item 1101(b) of Regulation AB (§ 229.1101(b) of this chapter), that has:

(1) No or nominal operations; and

(2) Either:

(i) No or nominal assets;

(ii) Assets consisting solely of cash and cash equivalents; or

(iii) Assets consisting of any amount of cash and cash equivalents and nominal other assets.

NOTE: For purposes of this definition, the determination of a registrant's assets (including cash and cash equivalents) is based solely on the amount of assets that would be reflected on the registrant's balance sheet prepared in accordance with generally accepted accounting principles on the date of that determination.

Significant Subsidiary. The term "significant subsidiary" means a subsidiary, including its subsidiaries, which meets any of the following conditions.

(1) The registrant's and its other subsidiaries' investments in and advances to the subsidiary exceed 10 percent of the total assets of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year (for a proposed business combination to be accounted for as a pooling of interests, this condition is also met when the number of common shares exchanged or to be exchanged by the registrant exceeds 10 percent of its total common shares outstanding at the date the combination is initiated) or

(2) The registrant's and its other subsidiaries' proportionate share of the total assets (after intercompany eliminations) of the subsidiary exceeds 10 percent of the total assets of the registrants and its subsidiaries consolidated as of the end of the most recently completed fiscal year; or

(3) The registrant's and its other subsidiaries' equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle of the subsidiary exceeds 10 percent of such income of the registrant and its subsidiaries consolidated for the most recently completed fiscal year.

Computational note: For purposes of making the prescribed income test the following guidance should be applied:

1. When a loss has been incurred by either the parent and its subsidiaries consolidated or the tested subsidiary, but not both, the equity in the income or loss of the tested subsidiary should be excluded from the income of the registrant and its subsidiaries consolidated for purposes of the computation.

2. If income of the registrant and its subsidiaries consolidated for the most recent fiscal year is at least 10 percent lower than the average of the income for the last five fiscal years, such average income should be substituted for purposes of the computation. Any loss years should be omitted for purposes of computing average income.

Smaller reporting company: As used in this part, the term *smaller reporting company* means an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:

(1) Had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or

(2) In the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, had a public float of less than $75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus, in the case of a Securities Act registration statement, the number of such shares included in the registration statement by the estimated public offering price of the shares; or

(3) In the case of an issuer whose public float as calculated under paragraph (1) or (2) of this definition was zero, had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available.

(4) Determination: Whether or not an issuer is a smaller reporting company is determined on an annual basis.

(i) For issuers that are required to file reports under section 13(a) or 15(d) of the Exchange Act, the determination is based on whether the issuer came within the definition of smaller reporting company using the amounts specified in paragraph (f)(2)(iii) of Item 10 of Regulation S-K (§ 229.10(f)(1)(i) of this chapter), as of the last business day of the second fiscal quarter of the issuer's previous fiscal year. An issuer in this category must reflect this determination in the information it provides in its quarterly report on Form 10-Q for the first fiscal quarter of the next year, indicating on the cover page of that filing, and in subsequent filings for that fiscal year, whether or not it is a smaller reporting company, except that, if a determination based on public float indicates that the issuer is newly eligible to be a smaller reporting company, the issuer may choose to reflect this determination beginning with its first quarterly report on Form 10-Q following the determination, rather than waiting until the first fiscal quarter of the next year.

(ii) For determinations based on an initial Securities Act or Exchange Act registration statement under paragraph (f)(1)(ii) of Item 10 of Regulation S-K (§ 229.10(f)(1)(ii) of this chapter), the issuer must reflect the determination in the information it provides in the registration statement and must appropriately indicate on the cover page of the filing, and subsequent filings for the fiscal year in which the filing is made, whether or not it is a smaller reporting company. The

issuer must redetermine its status at the end of its second fiscal quarter and then reflect any change in status as provided in paragraph (4)(i) of this definition. In the case of a determination based on an initial Securities Act registration statement, an issuer that was not determined to be a smaller reporting company has the option to redetermine its status at the conclusion of the offering covered by the registration statement based on the actual offering price and number of shares sold.

(iii) Once an issuer fails to qualify for smaller reporting company status, it will remain unqualified unless it determines that its public float, as calculated in accordance with paragraph (f)(1) of this definition, was less than $50 million as of the last business day of its second fiscal quarter or, if that calculation results in zero because the issuer had no public equity outstanding or no market price for its equity existed, if the issuer had annual revenues of less than $40 million during its previous fiscal year.

Subsidiary. A "subsidiary" of a specified person is an affiliate controlled by such person directly, or indirectly through one or more intermediaries. (See also "majority owned subsidiary," "significant subsidiary," "totally held subsidiary" and "wholly owned subsidiary.")

Succession. The term "succession" means the direct acquisition of the assets comprising a going business, whether by merger, consolidation, purchase, or other direct transfer. The term does not include the acquisition of control of a business unless followed by the direct acquisition of its assets. The terms "succeed" and "successor" have meanings correlative to the foregoing.

Totally held subsidiary. The term "totally held subsidiary" means a subsidiary (1) substantially all of whose outstanding securities are owned by its parent and/or the parent's other totally held subsidiaries, and (2) which is not indebted to any person other than its parent and/or the parent's other totally held subsidiaries in an amount which is material in relation to the particular subsidiary, excepting indebtedness incurred in the ordinary course of business which is not overdue and which matures within one year from the date of its creation, whether evidenced by securities or not.

Voting securities. The term "voting securities" means securities the holders of which are presently entitled to vote for the election of directors.

Well-known seasoned issuer. A *well-known seasoned issuer* is an issuer that, as of the most recent determination date determined pursuant to paragraph (2) of this definition:

(1)(i) Meets all the registrant requirements of General Instruction I.A. of Form S-3 or Form F-3 (§239.13 or §239.33 of this chapter) and either:

(A) As of a date within 60 days of the determination date, has a worldwide market value of its outstanding voting and non-voting common equity held by non-affiliates of $700 million or more; or

(B)(*1*) As of a date within 60 days of the determination date, has issued in the last three years at least $1 billion aggregate principal amount of non-convertible securities, other than common equity, in primary offerings for cash, not exchange, registered under the Act; and

(*2*) Will register only non-convertible securities, other than common equity, and full and unconditional guarantees permitted pursuant to paragraph (1)(ii) of this definition unless, at the determination date, the issuer also is eligible to register a primary offering of its securities relying on General Instruction I.B.1. of Form S-3 or Form F-3.

(*3*) Provided that as to a parent issuer only, for purposes of calculating the aggregate principal amount of outstanding non-convertible securities under paragraph (1)(i)(B)(*1*) of this definition, the parent issuer may include the aggregate principal amount of non-convertible securities, other than common equity, of its majority-owned subsidiaries issued in registered primary offerings for cash, not exchange, that it has fully and unconditionally guaranteed, within the meaning of Rule 3-10 of Regulation S-X (§ 210.3-10 of this chapter) in the last three years; or

(ii) Is a majority-owned subsidiary of a parent that is a well-known seasoned issuer pursuant to paragraph (1)(i) of this definition and, as to the subsidiaries' securities that are being or may be offered on that parent's registration statement:

(A) The parent has provided a full and unconditional guarantee, as defined in Rule 3-10 of Regulation S-X, of the payment obligations on the subsidiary's securities and the securities are non-convertible securities, other than common equity;

(B) The securities are guarantees of:

(*1*) Non-convertible securities, other than common equity, of its parent being registered; or

(*2*) Non-convertible securities, other than common equity, of another majority-owned subsidiary being registered where there is a full and unconditional guarantee, as defined in Rule 3-10 of Regulation S-X, of such non-convertible securities by the parent; or

(C) The securities of the majority-owned subsidiary meet the conditions of General Instruction I.B.2 of Form S-3 or Form F-3.

(iii) Is not an ineligible issuer as defined in this section.

(iv) Is not an asset-backed issuer as defined in Item 1101 of Regulation AB (§229.1101(b) of this chapter).

(v) Is not an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*) or a business development company as defined in section 2(a)(48) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(48)).

(2) For purposes of this definition, the determination date as to whether an issuer is a well-known seasoned issuer shall be the latest of:

(i) The time of filing of its most recent shelf registration statement; or

(ii) The time of its most recent amendment (by post-effective amendment, incorporated report filed pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d) of this chapter), or form of prospectus) to a shelf registration statement for purposes of complying with section 10(a)(3) of the Act (or if such amendment has not been made within the time period required by section 10(a)(3) of the Act, the date on which such amendment is required); or

(iii) In the event that the issuer has not filed a shelf registration statement or amended a shelf registration statement for purposes of complying with section 10(a)(3) of the Act for sixteen months, the time of filing of the issuer's most recent annual report on Form 10-K (§249.310 of this chapter) or Form 20-F (§249.220f of this chapter) (or if such report has not been filed by its due date, such due date).

Wholly owned subsidiary. The term "wholly owned subsidiary" means a subsidiary substantially all of whose outstanding voting securities are owned by its parent and/or the parent's other wholly owned subsidiaries.

Written communication. Except as otherwise specifically provided or the context otherwise requires, a *written communication* is any communication that is written, printed, a radio or television broadcast, or a graphic communication as defined in this section.

Note to definition of "written communication." A communication that is a radio or television broadcast is a written communication regardless of the means of transmission of the broadcast.

Rule 406. Confidential Treatment of Information Filed with the Commission.

Preliminary Notes: (1) Confidential treatment of supplemental information or other information not required to be filed under the Act should be requested under 17 CFR §200.83 and not under this rule.

(2) All confidential treatment requests shall be submitted in paper format only, whether or not the filer is an electronic filer. See Rule 101(c)(1)(i) of Regulation S-T (§232.101(c)(1)(i) of this chapter.

(a) Any person submitting any information in a document required to be filed under the Act may make written objection to its public disclosure by following the procedure in paragraph (b) of this section, which shall be the exclusive means of requesting confidential treatment of information included in any document (hereinafter referred to as the "material filed") required to be filed under the Act, *except* that if the material filed is a registration statement on Form S-8 (§239.16b of this chapter) or on Form S-3, F-2, F-3 (§239.13, §239.32 or §239.33 of this chapter) relating to a dividend or interest reinvestment plan, or on Form S-4 (§239.25 of this chapter) complying with General Instruction G of that Form, or if the material filed is a registration statement that does not contain a delaying amendment pursuant to Rule 473 (§230.473 of this chapter), the person shall comply with the procedure in paragraph (b) *prior* to the filing of a registration statement.

(b) The person shall omit from the material filed the portion thereof which it desires to keep undisclosed (hereinafter called the confidential portion). In lieu thereof, the person shall indicate at the appropriate place in the material filed that the confidential portion has been so omitted and filed separately with the Commission. The person shall file with the material filed:

(1) One copy of the confidential portion, marked "Confidential Treatment," of the material filed with the Commission. The copy shall contain an appropriate identification of the item or other requirement involved and, notwithstanding that the confidential portion does not constitute the whole of the answer or required disclosure, the entire answer or required disclosure, except that in the case where the confidential portion is part of a financial statement or schedule, only the particular financial statement or schedule need be included. The copy of the confidential portion shall be in the same form as the remainder of the material filed;

(2) An application making objection to the disclosure of the confidential portion. Such application shall be on a sheet or sheets separate from the confidential portion, and shall contain:

(i) An identification of the portion;

(ii) A statement of the grounds of the objection referring to and analyzing the applicable exemption(s) from disclosure under §200.80 of this chapter, the Commission's rule adopted under the Freedom of Information Act (5 U.S.C. 552), and a justification of the period of time for which confidential treatment is sought;

(iii) A detailed explanation of why, based on the facts and circumstances of the particular case, disclosure of the information is unnecessary for the protection of investors;

(iv) A written consent to the furnishing of the confidential portion to other government agencies, offices, or bodies and to the Congress; and

(v) The name, address and telephone number of the person to whom all notices and orders issued under this rule at any time should be directed.

(3) The copy of the confidential portion and the application filed in accordance with this paragraph (b) shall be enclosed in a separate envelope marked "Confidential Treatment" and addressed to The Secretary, Securities and Exchange Commission, Washington, D.C. 20549.

(c) Pending a determination as to the objection, the material for which confidential treatment has been applied will not be made available to the public.

(d) If it is determined by the Division, acting pursuant to delegated authority, that the application should be granted, an order to that effect will be entered, and a notation to that effect will be made at the appropriate place in the material filed. Such a determination will not preclude reconsideration whenever appropriate, such as upon receipt of any subsequent request under the Freedom of Information Act and, if appropriate, revocation of the confidential status of all or a portion of the information in question.

(e) If the Commission denies the application, or the Division, acting pursuant to delegated authority, denies the application and Commission review is not sought pursuant to §201.431 of this chapter, confirmed telegraphic notice of the order of denial will be sent to the person named in the application pursuant to paragraph (b)(2)(v) of this section. In such case, if the material filed may be withdrawn pursuant to an applicable statute, rule, or regulation, the registrant shall have the right to withdraw the material filed in accordance with the terms of the applicable statute, rule, or regulation, but without the necessity of stating any grounds for the withdrawal or of obtaining the further assent of the Commission. In the event of such withdrawal, the confidential portion will be returned to the registrant. If the material filed may not be so withdrawn, the confidential portion will be made available for public inspection in the same manner as if confidential treatment had been revoked under paragraph (h) of this section.

(f) If a right of withdrawal pursuant to paragraph (e) of this section is not exercised, the confidential portion will be made available for public inspection as part of the material filed, and the registrant shall amend the material filed to include all information required to be set forth in regard to such confidential portion.

(g) In any case where a prior grant of confidential treatment has been revoked, the person named in the application pursuant to paragraph (b)(2)(v) of this section will be so informed by registered or certified mail. Pursuant to §201.26 of this chapter, persons making objections to disclosure may petition the Commission for review of a determination by the Division revoking confidential treatment.

(h) Upon revocation of confidential treatment, the confidential portion shall be made available to the public at the time and according to the conditions specified in paragraphs (h) (1)-(2):

(1) Upon the lapse of five days after the dispatch of notice by registered or certified mail of a determination disallowing an objection, if prior to the lapse of such five days the person shall not have communicated to the Secretary of the Commission his intention to seek review by the Commission under §201.431 of this chapter of the determination made by the Division; or

(2) If such a petition for review shall have been filed under §201.431 of this chapter, upon final disposition adverse to the petitioner.

(i) If the confidential portion is made available to the public, one copy thereof shall be attached to each copy of the material filed with the Commission.

Rule 408. Additional Information.

(a) In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

(b) Notwithstanding paragraph (a) of this section, unless otherwise required to be included in the registration statement, the failure to include in a registration statement information in-

cluded in a free writing prospectus will not, solely by virtue of inclusion of the information in a free writing prospectus (as defined in Rule 405 (§230.405)), be considered an omission of material information required to be included in the registration statement.

Rule 409. Information Unknown or Not Reasonably Available.

Information required need be given only insofar as it is known or reasonably available to the registrant. If any required information is unknown and not reasonably available to the registrant, either because the obtaining thereof could involve unreasonable effort or expense, or because it rests peculiarly within the knowledge of another person not affiliated with the registrant, the information may be omitted, subject to the following conditions:

(a) The registrant shall give such information on the subject as it possesses or can acquire without unreasonable effort or expense, together with the sources thereof.

(b) The registrant shall include a statement either showing that unreasonable effort or expense would be involved or indicating the absence of any affiliation with the person within whose knowledge the information rests and stating the result of a request made to such person for the information.

Rule 410. Disclaimer of Control.

If the existence of control is open to reasonable doubt in any instance, the registrant may disclaim the existence of control and any admission thereof; in such case, however, the registrant shall state the material facts pertinent to the possible existence of control.

Rule 411. Incorporation by Reference.

(a) ***Prospectuses.*** Except as provided by this section, Item 1100(c) of Regulation AB (§229.1100(c) of this chapter) for registered offerings of asset-backed securities, or unless otherwise provided in the appropriate form, information shall not be incorporated by reference in a prospectus. Where a summary or outline of the provisions of any document is required in the prospectus, the summary or outline may incorporate by reference particular items, sections or paragraphs of any exhibit and may be qualified in its entirety by such reference.

(b) ***Information not required in a prospectus.*** Except for exhibits covered by paragraph (c) of this section, information may be incorporated by reference in answer, or partial answer, to any item that calls for information not required to be included in a prospectus subject to the following provisions:

(1) Non-financial information may be incorporated by reference to any document;

(2) Financial information may be incorporated by reference to any document, provided any financial statement so incorporated meets the requirements of the forms on which the statement is filed. Financial statements or other financial data required to be given in comparative form for two or more fiscal years or periods shall not be incorporated by reference unless the information incorporated by reference includes the entire period for which the comparative data is given;

(3) Information contained in any part of the registration statement, including the prospectus, may be incorporated by reference in answer, or partial answer, to any item that calls for information not required to be included in the prospectus; and

(4) Unless the information is incorporated by reference to a document which complies with the time limitations of §228.10(f) and §229.10(d) of this chapter, then the document, or part thereof, containing the incorporated information is required to be filed as an exhibit.

(c) ***Exhibits.*** Any document or part thereof filed with the Commission pursuant to any Act administered by the Commission may, subject to the limitations of §228.10(f) and §229.10(d) of this chapter, be incorporated by reference as an exhibit to any registration statement. If any modification has occurred in the text of any document incorporated by reference since the filing thereof, the registrant shall file with the reference a statement containing the text of such modification and the date thereof.

(d) ***General.*** Any incorporation by reference of information pursuant to this section shall be subject to the provisions of Rule 24 of the Commission's Rules of Practice restricting incorporation by reference of documents which incorporate by reference other information. Information incorporated by reference shall be clearly identified in the reference by page, paragraph, caption or otherwise. If the information is incorporated by reference to a previously filed document, the file number of such document shall be included. Where only certain pages of a document are incorporated by reference and filed with the statement, the document from which the information is taken shall be clearly identified in the reference. An express statement that the specified matter is incorporated by reference shall be made at the particular place in the registration statement where the information is required. Information shall not be incorporated by reference in any case where such incorporation would render the statement incomplete, unclear or confusing.

Rule 412. Modified or Superseded Documents.

(a) Any statement contained in a document incorporated or deemed to be incorporated by reference or deemed to be part of a registration statement or the prospectus that is part of the registration statement shall be deemed to be modified or superseded for purposes of the registration statement or the prospectus that is part of the registration statement to the extent that a statement contained in the prospectus that is part of the registration statement or in any other subsequently filed document which also is or is deemed to be incorporated by reference or deemed to be part of the registration statement or prospectus that is part of the registration statement modifies or replaces such statement. Any statement contained in a document that is deemed to be incorporated by reference or deemed to be part of a registration statement or the prospectus that is part of the registration statement after the most recent effective date or after the date of the most recent prospectus that is part of the registration statement may modify or replace existing statements contained in the registration statement or the prospectus that is part of the registration statement.

(b) The modifying or superseding statement may, but need not, state that it has modified or superseded a prior statement or include any other information set forth in the document which is not so modified or superseded. The making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement, when made, constituted an untrue statement of a material fact, an omission to state a material fact necessary to make a statement not misleading, or the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business or artifice to defraud, as those terms are used in the Act, the Securities Exchange Act of 1934, the Investment Company Act of 1940, or the rules and regulations thereunder.

(c) Any statement so modified shall not be deemed in its unmodified form to constitute part of the registration statement or prospectus for purpose of the Act. Any statement so superseded shall not be deemed to constitute a part of the registration statement or the prospectus for purposes of the Act.

Rule 413. Registration of Additional Securities and Additional Classes of Securities.

(a) Except as provided in section 24(f) of the Investment Company Act of 1940 (15 U.S.C. 80a-24(f)) and in paragraph (b) of this section, where a registration statement is already in effect, the registration of additional securities shall only be effected through a separate registration statement relating to the additional securities.

(b) Notwithstanding paragraph (a) of this section, the following additional securities or additional classes of securities may be added to an automatic shelf registration statement already in effect by filing a post-effective amendment to that automatic shelf registration statement:

(1) Securities of a class different than those registered on the effective automatic shelf registration statement identified as provided in Rule 430B(a) (§230.430B(a)); or

(2) Securities of a majority-owned subsidiary that are permitted to be included in an automatic shelf registration statement, provided that the subsidiary and the securities are identified as provided in Rule 430B and the subsidiary satisfies the signature requirements of an issuer in the post-effective amendment.

Rule 414. Registration by Certain Successor Issuers.

If any issuer, except a foreign issuer exempted by Rule 3a12-3 (17 CFR 240.3a12-3), incorporated under the laws of any State or foreign government and having securities registered under the Act has been succeeded by an issuer incorporated under the laws of another State or foreign government for the purpose of changing the State or country of incorporation of the enterprises, or if any issuer has been succeeded by an issuer for the purpose of changing its form of organization, the registration statement of the predecessor issuer shall be deemed the registration statement of the successor issuer for the purpose of continuing the offering provided:

(a) Immediately prior to the succession the successor issuer had no assets or liabilities other than nominal assets or liabilities;

(b) The succession was effected by a merger or similar succession pursuant to statutory provisions or the terms of the organic instruments under which the successor issuer acquired all of the assets and assumed all of the liabilities and obligations of the predecessor issuer;

(c) The succession was approved by security holders of the predecessor issuer at a meeting for which proxies were solicited pursuant to section 14(a) of the Securities Exchange Act of 1934 or section 20(a) of the Investment Company Act of 1940 or information was furnished to security holders pursuant to section 14(c) of the Securities Exchange Act of 1934; and

(d) The successor issuer has filed an amendment to the registration statement of the predecessor issuer expressly adopting such statements as its own registration statement for all purposes of the Act and the Securities Exchange Act of 1934 and setting forth any additional information necessary to reflect any material changes made in connection with or resulting from the succession, or necessary to keep the registration statement from being misleading in any material respect, and such amendment has become effective.

Rule 417. Date of Financial Statements.

Whenever financial statements of any person are required to be furnished as of a date within a specified period prior to the date of filing the registration statement and the last day of such period falls on a Saturday, Sunday, or holiday, such registration statement may be filed on the first business day following the last day of the specified period.

Rule 418. Supplemental Information.

(a) The Commission or its staff may, where it is deemed appropriate, request supplemental information concerning the registrant, the registration statement, the distribution of the securities, market activities and underwriters' activities. Such information includes, but is not limited to, the following items which the registrant should be prepared to furnish promptly upon request:

(1)(i) Any reports or memoranda which have been prepared for external use by the registrant or a principal underwriter, as defined in Rule 405 (§230.405), in connection with the proposed offering;

(ii) A statement as to the actual or proposed use and distribution of the reports or memoranda specified in paragraph (a)(1)(i) of this section, identifying each class of persons who have received or will receive such reports or memoranda and the number of copies distributed to each such class;

(2) In the case of a registration statement relating to a business combination as defined in Rule 145(a) (17 CFR 230.145(a)), exchange offer, tender offer or similar transaction, any feasibility studies, management analyses, fairness opinions or similar reports prepared by or for any of the parties to the subject transaction in connection with such transaction;

(3) Except in the case of a registrant eligible to use Form S-3 (§239.13 of this chapter), any engineering, management or similar reports or memoranda relating to broad aspects of the business, operations or products of the registrant, which have been prepared within the past twelve months for or by the registrant and any affiliate of the registrant or any principal underwriter, as defined in Rule 405 (§230.405), of the securities being registered except for:

(i) Reports solely comprised of recommendations to buy, sell or hold the securities of the registrant, unless such recommendations have changed within the past six months; and

(ii) Any information contained in documents already filed with the Commission.

(4) Where there is a registration of an at-the-market offering, as defined in §242.100 of this chapter, of more than 10 percent of the securities outstanding, where the offering includes securities owned by officers, directors or affiliates of the registrant and where there is no underwriting agreement, information (i) concerning contractual arrangements between selling security holders of a limited group or of several groups of related shareholders to comply with the anti-manipulation rules until the offering by all members of the group is completed and to inform the exchange, brokers and selling security holders when the distribution by the members of the group is over, or (ii) concerning the registrant's efforts to notify members of a large group of unrelated sellers of the applicable Commission rules and regulations;

(5) Where the registrant recently has introduced a new product or has begun to do business in a new industry segment or has made public its intentions to introduce a new product or to do business in a new industry segment, and this action requires the investment of a material amount of the assets of the registrant or otherwise is material, copies of any studies prepared for the registrant by outside persons or any internal studies, documents, reports or memoranda the contents of which were material to the decision to develop the product or to do business in the new segment including, but not limited to, documents relating to financial requirements and engineering, competitive, environmental and other considerations, but excluding technical documents;

(6) Where reserve estimates are referred to in a document, a copy of the full report of the engineer or other expert who estimated the reserves;

(7) With respect to the extent of the distribution of a preliminary prospectus, information concerning:

(i) The date of the preliminary prospectus distributed;

(ii) The dates or approximate dates of distribution;

(iii) The number of prospective underwriters and dealers to whom the preliminary prospectus was furnished;

(iv) The number of prospectuses so distributed;

(v) The number of prospectuses distributed to others, identifying them in general terms; and

(vi) The steps taken by such underwriters and dealers to comply with the provisions of Rule 15c2-8 under the Securities Exchange Act of 1934 (§240.15c2-8 of this chapter)

and

(8) Any free writing prospectuses used in connection with the offering.

(b) Supplemental information described in paragraph (a) of this section shall not be required to be filed with or deemed part of and included in the registration statement, unless otherwise required. The information shall be returned to the registrant upon request, provided that:

(1) Such request is made at the time such information is furnished to the staff;

(2) The return of such information is consistent with the protection of investors;

(3) The return of such information is consistent with the provisions of the Freedom of Information Act [5 U.S.C. 552]; and

(4) The information was not filed in electronic format.

Form and Content of Prospectuses

Rule 420. Legibility of Prospectus.

(a) The body of all printed prospectuses and all notes to financial statements and other tabular data included therein shall be in roman type at least as large and as legible as 10-point modern type. However, (1) to the extent necessary for convenient presentation, financial statements and other tabular data, including tabular data in notes, and (2) prospectuses deemed to be omitting prospectuses under rule 482 (17 CFR 230.482) may be in roman type at least as large and as legible as 8-point modern type. All such type shall be leaded at least 2 points.

(b) Where a prospectus is distributed through an electronic medium, issuers may satisfy legibility requirements applicable to printed documents, such as paper size, type size and font, bold-face type, italics and red ink, by presenting all required information in a format readily communicated to investors, and where indicated, in a manner reasonably calculated to draw investor attention to specific information.

Rule 421. Presentation of Information in Prospectuses.

(a) The information required in a prospectus need not follow the order of the items or other requirements in the form. Such information shall not, however, be set forth in such fashion as to obscure any of the required information or any information necessary to keep the required information from being incomplete or misleading. Where an item requires information to be given in a prospectus in tabular form it shall be given in substantially the tabular form specified in the item.

(b) You must present the information in a prospectus in a clear, concise and understandable manner. You must prepare the prospectus using the following standards:

(1) Present information in clear, concise sections, paragraphs, and sentences. Whenever possible, use short, explanatory sentences and bullet lists;

(2) Use descriptive headings and subheadings;

(3) Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus. Define terms in a glossary or other section of the document only if the meaning is unclear from the context. Use a glossary only if it facilitates understanding of the disclosure; and

(4) Avoid legal and highly technical business terminology.

Note to §230.421(b):

In drafting the disclosure to comply with this section, you should avoid the following:

1. Legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;

2. Vague "boilerplate" explanations that are imprecise and readily subject to different interpretations;

3. Complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and

4. Disclosure repeated in different sections of the document that increases the size of the document but does not enhance the quality of the information.

(c) All information required to be included in a prospectus shall be clearly understandable without the necessity of referring to the particular form or to the general rules and regulations. Except as to financial statements and information required in a tabular form, the information set forth in a prospectus may be expressed in condensed or summarized form. In lieu of repeating information in the form of notes to financial statements, references may be made to other parts of the prospectus where such information is set forth.

(d)(1) To enhance the readability of the prospectus, you must use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section.

(2) You must draft the language in these sections so that at a minimum it substantially complies with each of the following plain English writing principles:

(i) Short sentences;

(ii) Definite, concrete, everyday words;

(iii) Active voice;

(iv) Tabular presentation or bullet lists for complex material, whenever possible;

(v) No legal jargon or highly technical business terms; and

(vi) No multiple negatives.

(3) In designing these sections or other sections of the prospectus, you may include pictures, logos, charts, graphs, or other design elements so long as the design is not misleading and the required information is clear. You are encouraged to use tables, schedules, charts and graphic illustrations of the results of operations, balance sheet, or other financial data that present the data in an understandable manner. Any presentation must be consistent with the financial statements and non-financial information in the prospectus. You must draw the graphs and charts to scale. Any information you provide must not be misleading.

Instruction to §230.421: You should read Securities Act Release No. 33-7497 (January 28, 1998) for information on plain English principles.

Rule 423. Date of Prospectuses.

Except for a form of prospectus used after the effective date of the registration statement and before the determination of the offering price as permitted by Rule 430A(c) under the Securities Act (§230.430A(c) of this chapter) or before the opening of bids as permitted by Rule 445(c) under the Securities Act (§230.445(c) of this chapter), each prospectus used after the effective date of the registration statement shall be dated approximately as of such effective date; provided, however, that a revised or amended prospectus used thereafter need only bear the approximate date of its issuance. Each supplement to a prospectus shall be dated separately the approximate date of its issuance.

Rule 424. Filing of Prospectuses, Number of Copies.

(a) Except as provided in paragraph (f) of this section, five copies of every form of prospectus sent or given to any person prior to the effective date of the registration statement which varies from the form or forms of prospectus included in the registration statement as filed pursuant to §230.402(a) of this chapter shall be filed as a part of the registration statement not later than the date such form of prospectus is first sent or given to any person: *Provided, however,* That only a form of prospectus that contains substantive changes from or additions to a prospectus previously filed with the Commission as part of a registration statement need be filed pursuant to this paragraph (a).

(b) Ten copies of each form of prospectus purporting to comply with section 10 of the Act, except for documents constituting a prospectus pursuant to Rule 428(a) (§230.428(a)) or free

writing prospectuses pursuant to Rule 164 and Rule 433 (§230.164 and §230.433), shall be filed with the Commission in the form in which it is used after the effectiveness of the registration statement and identified as required by paragraph (e) of this section; *provided*, *however*, that only a form of prospectus that contains substantive changes from or additions to a previously filed prospectus is required to be filed; *Provided, further*, that this paragraph (b) shall not apply in respect of a form of prospectus contained in a registration statement and relating solely to securities offered at competitive bidding, which prospectus is intended for use prior to the opening of bids. Ten copies of the form of prospectus shall be filed or transmitted for filing as follows:

(1) A form of prospectus that discloses information previously omitted from the prospectus filed as part of an effective registration statement in reliance upon Rule 430A under the Securities Act [§230.430A of this chapter] shall be filed with the Commission no later than the second business day following the earlier of the date of determination of the offering price or the date it is first used after effectiveness in connection with a public offering or sales, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(2) A form of prospectus that is used in connection with a primary offering of securities pursuant to Rule 415(a)(1)(x) (§230.415(a)(1)(x)) or a primary offering of securities registered for issuance on a delayed basis pursuant to Rule 415(a)(1)(vii) or (viii) (§230.415(a)(1)(vii) or (viii)) and that, in the case of Rule 415(a)(1)(viii) discloses the public offering price, description of securities or similar matters, and in the case of Rule 415(a)(1)(vii) and (x) discloses information previously omitted from the prospectus filed as part of an effective registration statement in reliance on Rule 430B (§230.430B), or, in the case of asset-backed securities, Rule 430D (§230.430D) shall be filed with the Commission no later than the second business day following the earlier of the date of the determination of the offering price or the date it is first used after effectiveness in connection with a public offering or sales, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(3) A form of prospectus that reflects facts or events other than those covered in paragraphs (b)(1)(2) and (6) of this section that constitute a substantive change from or addition to the information set forth in the last form of prospectus filed with the Commission under this section or as part of a registration statement under the Securities Act shall be filed with the Commission no later than the fifth business day after the date it is first used after effectiveness in connection with a public offering or sales, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(4) A form of prospectus that discloses information, facts or events covered in both paragraphs (b)(1) and (3) shall be filed with the Commission no later than the second business day following the earlier of the date of the determination of the offering price or the date it is first used after effectiveness in connection with a public offering or sales, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(5) A form of prospectus that discloses information, facts or events covered in both paragraphs (b)(2) and (3) shall be filed with the Commission no later than the second business day

following the earlier of the date of the determination of the offering price or the date it is first used after effectiveness in connection with a public offering or sales, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(6) A form of prospectus used in connection with an offering of securities under Canada's National Policy Statement No. 45 pursuant to Rule 415 under the Securities Act (§230.415 of this chapter) that is not made in the United States shall be filed with the Commission no later than the date it is first used in Canada, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(7) A form of prospectus that identifies selling security holders and the amounts to be sold by them that was previously omitted from the registration statement and the prospectus in reliance upon Rule 430B (§230.430B) shall be filed with the Commission no later than the second business day following the earlier of the date of sale or the date of first use or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(8) A form of prospectus otherwise required to be filed pursuant to paragraph (b) of this section that is not filed within the time frames specified in paragraph (b) of this section must be filed pursuant to this paragraph as soon as practicable after the discovery of such failure to file.

Note to paragraph (b)(8) of Rule 424

A form of prospectus required to be filed pursuant to another paragraph of Rule 424(b) that is filed under Rule 424(b)(8) shall nonetheless be "required to be filed" under such other paragraph.

Instruction to paragraph (b): Notwithstanding §230.424(b)(2) and (b)(5) above, a form of prospectus or prospectus supplement relating to an offering of asset-backed securities under §230.415(a)(1)(vii) §230.415(a)(1)(xii) that is required to be filed pursuant to paragraph (b) of this section shall be filed with the Commission no later than the second business day following the date it is first used after effectiveness in connection with a public offering or sales, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(c) If a form of prospectus, other than one filed pursuant to paragraph (b)(1) or (b)(4) of this Rule, consists of a prospectus supplement attached to a form of prospectus that (1) previously had been filed or (2) was not required to be filed pursuant to paragraph (b) because it did not contain substantive changes from a prospectus that previously was filed, only the prospectus supplement need be filed under paragraph (b) of this rule, provided that the first page of each prospectus supplement includes a cross reference to the date(s) of the related prospectus and any prospectus supplements thereto that together constitute the prospectus required to be delivered by Section 5(b) of the Securities Act [15 U.S.C. 77e(b)] with respect to the securities currently being offered or sold. The cross reference may be set forth in longhand, provided it is legible.

NOTE: Any prospectus supplement being filed separately that is smaller than a prospectus page should be attached to an 8½" x 11" sheet of paper.

(d) Every prospectus consisting of a radio or television broadcast shall be reduced to writing. Five copies of every such prospectus shall be filed with the Commission in accordance with the requirements of this section.

(e) Each copy of a form of prospectus filed under this rule shall contain in the upper right corner of the cover page the paragraph of this rule, including the subparagraph if applicable, under which the filing is made, and the file number of the registration statement to which the prospectus relates. The information required by this paragraph may be set forth in longhand, provided it is legible.

(f) This rule shall not apply with respect to prospectuses of an investment company registered under the Investment Company Act of 1940 or a business development company.

(g) A form of prospectus filed pursuant to this section that operates to reflect the payment of filing fees for an offering or offerings pursuant to Rule 456(b) (§230.456(b)) must include on its cover page the calculation of registration fee table reflecting the payment of such filing fees for the securities that are the subject of the payment.

(h)(1) Three copies of a form of prospectus relating to an offering of asset-backed securities pursuant to § 230.415(a)(1)(vii) or § 230.415(a)(1)(xii) disclosing information previously omitted from the prospectus filed as part of an effective registration statement in reliance on § 230.430D shall be filed with the Commission at least three business days before the date of the first sale in the offering, or if used earlier, the earlier of:

(i) The applicable number of business days before the date of the first sale; or

(ii) The second business day after first use.

(2) Three copies of a prospectus supplement relating to an offering of asset-backed securities pursuant to § 230.415(a)(1)(vii) or § 230.415(a)(1)(xii) that reflects any material change from the information contained in a prospectus filed in accordance with § 230.424(h)(1) shall be filed with the Commission at least forty-eight hours before the date and time of the first sale in the offering. The prospectus supplement must clearly delineate what material information has changed and how the information has changed from the prospectus filed in accordance with paragraph (h)(1) of this section.

Instruction to paragraph (h): The filing requirements of this paragraph (h) do not apply if a filing is made solely to add fees pursuant to § 230.457 and for no other purpose.

Rule 425. Filing of Certain Prospectuses and Communications under §230.135 in Connection with Business Combination Transactions.

(a) All written communications made in reliance on §230.165 are prospectuses that must be filed with the Commission under this section on the date of first use.

(b) All written communications that contain no more information than that specified in §230.135 must be filed with the Commission on or before the date of first use except as provided in paragraph (d)(1) of this section. A communication limited to the information specified in §230.135 will not be deemed an offer in accordance with §230.135 even though it is filed under this section.

(c) Each prospectus or §230.135 communication filed under this section must identify the filer, the company that is the subject of the offering and the Commission file number for the related registration statement or, if that file number is unknown, the subject company's Exchange Act or Investment Company Act file number, in the upper right corner of the cover page.

(d) Notwithstanding paragraph (a) of this section, the following need not be filed under this section:

(1) Any written communication that is limited to the information specified in §230.135 and does not contain new or different information from that which was previously publicly disclosed and filed under this section.

(2) Any research report used in reliance on §230.137, §230.138 and §230.139;

(3) Any confirmation described in §240.10b-10 of this chapter; and

(4) Any prospectus filed under §230.424.

Notes to Rule 425:

1. File five copies of the prospectus or §230.135 communication if paper filing is permitted.

2. No filing is required under §240.13e-4(c), §240.14a-12(b), §240.14d-2(b), or §240.14d-9(a), if the communication is filed under this section. Communications filed under this section also are deemed filed under the other applicable sections.

Rule 427. Contents of Prospectus Used After Nine Months.

There may be omitted from any prospectus used more than 9 months after the effective date of the registration statement any information previously required to be contained in the prospectus insofar as later information covering the same subjects, including the latest available certified financial statement, as of a date not more than 16 months prior to the use of the prospectus is contained therein.

Rule 429. Prospectus Relating to Several Registration Statements.

(a) Where a registrant has filed two or more registration statements, it may file a single prospectus in the latest registration statement in order to satisfy the requirements of the Act and the rules and regulations thereunder for that offering and any other offering(s) registered on the earlier registration statement(s). The combined prospectus in the latest registration statement must include all of the information that currently would be required in a prospectus relating to all offering(s) that it covers. The combined prospectus may be filed as part of the initial filing of the latest registration statement, in a pre-effective amendment to it or in a post-effective amendment to it.

(b) Where a registrant relies on paragraph (a) of this section, the registration statement containing the combined prospectus shall act, upon effectiveness, as a post-effective amendment to any earlier registration statement whose prospectus has been combined in the latest registration statement. The registrant must identify any earlier registration statement to which the combined prospectus relates by setting forth the Commission file number at the bottom of the facing page of the latest registration statement.

Rule 430. Prospectus for Use Prior to Effective Date.

(a) A form of prospectus filed as a part of the registration statement shall be deemed to meet the requirements of section 10 of the Act for the purpose of section 5(b)(1) thereof prior to the effective date of the registration statement, provided such form of prospectus contains substantially the information required by the Act and the rules and regulations thereunder to be included in a prospectus meeting the requirements of section 10(a) of the Act for the securities being registered, or contains substantially that information except for the omission of information with respect to the offering price, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, conversion rates, call prices, or other matters dependent upon the offering price. Every such form of prospectus shall be deemed to have been filed as a part of the registration statement for the purpose of section 7 of the Act.

(b) A form of prospectus filed as part of a registration statement on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter) shall be deemed to meet the requirements of Section 10 (15 U.S.C. 77j) of the Securities Act for the purpose of Section 5(b)(1) (15 U.S.C. 77e(b)(1)) thereof prior to the effective date of the registration statement, provided that:

(1) Such form of prospectus meets the requirements of paragraph (a) of this section; and

(2) Such registration statement contains a form of Statement of Additional Information that is made available to persons receiving such prospectus upon written or oral request, and without charge, unless the form of prospectus contains the information otherwise required to be disclosed in the form of Statement of Additional Information. Every such form of prospectus shall be deemed to have been filed as part of the registration statement for the purpose of section 7 of the Act.

Rule 430A. Prospectus in a Registration Statement at the Time of Effectiveness.

(a) The form of prospectus filed as part of a registration statement that is declared effective may omit information with respect to the public offering price, underwriting syndicate (including any material relationships between the registrant and underwriters not named therein), underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, conversion rates, call prices and other items dependent upon the offering price, delivery dates, and terms of the securities dependent upon the offering date; and such form of prospectus need not contain such information in order for the registration statement to meet the requirements of Section 7 of the Securities Act [15 U.S.C. 77g] for the purposes of Section 5 thereof [15 U.S.C. 77e], *Provided that:*

(1) the securities to be registered are offered for cash;

(2) the registrant furnishes the undertakings required by Item 512(i) of Regulation S-K [§229.512(i) of this chapter]; and

(3) the information omitted in reliance upon paragraph (a) from the form of prospectus filed as part of a registration statement that is declared effective is contained in a form of prospectus filed with the Commission pursuant to Rule 424(b) or Rule 497(h) under the Securities Act [§§230.424(b) or 230.497(h) of this chapter]; except that if such form of prospectus is not so filed by the later of fifteen business days after the effective date of the registration statement or fifteen business days after the effectiveness of a post-effective amendment thereto that contains a form of prospectus, or transmitted by a means reasonably calculated to result in filing with the Commission by that date, the information omitted in reliance upon paragraph (a) must be contained in an effective post-effective amendment to the registration statement.

Instruction to paragraph (a): A decrease in the volume of securities offered or change in the bona fide estimate of the maximum offering price range from that indicated in the form of prospectus filed as part of a registration statement that is declared effective may be disclosed in the form of prospectus filed with the Commission pursuant to §230.424(b) or §230.497(h) under the Securities Act so long as the decrease in the volume or change in the price range would not materially change the disclosure contained in the registration statement at effectiveness. Notwithstanding the foregoing, any increase or decrease in volume (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b)(1) (§230.424(b)(1)) or Rule 497(h) (§230.497(h)) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement.

(b) The information omitted in reliance upon paragraph (a) from the form of prospectus filed as part of an effective registration statement, and contained in the form of prospectus filed with the Commission pursuant to Rule 424(b) or Rule 497(h) under the Securities Act [§§230.424(b) or 230.497(h) of this chapter], shall be deemed to be a part of the registration statement as of the time it was declared effective.

(c) When used prior to determination of the offering price of the securities, a form of prospectus relating to the securities offered pursuant to a registration statement that is declared effective with information omitted from the form of prospectus filed as part of such effective registration statement in reliance upon this Rule 430A need not contain information omitted pursuant to paragraph (a), in order to meet the requirements of Section 10 of the Securities Act [15 U.S.C. 77j] for the purpose of Section 5(b)(1) [15 U.S.C. 77e(b)(1)] thereof. This provision shall not limit the information required to be contained in a form of prospectus meeting the requirements of Section 10(a) of the Act for the purposes of Section 5(b)(2) thereof or exception (a) of Section 2(10) [15 U.S.C. 77b(10)] thereof.

(d) This rule shall not apply to registration statements for securities to be offered by competitive bidding.

(e) In the case of a registration statement filed on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter), the references to "form of prospectus" in paragraphs (a) and (b) of this section and the accompanying Note shall be deemed also to refer to the form of Statement of Additional Information filed as part of such a registration statement.

(f) This section may apply to registration statements that are immediately effective pursuant to Rule 462(e) and (f) (§230.462(e) and (f)).

NOTE: If information is omitted in reliance upon paragraph (a) from the form of prospectus filed as part of an effective registration statement, or effective post-effective amendment thereto, the registrant must ascertain promptly whether a form of prospectus transmitted for filing under Rule 424(b) or Rule 497(h) under the Securities Act actually was received for filing by the Commission and, in the event that it was not, promptly file such prospectus.

Rule 431. Summary Prospectuses.

(a) A summary prospectus prepared and filed (except a summary prospectus filed by an open-end management investment company registered under the Investment Company Act of 1940 as part of a registration statement in accordance with this section shall be deemed to be a prospectus permitted under section 10(b) of the Act (15 U.S.C. 77j(b)) for the purposes of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)) if the form used for registration of the securities to be offered provides for the use of a summary prospectus and the following conditions are met:

(1)(i) The registrant is organized under the laws of the United States or any State or Territory or the District of Columbia and has its principal business operations in the United States or its territories; or

(ii) The registrant is a foreign private issuer eligible to use Form F-2 (§239.32 of this chapter);

(2) The registrant has a class of securities registered pursuant to section 12(b) of the Securities Exchange Act of 1934 or has a class of equity securities registered pursuant to section 12(g) of that Act or is required to file reports pursuant to section 15(d) of that Act;

(3) The registrant: (i) has been subject to the requirements of section 12 or 15(d) of the Securities Exchange Act of 1934 and has filed all the material required to be filed pursuant to sections 13, 14 or 15(d) of that Act for a period of at least thirty-six calendar months immediately preceding the filing of the registration statement; and (ii) has filed in a timely manner all reports required to be filed during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement and, if the registrant has used (during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement) Rule 12b-25(b) under the Securities Exchange Act of 1934 (§240.12b-25 of this chapter) with respect to a report or portion of a report, that report or portion thereof has actually been filed within the time period prescribed by that Rule; and

(4) Neither the registrant nor any of its consolidated or unconsolidated subsidiaries has, since the end of its last fiscal year for which certified financial statements of the registrant and its consolidated subsidiaries were included in a report filed pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934: (i) failed to pay any dividend or sinking fund installment on preferred stock; or (ii) defaulted on any installment or installments on indebtedness for borrowed money, or on any rental on one or more long term leases, which defaults in the aggregate are material to the financial position of the registrant and its consolidated and unconsolidated subsidiaries, taken as a whole.

(b) A summary prospectus shall contain the information specified in the instructions as to summary prospectuses in the form used for registration of the securities to be offered. Such prospectus may include any other information the substance of which is contained in the registration statement except as otherwise specifically provided in the instructions as to summary prospectuses in the form used for registration. It shall not include any information the substance of which is not contained in the registration statement except that a summary prospectus may contain any information specified in Rule 134(a) (§230.134(a)). No reference need be made to inapplicable terms and negative answers to any item of the form may be omitted.

(c) All information included in a summary prospectus, other than the statement required by paragraph (e) of this section, may be expressed in such condensed or summarized form as may be appropriate in the light of the circumstances under which the prospectus is to be used. The information need not follow the numerical sequence of the items of the form used for registration. Every summary prospectus shall be dated approximately as of the date of its first use.

(d) When used prior to the effective date of the registration statement, a summary prospectus shall be captioned a "Preliminary Summary Prospectus" and shall comply with the applicable requirements relating to a preliminary prospectus.

(e) A statement to the following effect shall be prominently set forth in conspicuous print at the beginning or at the end of every summary prospectus: "Copies of a more complete pro-

spectus may be obtained from" (Insert name(s), address(es) and telephone number(s)). Copies of a summary prospectus filed with the Commission pursuant to paragraph (g) of this section may omit the names of persons from whom the complete prospectus may be obtained.

(f) Any summary prospectus published in a newspaper, magazine or other periodical need only be set in type at least as large as 7 point modern type. Nothing in this rule shall prevent the use of reprints of a summary prospectus published in a newspaper, magazine, or other periodical, if such reprints are clearly legible.

(g) Eight copies of every proposed summary prospectus shall be filed as a part of the registration statement, or as an amendment thereto, at least 5 days (exclusive of Saturdays, Sundays and holidays) prior to the use thereof, or prior to the release for publication by any newspaper, magazine or other person, whichever is earlier. The Commission may, however, in its discretion, authorize such use or publication prior to the expiration of the 5-day period upon a written request for such authorization. Within 7 days after the first use or publication thereof, 5 additional copies shall be filed in the exact form in which it was used or published.

Written Consents

Rule 436. Consents Required in Special Cases.

(a) If any portion of the report or opinion of an expert or counsel is quoted or summarized as such in the registration statement or in a prospectus, the written consent of the expert or counsel shall be filed as an exhibit to the registration statement and shall expressly state that the expert or counsel consents to such quotation or summarization.

(b) If it is stated that any information contained in the registration statement has been reviewed or passed upon by any persons and that such information is set forth in the registration statement upon the authority of or in reliance upon such persons as experts, the written consents of such persons shall be filed as exhibits to the registration statement.

(c) Notwithstanding the provisions of paragraph (b) of this section, a report on unaudited interim financial information (as defined in paragraph (d) of this section) by an independent accountant who has conducted a review of such interim financial information shall not be considered a part of a registration statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of sections 7 and 11 of the Act.

(d) The term "report on unaudited interim financial information" shall mean a report which consists of the following:

(1) A statement that the review of interim financial information was made in accordance with established professional standards for such reviews;

(2) An identification of the interim financial information reviewed;

(3) A description of the procedures for a review of interim financial information;

(4) A statement that a review of interim financial information is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is an expression of opinion regarding the financial statements taken as a whole, and, accordingly, no such opinion is expressed; and

(5) A statement about whether the accountant is aware of any material modifications that should be made to the accompanying financial information so that it conforms with generally accepted accounting principles.

(e) Where a counsel is named as having acted for the underwriters or selling security holders, no consent will be required by reason of his being named as having acted in such capacity.

(f) Where the opinion of one counsel relies upon the opinion of another counsel, the consent of the counsel whose prepared opinion is relied upon need not be furnished.

(g)(1) Notwithstanding the provisions of paragraphs (a) and (b) of this section, the security rating assigned to a class of debt securities, a class of convertible debt securities, or a class of preferred stock by a nationally recognized statistical rating organization, or with respect to registration statements on Form F-9 (§239.39 of this chapter) by any other rating organization specified in the Instruction to paragraph (a)(2) of General Instruction I of Form F-9, shall not be considered a part of the registration statement prepared or certified by a person within the meaning of sections 7 and 11 of the Act.

(2) For the purpose of paragraph (g)(1) of this section, the term nationally recognized statistical rating organization shall have the same meaning as used in Rule 15c3-1(c)(2)(vi)(F) [17 CFR 240.15c3-1 (c)(2)(vi)(F)].

Rule 437. Application to Dispense With Consent.

An application to the Commission to dispense with any written consent of an expert pursuant to section 7 of the act shall be made by the registrant and shall be supported by an affidavit or affidavits establishing that the obtaining of such consent is impracticable or involves undue hardship on the registrant. Such application shall be filed and the consent of the Commission shall be obtained prior to the effective date of the registration statement.

Rule 438. Consents of Persons About to Become Directors.

If any person who has not signed the registration statement is named therein as about to become a director, the written consent of such person shall be filed with the registration statement. Any such consent, however, may be omitted if there is filed with the registration statement a statement by the registrant, supported by an affidavit or affidavits, setting forth the reasons for such omission and establishing that the obtaining of such consent is impracticable or involves undue hardship on the registrant.

Rule 439. Consent to Use of Material Incorporated by Reference.

(a) If the Act or the rules and regulations of the Commission require the filing of a written consent to the use of any material in connection with the registration statement, such consent shall be filed as an exhibit to the registration statement even though the material is incorporated therein by reference. Where the filing of a written consent is required with respect to material incorporated in the registration statement by reference, which is to be filed subsequent to the effective date of the registration statement, such consent shall be filed as an amendment to the registration statement no later than the date on which such material is filed with the Commission, unless express consent to incorporation by reference is contained in the material to be incorporated by reference.

(b) Notwithstanding paragraph (a) of this section, any required consent may be incorporated by reference into a registration statement filed pursuant to Rule 462(b) (§230.462(b)) or a post-effective amendment filed pursuant to Rule 462(e) (§230.462(e)) from a previously filed registration statement relating to that offering, provided that the consent contained in the previously filed registration statement expressly provides for such incorporation.

Filing Fees; Effective Date

Rule 455. Place of Filing.

All registration statements and other papers filed with the Commission shall be filed at its principal office. Such material may be filed by delivery to the Commission; provided, however, that only registration statements and post-effective amendments thereto filed pursuant to Rule 462(b) (§ 230.462(b)) and Rule 110(d) (§ 230.110(d)) may be filed by means of facsimile transmission.

Rule 456. Date of Filing; Timing of Fee Payment.

(a) The date on which any papers are actually received by the Commission shall be the date of filing thereof, if all the requirements of the Act and the rules with respect to such filing have been complied with and the required fee paid. The failure to pay an insignificant amount of the required fee at the time of filing, as the result of a bona fide error, shall not be deemed to affect the date of filing.

(b)(1) Notwithstanding paragraph (a) of this section, a well-known seasoned issuer that registers securities offerings on an automatic shelf registration statement, or registers additional securities or classes of securities thereon pursuant to Rule 413(b) (§230.413(b)), may, but is not required to, defer payment of all or any part of the registration fee to the Commission required by section 6(b)(2) of the Act on the following conditions:

(i) If the issuer elects to defer payment of the registration fee, it shall pay the registration fees (pay-as-you-go registration fees) calculated in accordance with Rule 457(r) (§230.457(r)) in advance of or in connection with an offering of securities from the registration statement within the time required to file the prospectus supplement pursuant to Rule 424(b) (§230.424(b)) for the offering, *provided*, *however*, that if the issuer fails, after a good faith effort to pay the filing

fee within the time required by this section, the issuer may still be considered to have paid the fee in a timely manner if it is paid within four business days of its original due date; and

(ii) The issuer reflects the amount of the pay-as-you-go registration fee paid or to be paid in accordance with paragraph (b)(1)(i) of this section by updating the "Calculation of Registration Fee" table to indicate the class and aggregate offering price of securities offered and the amount of registration fee paid or to be paid in connection with the offering or offerings either in a post-effective amendment filed at the time of the fee payment or on the cover page of a prospectus filed pursuant to Rule 424(b) (§230.424(b)).

(2) A registration statement filed relying on the pay-as-you-go registration fee payment provisions of paragraph (b)(1) of this section will be considered filed as to the securities or classes of securities identified in the registration statement for purposes of this section and section 5 of the Act when it is received by the Commission, if it complies with all other requirements of the Act and the rules with respect to it.

(3) The securities sold pursuant to a registration statement will be considered registered, for purposes of section 6(a) of the Act, if the pay-as-you-go registration fee has been paid and the post-effective amendment or prospectus including the amended "Calculation of Registration Fee" table is filed pursuant to paragraph (b)(1) of this section.

(c)(1) Notwithstanding paragraph (a) of this section, an asset-backed issuer that registers asset-backed securities offerings on Form SF-3, may, but is not required to, defer payment of all or any part of the registration fee to the Commission required by section 6(b)(1) of the Act on the following conditions:

(i) If the issuer elects to defer payment of the registration fee, it shall pay the registration fees (pay-as-you-go registration fees) calculated in accordance with § 230.457(s) in advance of or in connection with an offering of securities from the registration statement at the time of filing the prospectus pursuant to § 230.424(h) for the offering; and

(ii) The issuer reflects the amount of the pay-as-you-go registration fee paid or to be paid in accordance with paragraph (c)(1)(i) of this section by updating the "Calculation of Registration Fee" table to indicate the class and aggregate offering price of securities offered and the amount of registration fee paid or to be paid in connection with the offering or offerings on the cover page of a prospectus filed pursuant to § 230.424(h).

(2) A registration statement filed relying on the pay-as-you-go registration fee payment provisions of paragraph (c)(1) of this section will be considered filed as to the securities or classes of securities identified in the registration statement for purposes of this section and section 5 of the Act when it is received by the Commission, if it complies with all other requirements of the Act and the rules with respect to it.

(3) The securities sold pursuant to a registration statement will be considered registered, for purpose of section 6(a) of the Act, if the pay-as-you-go registration fee has been paid and the prospectus including the amended "Calculation of Registration Fee" table is filed pursuant to paragraph (c)(1) of this section.

Rule 459. Calculation of Effective Date.

Saturdays, Sundays and holidays shall be counted in computing the effective date of registration statements under section 8(a) of the Act. In the case of statements which become effective on the twentieth day after filing, the twentieth day shall be deemed to begin at the expiration of nineteen periods of 24 hours each from 5:30 p.m. Eastern Standard Time or Eastern Daylight-Saving Time, whichever is in effect at the principal office of the Commission on the date of filing.

Rule 460. Distribution of Preliminary Prospectus.

(a) Pursuant to the statutory requirement that the Commission in ruling upon requests for acceleration of the effective date of a registration statement shall have due regard to the adequacy of the information respecting the issuer theretofore available to the public, the Commission may consider whether the persons making the offering have taken reasonable steps to make the information contained in the registration statement conveniently available to underwriters and dealers who it is reasonably anticipated will be invited to participate in the distribution of the security to be offered or sold.

(b)(1) As a minimum, reasonable steps to make the information conveniently available would involve the distribution, to each underwriter and dealer who it is reasonably anticipated will be invited to participate in the distribution of the security, a reasonable time in advance of the anticipated effective date of the registration statement, of as many copies of the proposed form of preliminary prospectus permitted by Rule 430 (§230.430) as appears to be reasonable to secure adequate distribution of the preliminary prospectus.

(2) In the case of a registration statement filed by a closed-end investment company on Form N-2 (§239.14 and §274.11a-1 of this chapter), reasonable steps to make information conveniently available would involve distribution of a sufficient number of copies of the Statement of Additional Information required by Rule 430(b) [§230.430(b) of this chapter] as it appears to be reasonable to secure their adequate distribution either to each underwriter or dealer who it is reasonably anticipated will be invited to participate in the distribution of the security, or to the underwriter, dealer or other source named on the cover page of the preliminary prospectus as being the person investors should contact in order to obtain the Statement of Additional Information.

(c) The granting of acceleration will not be conditioned upon

(1) The distribution of a preliminary prospectus in any state where such distribution would be illegal; or

(2) The distribution of a preliminary prospectus (i) in the case of a registration statement relating solely to securities to be offered at competitive bidding, provided the undertaking in Item 512(d)(1) of Regulation S-K (§229.512(d)(2) of this chapter) is included in the registration statement and distribution of prospectuses pursuant to such undertaking is made prior to the publication or distribution of the invitation for bids, or (ii) in the case of a registration statement relating to a security issued by a face-amount certificate company or a redeemable security issued

by an open-end management company or unit investment trust if any other security of the same class is currently being offered or sold, pursuant to an effective registration statement by the issuer or by or through an underwriter, or (iii) in the case of an offering of subscription rights unless it is contemplated that the distribution will be made through dealers and the underwriters intend to make the offering during the stockholders' subscription period, in which case copies of the preliminary prospectus must be distributed to dealers prior to the effective date of the registration statement in the same fashion as is required in the case of other offerings through underwriters, or (iv) in the case of a registration statement pertaining to a security to be offered pursuant to an exchange offer or transaction described in Rule 145 (§230.145).

Rule 461. Acceleration of Effective Date.

(a) Requests for acceleration of the effective date of a registration statement shall be made by the registrant and the managing underwriters of the proposed issue, or, if there are no managing underwriters, by the principal underwriters of the proposed issue, and shall state the date upon which it is desired that the registration statement shall become effective. Such requests may be made in writing or orally, provided that, if an oral request is to be made, a letter indicating that fact and stating that the registrant and the managing or principal underwriters are aware of their obligations under the Act must accompany the registration statement (or a pre-effective amendment thereto) at the time of filing with the Commission. Written requests may be sent to the Commission by facsimile transmission. If by reason of the expected arrangement in connection with the offering, it is to be requested that the registration statement shall become effective at a particular hour of the day, the Commission must be advised to that effect not later than the second business day before the day which it is desired that the registration statement shall become effective. A person's request for acceleration will be considered confirmation of such person's awareness of the person's obligations under the Act. Not later than the time of filing the last amendment prior to the effective date of the registration statement, the registrant shall inform the Commission as to whether or not the amount of compensation to be allowed or paid to the underwriters and any other arrangements among the registrant, the underwriters and other broker dealers participating in the distribution, as described in the registration statement, have been reviewed to the extent required by the National Association of Securities Dealers, Inc. and such Association has issued a statement expressing no objections to the compensation and other arrangements.

(b) Having due regard to the adequacy of information respecting the registrant theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the registrant issuer and the rights of holders thereof can be understood, and to the public interest and the protection of investors, as provided in section 8(a) of the Act, it is the general policy of the Commission, upon request, as provided in paragraph (a) of this section, to permit acceleration of the effective date of the registration statement as soon as possible after the filing of appropriate amendments, if any. In determining the date on which a registration statement shall become effective, the following are included in the situations in which the Commission considers that the statutory standards of section 8(a) may not be met and may refuse to accelerate the effective date:

(1) Where there has not been a bona fide effort to make the prospectus reasonably concise, readable, and in compliance with the plain English requirements of Rule 421(d) of Regulation C (17 CFR 230.421(d)) in order to facilitate an understanding of the information in the prospectus.

(2) Where the form of preliminary prospectus, which has been distributed by the issuer or underwriter, is found to be inaccurate or inadequate in any material respect, until the Commission has received satisfactory assurance that appropriate correcting material has been sent to all underwriters and dealers who received such preliminary prospectus or prospectuses in quantity sufficient for their information and the information of others to whom the inaccurate or inadequate material was sent.

(3) Where the Commission is currently making an investigation of the issuer, a person controlling the issuer, or one of the underwriters, if any, of the securities to be offered, pursuant to any of the Acts administered by the Commission.

(4) Where one or more of the underwriters, although firmly committed to purchase securities covered by the registration statement, is subject to and does not meet the financial responsibility requirements of Rule 15c3-1 under the Securities Exchange Act of 1934 (§240.15c3-1 of this chapter). For the purposes of this paragraph underwriters will be deemed to be firmly committed even though the obligation to purchase is subject to the usual conditions as to receipt of opinions of counsel, accountants, etc., the accuracy of warranties or representations, the happening of calamities or the occurrence of other events the determination of which is not expressed to be in the sole or absolute discretion of the underwriters.

(5) Where there have been transactions in securities of the registrant by persons connected with or proposed to be connected with the offering which may have artificially affected or may artificially affect the market price of the security being offered.

(6) Where the amount of compensation to be allowed or paid to the underwriters and any other arrangements among the registrant, the underwriters and other broker dealers participating in the distribution, as described in the registration statement, if required to be reviewed by the National Association of Securities Dealers, Inc. (NASD), have been reviewed by the NASD and the NASD has not issued a statement expressing no objections to the compensation and other arrangements.

(7) Where, in the case of a significant secondary offering at the market, the registrant, selling security holders and underwriters have not taken sufficient measures to insure compliance with Regulation M (§§242.100 through 242.105 of this chapter).

(c) Insurance against liabilities arising under the Act, whether the cost of insurance is borne by the registrant, the insured or some other person, will not be considered a bar to acceleration, unless the registrant is a registered investment company or a business development company and the cost of such insurance is borne by other than an insured officer or director of the registrant. In the case

of such a registrant, the Commission may refuse to accelerate the effective date of the registration statement when the registrant is organized or administered pursuant to any instrument (including a contract for insurance against liabilities arising under the Act) that protects or purports to protect any director or officer of the company against any liability to the company or its security holders to which he or she would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office.

Rule 462. Immediate Effectiveness of Certain Registration Statements and Post-Effective Amendments.

(a) A registration statement on Form S-8 (§239.16b of this chapter) and a registration statement on Form S-3 (§239.13 of this chapter) or on Form F-3 (§239.33 of this chapter) for a dividend or interest reinvestment plan shall become effective upon filing with the Commission.

(b) A registration statement and any post-effective amendment thereto shall become effective upon filing with the Commission if:

(1) The registration statement is for registering additional securities of the same class(es) as were included in an earlier registration statement for the same offering and declared effective by the Commission;

(2) The new registration statement is filed prior to the time confirmations are sent or given; and

(3) The new registration statement registers additional securities in an amount and at a price that together represent no more than 20% of the maximum aggregate offering price set forth for each class of securities in the "Calculation of Registration Fee" table contained in such earlier registration statement.

(c) If the prospectus contained in a post-effective amendment filed prior to the time confirmations are sent or given contains no substantive changes from or additions to the prospectus previously filed as part of the effective registration statement, other than price-related information omitted from the registration statement in reliance on Rule 430A of the Act (§230.430A), such post-effective amendment shall become effective upon filing with the Commission.

(d) A post-effective amendment filed solely to add exhibits to a registration statement shall become effective upon filing with the Commission.

(e) An automatic shelf registration statement, including an automatic shelf registration statement filed in accordance with Rule 415(a)(6) (§230.415(a)(6)), and any post-effective amendment thereto, including a post-effective amendment filed to register additional classes of securities pursuant to Rule 413(b) (§230.413(b)), shall become effective upon filing with the Commission.

(f) A post-effective amendment filed pursuant to paragraph (e) of this section for purposes of adding a new issuer and its securities as permitted by Rule 413(b) (§230.413(b)) that satisfies

the requirements of Form S-3 or Form F-3 (§239.13 or §239.33 of this chapter), as applicable, including the signatures required by Rule 402(e) (§230.402(e)), and contains a prospectus satisfying the requirements of Rule 430B (§230.430B), shall become effective upon filing with the Commission.

Amendments; Withdrawals

Rule 470. Formal Requirements For Amendments.

Except for telegraphic amendments filed pursuant to Rule 473 (§230.473), amendments to a registration statement shall be filed under cover of an appropriate facing sheet, shall be numbered consecutively in the order in which filed, and shall indicate on the facing sheet the applicable registration form on which the amendment is prepared and the file number of the registration statement.

Rule 471. Signatures to Amendments.

(a) Except as provided in Rule 447 (§230.447) and in Rule 478 (§230.478), every amendment to a registration statement shall be signed by the persons specified in section 6(a) of the Act. At least one copy of every amendment filed with the Commission shall be signed. Unsigned copies shall be conformed.

(b) Where the Act or the rules thereunder require a document filed with or furnished to the Commission to be signed, such document shall be manually signed, or signed using either typed signatures or duplicated or facsimile versions of manual signatures. Where typed, duplicated or facsimile signatures are used, each signatory to the filing shall manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in the filing. Such document shall be executed before or at the time the filing is made and shall be retained by the registrant for a period of five years. Upon request, the registrant shall furnish to the Commission or its staff a copy of any or all documents retained pursuant to this section.

Rule 472. Filing of Amendments; Number of Copies.

(a) Except for telegraphic amendments filed pursuant to Rule 473 (§230.473), there shall be filed with the Commission three complete, unmarked copies of every amendment, including exhibits and all other papers and documents filed as part of the amendment, and eight additional copies of such amendment at least five of which shall be marked to indicate clearly and precisely, by underlining or in some other appropriate manner, the changes effected in the registration statement by the amendment. Where the amendment to the registration statement incorporates into the prospectus documents which are required to be delivered with the prospectus in lieu of prospectus presentation, the eight additional copies shall be accompanied by eight copies of such documents. No other exhibits are required to accompany such additional copies.

(b) Every amendment which relates to a prospectus shall include copies of the prospectus as amended. Each such copy of the amended prospectus shall be accompanied by a copy of the cross

reference sheet required by Rule 481(a) (§230.481(a)), where applicable, if the amendment of the prospectus resulted in any change in the accuracy of the cross reference sheet previously filed. Notwithstanding the foregoing provisions of this paragraph, only copies of the changed pages of the prospectus, and the cross reference sheet if amended, need be included in an amendment filed pursuant to an undertaking referred to in Item 512(d) of Regulation S-K (§229.512(d) of this chapter).

(c) Every amendment of a financial statement which is not included in the prospectus shall include copies of the financial statement as amended. Every amendment relating to a certified financial statement shall include the consent of the certifying accountant to the use of his certificate in connection with the amended financial statement in the registration statement or prospectus and to being named as having certified such financial statement.

(d) Notwithstanding any other provision of this section, if a registration statement filed on Form S-8 (§239.16b of this chapter) is amended, there shall be filed with the Commission three complete, unmarked copies of every amendment, including exhibits and all other papers and documents filed as part of the amendment. Three additional, unmarked copies of such amendments shall be furnished to the Commission. No exhibits are required to accompany the additional copies of amendments to registration statements filed on Form S-8.

(e) Notwithstanding any other provision of this section, if a post-effective amendment is filed pursuant to Rule 462(b) (§230.462(b)) and Rule 110(d) (§230.110(d)), one copy of the complete post-effective amendment, including exhibits and all other papers and documents filed as a part thereof shall be filed with the Commission. Such copy should not be bound and may contain facsimile versions of manual signatures in accordance with Rule 402(e) (§230.402(e)).

Rule 473. Delaying Amendments.

(a) An amendment in the following form filed with a registration statement, or as an amendment to a registration statement which has not become effective, shall be deemed, for the purpose of section 8(a) of the Act, to be filed on such date or dates as may be necessary to delay the effective date of such registration statement (1) until the registrant shall file a further amendment which specifically states as provided in paragraph (b) of this section that such registration statement shall thereafter become effective in accordance with section 8(a) of the Act, or (2) until the registration statement shall become effective on such date as the Commission, acting pursuant to section 8(a), may determine:

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission acting pursuant to said section 8(a), may determine.

(b) An amendment which for the purpose of paragraph (a)(1) of this section specifically states that a registration statement shall thereafter become effective in accordance with section 8(a) of the Act, shall be in the following form:

This registration statement shall hereafter become effective in accordance with the provisions of section 8(a) of the Securities Act of 1933.

(c) An amendment pursuant to paragraph (a) of this section which is filed with a registration statement shall be set forth on the facing page thereof following the calculation of the registration fee. Any such amendment filed after the filing of the registration statement, any amendment altering the proposed date of public sale of the securities being registered, or any amendment filed pursuant to paragraph (b) of this section may be made by telegram, letter or facsimile transmission. Each such telegraphic amendment shall be confirmed in writing within a reasonable time by the filing of a signed copy of the amendment. Such confirmation shall not be deemed an amendment.

(d) No amendments pursuant to paragraph (a) of this section may be filed with a registration statement on Form F-7, F-8 or F-80 (§239.37, §239.38 or §239.41 of this chapter); on F-10 (§239.40 of this chapter) relating to an offering being made contemporaneously in the United States and the issuer's home jurisdiction; on Form S-8 (§239.16b of this chapter); on Form S-3 or F-3 (§239.13 or §239.33 of this chapter) relating to a dividend or interest reinvestment plan; on Form S-3 or Form F-3 relating to an automatic shelf registration statement; or on Form S-4 (§239.25 of this chapter) complying with General Instruction G of that Form.

Rule 474. Date of Filing of Amendments.

The date on which amendments are actually received by the Commission shall be the date of filing thereof, if all of the requirements of the Act and the rules with respect to such filing have been complied with.

Rule 475. Amendment Filed with Consent of Commission.

An application for the Commission's consent to the filing of an amendment with the effect provided in section 8(a) of the Act may be filed before or after or concurrently with the filing of the amendment. The application shall be signed and shall state fully the grounds upon which it is made. The Commission's consent shall be deemed to have been given and the amendment shall be treated as a part of the registration statement only when the Commission shall after the filing of such amendment enter an order to that effect.

Rule 476. Amendment Filed Pursuant to Order of Commission.

An amendment filed prior to the effective date of a registration statement shall be deemed to have been filed pursuant to an order of the Commission within the meaning of section 8(a) of the Act so as to be treated as a part of the registration statement only when the Commission shall after the filing of such amendment enter an order declaring that it has been filed pursuant to the Commission's previous order.

Rule 477. Withdrawal of Registration Statement or Amendment.

(a) Except as provided in paragraph (b) of this section, any registration statement or any amendment or exhibit thereto may be withdrawn upon application if the Commission, finding such withdrawal consistent with the public interest and the protection of investors, consents thereto.

(b) Any application for withdrawal of a registration statement filed on Form F-2 (Sec. 239.32 of this chapter) relating to a dividend or interest reinvestment plan, or on Form S-4 (Sec. 239.25 of this chapter) complying with General Instruction G of that Form, and/or any pre-effective amendment thereto, will be deemed granted upon filing if such filing is made prior to the effective date. Any other application for withdrawal of an entire registration statement made before the effective date of the registration statement will be deemed granted at the time the application is filed with the Commission unless, within 15 calendar days after the registrant files the application, the Commission notifies the registrant that the application for withdrawal will not be granted.

(c) The registrant must sign any application for withdrawal and must state fully in it the grounds on which the registrant makes the application. The fee paid upon the filing of the registration statement will not be refunded to the registrant. The registrant must state in the application that no securities were sold in connection with the offering. If the registrant applies for withdrawal in anticipation of reliance on Sec. 230.155(c), the registrant must, without discussing any terms of the private offering, state in the application that the registrant may undertake a subsequent private offering in reliance on Sec. 230.155(c).

(d) Any withdrawn document will remain in the Commission's public files, as well as the related request for withdrawal.

Rule 478. Powers to Amend or Withdraw Registration Statement.

All persons signing a registration statement shall be deemed, in the absence of a statement to the contrary, to confer upon the registrant, and upon the agent for service named in the registration statement, the following powers:

(a) A power to amend the registration statement (1) by filing an amendment as provided in §230.473; (2) by filing any written consent; (3) by correcting typographical errors; (4) by reducing the amount of securities registered, pursuant to an undertaking contained in the registration statement.

(b) A power to make application pursuant to §230.475 for the Commission's consent to the filing of an amendment.

(c) A power to withdraw the registration statement or any amendment or exhibit thereto.

(d) A power to consent to the entry of an order under section 8(b) of the Act, waiving notice and hearing, such order being entered without prejudice to the right of the registrant thereafter to have the order vacated upon a showing to the Commission that the registration statement as amended is no longer incomplete or inaccurate on its face in any material respect.

Rule 479. Procedure with Respect to Abandoned Registration Statements and Post-effective Amendments.

When a registration statement, or a post-effective amendment to such a statement, has been on file with the Commission for a period of nine months and has not become effective the Commission may, in its discretion, proceed in the following manner to determine whether such

registration statement or amendment has been abandoned by the registrant. If the registration statement has been amended, otherwise than for the purpose of delaying the effective date thereof, or if the post-effective amendment has been amended, the nine-month period shall be computed from the date of the latest such amendment.

(a) A notice will be sent to the registrant, and to the agent for service named in the registration statement, by registered or certified mail, return receipt requested, addressed to the most recent addresses for the registrant and the agent for service reflected in the registration statement. Such notice will inform the registrant and the agent for service that the registration statement or amendment is out of date and must be either amended to comply with the applicable requirements of the Act and the rules and regulations thereunder or be withdrawn within 30 days after the date of such notice.

(b) If the registrant or the agent for service fails to respond to such notice by filing a substantive amendment or withdrawing the registration statement and does not furnish a satisfactory explanation as to why it has not done so within such 30 days, the Commission may, where consistent with the public interest and the protection of investors, enter an order declaring the registration statement or amendment abandoned.

(c) When such an order is entered by the Commission the papers comprising the registration statement or amendment will not be removed from the files of the Commission but an order shall be included in the file for the registration statement in the following manner: "Declared abandoned by order dated ."

Investment Companies; Business Development Companies

Note: The rules in this section of Regulation C (§§230.480 to 230.488 and §§230.495 to 230.498) apply only to investment companies and business development companies. Section 230.489 applies to certain entities excepted from the definition of investment company by rules under the Investment Company Act of 1940. The rules in the rest of Regulation C (§§230.400 to 230.479 and §§230.490 to 230.494), unless the context specifically indicates otherwise, also apply to investment companies and business development companies. See §230.400.

Rule 480. Title of securities.

If a registration statement is prepared on a form available solely to investment companies registered under the Investment Company Act of 1940, or a business development company which is selling or proposing to sell its securities pursuant to a registration statement which has been filed under the Act, wherever the title of securities is required to be stated there shall be given such information as will indicate the type and general character of the securities, including the following:

(a) In the case of shares, the par or stated value, if any; the rate of dividends, if fixed, and whether cumulative or non-cumulative; a brief indication of the preference, if any; and, if convertible, a statement to that effect.

(b) In the case of funded debt, the rate of interest; the date of maturity, or, if the issue matures serially, a brief indication of the serial maturities, such as "maturing serially from 1950 to 1960"; if the payment of principal or interest is contingent, an appropriate indication of such contingency; a brief indication of the priority of the issue; and, if convertible, a statement to that effect.

(c) In the case of any other kind of security, appropriate information of comparable character.

Rule 481. Information required in prospectuses.

Disclose the following in registration statements prepared on a form available solely to investment companies registered under the Investment Company Act of 1940 or in registration statements filed under the Act for a company that has elected to be regulated as a business development company under Sections 55 through 65 of the Investment Company Act (15 U.S.C. 80a-54-80a-64):

(a) ***Facing page.*** Indicate the approximate date of the proposed sale of the securities to the public.

(b) ***Outside Front Cover Page.*** *If applicable, include the following in plain English as required by §230.421(d):*

(1) ***Commission Legend.*** *Provide a legend that indicates that the Securities and Exchange Commission has not approved or disapproved of the securities or passed upon the accuracy or adequacy of the disclosure in the prospectus and that any contrary representation is a criminal offense. The legend may be in one of the following or other clear and concise language:*

Example A: The Securities and Exchange Commission has not approved or disapproved these securities or passed upon the adequacy of this prospectus. Any representation to the contrary is a criminal offense.

Example B: The Securities and Exchange Commission has not approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

(2) **"Subject to Completion" Legend.**

(i) If a prospectus or Statement of Additional Information will be used before the effective date of the registration statement, include on the outside front cover page of the prospectus or Statement of Additional Information, a prominent statement that:

(A) The information in the prospectus or Statement of Additional Information will be amended or completed;

(B) A registration statement relating to these securities has been filed with the Securities and Exchange Commission;

(C) The securities may not be sold until the registration statement becomes effective; and

(D) In a prospectus, that the prospectus is not an offer to sell the securities and it is not soliciting an offer to buy the securities in any state where offers or sales are not permitted, or in a Statement of Additional Information, that the Statement of Additional Information is not a prospectus.

(ii) The legend may be in the following language or other clear and understandable language:

The information in this prospectus (or Statement of Additional Information) is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus (or Statement of Additional Information) is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

(iii) In the case of a prospectus that omits pricing information under §230.430A, provide the information and legend in paragraph (b)(2) of this section if the prospectus or Statement of Additional Information is used before the initial public offering price is determined.

(c) ***Table of Contents.*** Include on either the outside front, inside front, or outside back cover page of the prospectus, a reasonably detailed table of contents. It must show the page number of the various sections or subdivisions of the prospectus. Include this table of contents immediately following the cover page in any prospectus delivered electronically.

(d) ***Stabilization and Other Transactions.*** (1) Indicate on the front cover page of the prospectus if the underwriter has any arrangement with the issuer, such as an over-allotment option, under which the underwriter may purchase additional shares in connection with the offering, and state the amount of additional shares the underwriter may purchase under the arrangement. Provide disclosure in the prospectus that briefly describes any transaction that the underwriter intends to conduct during the offering that stabilizes, maintains, or otherwise affects the market price of the offered securities. Include information on stabilizing transactions, syndicate short covering transactions, penalty bids, or any other transactions that affect the offered security's price. Describe the nature of the transactions clearly and explain how the transactions affect the offered security's price. Identify the exchange or other market on which these transactions may occur. If true, disclose that the underwriter may discontinue these transactions at any time;

(2) If the stabilizing began before the effective date of the registration statement, disclose in the prospectus the amount of securities bought, the prices at which they were bought and the period within which they were bought. In the event that §230.430A of this chapter is used, the prospectus filed under §230.497(h) or included in a post-effective amendment must contain information on the stabilizing transactions that took place before the determination of the public offering price shown in the prospectus; and

(3) If you are making a warrant or rights offering of securities to existing security holders and the securities not purchased by existing security holders are to be reoffered to the public, disclose in the prospectus used in connection with the reoffering:

(i) The amount of securities bought in stabilization activities during the offering period and the price or range of prices at which the securities were bought;

(ii) The amount of the offered securities subscribed for during the offering period;

(iii) The amount of the offered securities subscribed for by the underwriters during the offering period;

(iv) The amount of the offered securities sold during the offering period by the underwriters and the price or range of prices at which the securities were sold; and

(v) The amount of the offered securities to be reoffered to the public and the public offering price.

(e) ***Dealer Prospectus Delivery Obligations.*** On the outside back cover page of the prospectus, advise dealers of their prospectus delivery obligation, including the expiration date specified by Section 4(3) of the Act (15 U.S.C. 77d(3)) and §230.174. If the expiration date is not known on the effective date of the registration statement, include the expiration date in the copy of the prospectus filed under §230.497. This information need not be included if dealers are not required to deliver a prospectus under §230.174 or Section 24(d) of the Investment Company Act of 1940 (15 U.S.C. 80a-24). Use the following or other clear, plain language:

Dealer Prospectus Delivery Obligation

Until (insert date), all dealers that effect transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

(f) ***Electronic distribution.*** Where a prospectus is distributed through an electronic medium, issuers may satisfy legibility requirements applicable to printed documents, such as paper size, type size and font, bold-face type, italics and red ink, by presenting all required information in a format readily communicated to investors, and where indicated, in a manner reasonably calculated to draw investor attention to specific information.

Rule 482 Advertising by an investment company as satisfying requirements of section 10.

(a) Scope of rule. This section applies to an advertisement or other sales material (*advertisement*) with respect to securities of an investment company registered under the Investment Company Act of 1940 (1940 Act), or a business development company, that is selling or proposing to sell its securities pursuant to a registration statement that has been filed under the

Act. This section does not apply to an advertisement that is excepted from the definition of prospectus by section 2(a)(10) of the Act or Rule 498(d) or to a summary prospectus under Rule 498. An advertisement that complies with this section, which may include information the substance of which is not included in the prospectus specified in section 10(a) of the Act, will be deemed to be a prospectus under section 10(b) of the Act for the purposes of section 5(b)(1) of the Act.

Note to paragraph (a): The fact that an advertisement complies with this section does not relieve the investment company, underwriter, or dealer of any obligations with respect to the advertisement under the antifraud provisions of the federal securities laws. For guidance about factors to be weighed in determining whether statements, representations, illustrations, and descriptions contained in investment company advertisements are misleading, *see* § 230.156. In addition, an advertisement that complies with this section is subject to the legibility requirements of § 230.420.

(b) Required disclosure. This paragraph describes information that is required to be included in an advertisement in order to comply with this section.

(1) Availability of additional information. An advertisement must include a statement that advises an investor to consider the investment objectives, risks, and charges and expenses of the investment company carefully before investing; explains that the prospectus and, if available, the summary prospectus contain this and other information about the investment company; identifies a source from which an investor may obtain a prospectus and, if available, a summary prospectus; and states that the prospectus and, if available, the summary prospectus should be read carefully before investing.

(2) Advertisements used prior to effectiveness of registration statement. An advertisement that is used prior to effectiveness of the investment company's registration statement or the determination of the public offering price (in the case of a registration statement that becomes effective omitting information from the prospectus contained in the registration statement in reliance upon § 230.430A) must include the "Subject to Completion" legend required by § 230.481(b)(2).

(3) Advertisements including performance data. An advertisement that includes performance data of an open-end management investment company or a separate account registered under the 1940 Act as a unit investment trust offering variable annuity contracts (*trust account*) must include the following:

(i) A legend disclosing that the performance data quoted represents past performance; that past performance does not guarantee future results; that the investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost; and that current performance may be lower or higher than the performance data quoted. The legend should also identify either a toll-free (or collect) telephone number or a website where an investor may obtain performance data current to the most

recent month-end unless the advertisement includes total return quotations current to the most recent month ended seven business days prior to the date of use. An advertisement for a money market fund that is a government money market fund, as defined in §270.2a-7(a)(16) of this chapter or a retail money market fund, as defined in §270.2a-7(a)(25) of this chapter may omit the disclosure about principal value fluctuation; and

Note to paragraph (b)(3)(i): The date of use refers to the date or dates when an advertisement is used by investors, not the date on which an advertisement is published or submitted for publication. The date of use refers to the entire period of use by investors and not simply the first date on which an advertisement is used.

(ii) If a sales load or any other nonrecurring fee is charged, the maximum amount of the load or fee, and if the sales load or fee is not reflected, a statement that the performance data does not reflect the deduction of the sales load or fee, and that, if reflected, the load or fee would reduce the performance quoted.

(4) Money market funds.

(i) An advertisement for an investment company that holds itself out to be a money market fund, that is not a government money market fund, as defined in §270.2a-7(a)(16) of this chapter or a retail money market fund, as defined in §270.2a-7(a)(25) of this chapter must include the following statement:

You could lose money by investing in the Fund. Because the share price of the Fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The Fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

(ii) An advertisement for an investment company that holds itself out to be a money market fund, that is a government money market fund, as defined in §270.2a-7(a)(16) of this chapter or a retail money market fund, as defined in §270.2a-7(a)(25) of this chapter, and that is subject to the requirements of §270.2a-7(c)(2)(i) and/or (ii) of this chapter (or is not subject to the requirements of §270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to §270.2a-7(c)(2)(iii) of this chapter, but has chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §270.2a-7(c)(2)(i) and/or (ii)), must include the following statement:

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The Fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance

Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

(iii) An advertisement for an investment company that holds itself out to be a money market fund, that is a government money market fund, as defined in §270.2a-7(a)(16) of this chapter, that is not subject to the requirements of §270.2a-7(c)(2)(i) and/or (ii) of this chapter pursuant to §270.2a-7(c)(2)(iii) of this chapter, and that has not chosen to rely on the ability to impose liquidity fees and suspend redemptions consistent with the requirements of §270.2a-7(c)(2)(i) and/or (ii)), must include the following statement:

You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.

Note to paragraph (b)(4). If an affiliated person, promoter, or principal underwriter of the Fund, or an affiliated person of such a person, has contractually committed to provide financial support to the Fund, the statement may omit the last sentence ("The Fund's sponsor has no legal obligation to provide financial support to the Fund, and you should not expect that the sponsor will provide financial support to the Fund at any time.") for the term of the agreement. For purposes of this Note, the term "financial support" includes any capital contribution, purchase of a security from the Fund in reliance on §270.17a-9 of this chapter, purchase of any defaulted or devalued security at par, execution of letter of credit or letter of indemnity, capital support agreement (whether or not the Fund ultimately received support), performance guarantee, or any other similar action reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio; however, the term "financial support" excludes any routine waiver of fees or reimbursement of fund expenses, routine inter-fund lending, routine inter-fund purchases of fund shares, or any action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the fund's portfolio.

(5) Presentation. In a print advertisement, the statements required by paragraphs (b)(1) through (b)(4) of this section must be presented in a type size at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement, provided that when performance data is presented in a type size smaller than that of the major portion of the advertisement, the statements required by paragraph (b)(3) of this section may appear in a type size no smaller than that of the performance data. If an advertisement is delivered through an electronic medium, the legibility requirements for the statements required by paragraphs (b)(1) through (b)(4) of this section relating to type size and style may be satisfied by presenting the statements in any manner reasonably calculated to draw investor attention to them. In a radio or television advertisement, the statements required by paragraphs (b)(1) through (b)(4) of this section must be given emphasis equal to that used in the major portion of

the advertisement. The statements required by paragraph (b)(3) of this section must be presented in close proximity to the performance data, and, in a print advertisement, must be presented in the body of the advertisement and not in a footnote.

(6) Commission legend. An advertisement that complies with this section need not contain the Commission legend required by § 230.481(b)(1).

(c) Use of applications. An advertisement that complies with this section may not contain or be accompanied by any application by which a prospective investor may invest in the investment company, except that a prospectus meeting the requirements of section 10(a) of the Act by which a unit investment trust offers variable annuity or variable life insurance contracts may contain a contract application although the prospectus includes, or is accompanied by, information about an investment company in which the unit investment trust invests that, pursuant to this section, is deemed a prospectus under section 10(b) of the Act.

(d) Performance data for non-money market funds. In the case of an open-end management investment company or a trust account (other than a money market fund referred to in paragraph (e) of this section), any quotation of the company's performance contained in an advertisement shall be limited to quotations of:

(1) Current yield. A current yield that:

(i) Is based on the methods of computation prescribed in Form N-1A (§§ 239.15A and 274.11A of this chapter), N-3 (§§ 239.17a and 274.11b of this chapter), or N-4 (§§ 239.17b and 274.11c of this chapter);

(ii) Is accompanied by quotations of total return as provided for in paragraph (d)(3) of this section;

(iii) Is set out in no greater prominence than the required quotations of total return; and

(iv) Adjacent to the quotation and with no less prominence than the quotation, identifies the length of and the date of the last day in the base period used in computing the quotation.

(2) Tax-equivalent yield. A tax-equivalent yield that:

(i) Is based on the methods of computation prescribed in Form N-1A (§§ 239.15A and 274.11A of this chapter), N-3 (§§ 239.17a and 274.11b of this chapter), or N-4 (§§ 239.17b and 274.11c of this chapter);

(ii) Is accompanied by quotations of yield as provided for in paragraph (d)(1) of this section and total return as provided for in paragraph (d)(3) of this section;

(iii) Is set out in no greater prominence than the required quotations of yield and total return;

(iv) Relates to the same base period as the required quotation of yield; and

(v) Adjacent to the quotation and with no less prominence than the quotation, identifies the length of and the date of the last day in the base period used in computing the quotation.

(3) Average annual total return. Average annual total return for one, five, and ten year periods, except that if the company's registration statement under the Act (15 U.S.C. 77a et seq.) has been in effect for less than one, five, or ten years, the time period during which the registration statement was in effect is substituted for the period(s) otherwise prescribed. The quotations must:

(i) Be based on the methods of computation prescribed in Form N-1A (§§ 239.15A and 274.11A of this chapter), N-3 (§§ 239.17a and 274.11b of this chapter), or N-4 (§§ 239.17b and 274.11c of this chapter);

(ii) Be current to the most recent calendar quarter ended prior to the submission of the advertisement for publication;

(iii) Be set out with equal prominence; and

(iv) Adjacent to the quotation and with no less prominence than the quotation, identify the length of and the last day of the one, five, and ten year periods.

(4) After-tax return. For an open-end management investment company, average annual total return (after taxes on distributions) and average annual total return (after taxes on distributions and redemption) for one, five, and ten year periods, except that if the company's registration statement under the Act (15 U.S.C. 77a et seq.) has been in effect for less than one, five, or ten years, the time period during which the registration statement was in effect is substituted for the period(s) otherwise prescribed. The quotations must:

(i) Be based on the methods of computation prescribed in Form N-1A (§§ 239.15A and 274.11A of this chapter);

(ii) Be current to the most recent calendar quarter ended prior to the submission of the advertisement for publication;

(iii) Be accompanied by quotations of total return as provided for in paragraph (d)(3) of this section;

(iv) Include both average annual total return (after taxes on distributions) and average annual total return (after taxes on distributions and redemption);

(v) Be set out with equal prominence and be set out in no greater prominence than the required quotations of total return; and

(vi) Adjacent to the quotations and with no less prominence than the quotations, identify the length of and the last day of the one, five, and ten year periods.

(5) Other performance measures. Any other historical measure of company performance (not subject to any prescribed method of computation) if such measurement:

(i) Reflects all elements of return;

(ii) Is accompanied by quotations of total return as provided for in paragraph (d)(3) of this section;

(iii) In the case of any measure of performance adjusted to reflect the effect of taxes, is accompanied by quotations of total return as provided for in paragraph (d)(4) of this section;

(iv) Is set out in no greater prominence than the required quotations of total return; and

(v) Adjacent to the measurement and with no less prominence than the measurement, identifies the length of and the last day of the period for which performance is measured.

(e) Performance data for money market funds. In the case of a money market fund:

(1) Yield. Any quotation of the money market fund's yield in an advertisement shall be based on the methods of computation prescribed in Form N-1A (§§ 239.15A and 274.11A of this chapter), N-3 (§§ 239.17a and 274.11b of this chapter), or N-4 (§§ 239.17b and 274.11c of this chapter) and may include:

(i) A quotation of current yield that, adjacent to the quotation and with no less prominence than the quotation, identifies the length of and the date of the last day in the base period used in computing that quotation;

(ii) A quotation of effective yield if it appears in the same advertisement as a quotation of current yield and each quotation relates to an identical base period and is presented with equal prominence; or

(iii) A quotation or quotations of tax-equivalent yield or tax-equivalent effective yield if it appears in the same advertisement as a quotation of current yield and each quotation relates to the same base period as the quotation of current yield, is presented with equal prominence, and states the income tax rate used in the calculation.

(2) Total return. Accompany any quotation of the money market fund's total return in an advertisement with a quotation of the money market fund's current yield under paragraph (e)(1)(i) of this section. Place the quotations of total return and current yield next to each other, in the same size print, and if there is a material difference between the quoted total return and the quoted current yield, include a statement that the yield quotation more closely reflects the current earnings of the money market fund than the total return quotation.

(f) Advertisements that make tax representations. An advertisement for an open-end management investment company (other than a company that is permitted under § 270.35d-1(a)(4) of this chapter to use a name suggesting that the company's distributions are exempt from

federal income tax or from both federal and state income tax) that represents or implies that the company is managed to limit or control the effect of taxes on company performance must accompany any quotation of the company's performance permitted by paragraph (d) of this section with quotations of total return as provided for in paragraph (d)(4) of this section.

(g) Timeliness of performance data. All performance data contained in any advertisement must be as of the most recent practicable date considering the type of investment company and the media through which the data will be conveyed, except that any advertisement containing total return quotations will be considered to have complied with this paragraph provided that:

(1)(i) The total return quotations are current to the most recent calendar quarter ended prior to the submission of the advertisement for publication; and

(ii) Total return quotations current to the most recent month ended seven business days prior to the date of use are provided at the toll-free (or collect) telephone number or website identified pursuant to paragraph (b)(3)(i) of this section; or

(2) The total return quotations are current to the most recent month ended seven business days prior to the date of use of the advertisement.

Note to paragraph (g): The date of use refers to the date or dates when an advertisement is used by investors, not the date on which an advertisement is published or submitted for publication. The date of use refers to the entire period of use by investors and not simply the first date on which an advertisement is used.

(h) Filing. An advertisement that complies with this section need not be filed as part of the registration statement filed under the Act.

Note to paragraph (h): These advertisements, unless filed with NASD Regulation, Inc., are required to be filed in accordance with the requirements of § 230.497.

Rule 483. Exhibits for Certain Registration Statements.

If a registration statement is prepared on a form available solely to investment companies registered under the Investment Company Act of 1940, or a business development company which is selling or proposing to sell its securities pursuant to a registration statement which has been filed under the Act, the following provisions apply:

(a) Such registration statement shall contain an exhibit index, which should immediately precede the exhibits filed with such registration statement. The exhibit index shall indicate by handwritten, typed, printed or other legible form of notation in the manually signed original registration statement the page number in the sequential numbering system where such exhibit can be found. Where exhibits are incorporated by reference, this fact shall be noted in the exhibit index referred to in the preceding sentence. Further, the first page of the manually signed registration statement shall list the page in the filing where the exhibit index is located.

(b) If any name is signed to the registration statement pursuant to a power of attorney, copies of such powers of attorney shall be filed as an exhibit to the registration statement. In addition, if the name of any officer signing on behalf of the registrant, or attesting the registrant's seal, is signed pursuant to a power of attorney, certified copies of a resolution of the registrant's board of directors authorizing such signature shall also be filed as an exhibit to the registration statement. A power of attorney that is filed with the Commission shall relate to a specific filing, an amendment thereto, or a related registration statement that is to be effective upon filing pursuant to Rule 462(b) (§230.462(b)) under the Act.

(c)(1) All written consents are required to be filed as an exhibit to the registration statement, together with a list thereof. Such consents shall be dated and manually signed. Where the consent of an expert or counsel is contained in his report or opinion, a reference shall be made in the list to the report or opinion containing the consent.

(2) In a registration statement filed pursuant to Rule 462(b) (§230.462(b)) by a closed-end company, any required consent may be incorporated by reference into the registration statement from a previously filed registration statement related to the offering, provided that the consent contained in the previously filed registration statement expressly provides for such incorporation. Any consent filed in a Rule 462(b) (§230.462(b)) registration statement may contain duplicated or facsimile versions of required signatures, and such signatures shall be considered manually filed for the purposes of the Act and the rules thereunder.

(d) **The registrant:**

(1) May file such exhibits as it may desire in addition to those required by the appropriate form. Such exhibits shall be so marked as to indicate clearly the subject matters to which they refer;

(2) In any case where two or more indentures, contracts, franchises, or other documents required to be filed as exhibits are substantially identical in all material respects except as to the parties thereto, the dates of execution, or other details, need file a copy of only one of such documents, with a schedule identifying the other documents omitted and setting forth the material details in which such documents differ from the document of which a copy is filed. The Commission may at any time in its discretion require filing of copies of any documents so omitted; and

(3) If an exhibit to a registration statement (other than an opinion or consent), filed in preliminary form, has been changed only (i) to insert information as to interest, dividend or conversion rates, redemption or conversion prices, purchase or offering prices, underwriters' or dealers' commission, names, addresses or participation of underwriters or similar matters, which information appears elsewhere in an amendment to the registration statement, or (ii) to correct typographical errors, insert signatures or make other similar immaterial changes, then, notwithstanding any contrary requirement of any rule or form, need not refile such exhibit as so amended; provided the registrant states in the amendment to the registration statement the basis

provided by this rule for not refiling such exhibit. Any such incomplete exhibit may not, however, be incorporated by reference in any subsequent filing under any Act administered by the Commission.

Rule 484. Undertaking Required in Certain Registration Statements.

If a registration statement is prepared on a form available solely to investment companies registered under the Investment Company Act of 1940, or a business development company which is selling or proposing to sell its securities pursuant to a registration statement which has been filed under the Act, if (a) any acceleration is requested of the effective date of the registration statement pursuant to Rule 461 (§230.461), and (b)(1) any provision or arrangement exists whereby the registrant may indemnify a director, officer or controlling person of the registrant against liabilities arising under the Act, or (2) the underwriting agreement contains provisions by which indemnification against such liabilities is given by the registrant to the underwriter or controlling persons of the underwriter and the director, officer or controlling person of the registrant is such an underwriter or controlling person thereof or a member of any firm which is an underwriter, and (3) the benefits of such indemnification are not waived by such persons; the registration statement shall include a brief description of the indemnification provisions and an undertaking in substantially the following form:

Insofar as indemnification for liability arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

Rule 485. Effective Date of Post-Effective Amendments Filed by Certain Registered Investment Companies.

(a) ***Automatic Effectiveness.*** (1) Except as otherwise provided in this section, a post-effective amendment to a registration statement filed by a registered open-end management investment company, unit investment trust or separate account as defined in section 2(a)(37) of the Investment Company Act of 1940 [15 USC 80a-2(a)(37)] shall become effective on the sixtieth day after the filing thereof, or a later date designated by the registrant on the facing sheet of the amendment, which date shall be no later than eighty days after the date on which the amendment is filed.

(2) A post-effective amendment filed by a registered open-end management investment company for the purpose of adding a series shall become effective on the seventy-fifth day after the filing thereof or a later date designated by the registrant on the facing sheet of the amendment, which date shall be no later than ninety-five days after the date on which the amendment is filed.

(3) The Commission; having due regard to the public interest and the protection of investors, may declare an amendment filed under this paragraph (a) effective on an earlier date.

(b) ***Immediate Effectiveness.*** Except as otherwise provided in this section, a post-effective amendment to a registration statement filed by a registered open-end management investment company, unit investment trust or separate account as defined in section 2(a)(37) of the Investment Company Act of 1940 [15 USC 80a-2(a)(37)] shall become effective on the date upon which it is filed with the Commission, or a later date designated by the registrant on the facing sheet of the amendment which date shall be not later than thirty days after the date on which the amendment is filed, except that a post-effective amendment including a designation of a new effective date pursuant to paragraph (b)(1)(iii) of this section shall become effective on the new effective date designated therein, *Provided*, that the following conditions are met:

(1) It is filed for no purpose other than one or more of the following:

(i) Bringing the financial statements up to date under section 10(a)(3) of the Securities Act of 1933 [15 U.S.C. 77j(a)(3)] or Rules 3-12 or 3-18 of Regulation S-X [17 CFR 210.3-12 and 210.3-18];

(ii) Complying with an undertaking to file an amendment containing financial statements, which may be unaudited, within four to six months after the effective date of the registrant's registration statement under the Securities Act of 1933 [15 U.S.C. 77a et seq.];

(iii) Designating a new effective date for a previously filed post-effective amendment pursuant to paragraph (a) of this section, which has not yet become effective, *Provided*, that the new effective date shall be no earlier than the effective date designated in the previously filed amendment under paragraph (a) of this section and no later than thirty days after that date;

(iv) Disclosing or updating the information required by Items 5(b) or 10(a)(2) of Form N-1A [17 CFR 239.15A and 274.11A];

(v) Making any non-material changes which the registrant deems appropriate;

(vi) In the case of a separate account registered as a unit investment trust, to make changes in the disclosure in the unit investment trust's registration statement to reflect changes to disclosure in the registration statement of the investment company in which the unit investment trust invests all of its assets; and

(vii) Any other purpose which the Commission shall approve.

(2) The registrant represents that the amendment is filed solely for one or more of the purposes specified in paragraph (b)(1) of this section and that no material event requiring disclosure in the prospectus, other than one listed in paragraph (b)(1) of this section or one for which the Commission has approved a filing under paragraph (b)(1)(vii) of this section, has occurred since the latest of the following three dates:

(i) the effective date of the registrant's registration statement;

(ii) the effective date of its most recent post-effective amendment to its registration statement which included a prospectus; or

(iii) the filing date of a post-effective amendment filed under paragraph (a) of this section which has not become effective.

(3) The amendment recites on its facing sheet that the registrant proposes that the amendment will become effective under paragraph (b) of this section.

(4) The representations of the registrant referred to in paragraph (b)(2) of this section shall be made by certification on the signature page of the post-effective amendment that the amendment meets all the requirements for effectiveness under paragraph (b) of this section. If counsel prepared or reviewed the post-effective amendment filed under paragraph (b) of this section, counsel shall furnish to the Commission at the time the amendment is filed a written representation that the amendment does not contain disclosures that would render it ineligible to become effective under paragraph (b) of this section.

(c) Incomplete or Inaccurate Amendments; Suspension of Use of Paragraph (b)

(1) No amendment shall become effective under paragraph (a) of this section if, prior to the effective date of the amendment, it should appear to the Commission that the amendment may be incomplete or inaccurate in any material respect, and the Commission furnishes to the registrant written notice that the effective date of the amendment is to be suspended. Following such action by the Commission, the registrant may file with the Commission at any time a petition for review of the suspension. The Commission will order a hearing on the matter if a request for such a hearing is included in the petition. If the Commission has suspended the effective date of an amendment, the amendment shall become effective on such date as the Commission may determine, having due regard to the public interest and the protection of investors.

(2) The Commission may, in the manner and under the circumstances set forth in this paragraph (c)(2), suspend the ability of registrant to file a post-effective amendment under paragraph (b) of this section. The notice of such suspension shall be in writing and shall specify the period for which such suspension shall remain in effect. The Commission may issue a suspension if it appears to the Commission that a registrant which files a post-effective amendment under paragraph (b) of this section has not complied with the conditions of that paragraph. Any suspension

under this paragraph (c)(2) shall become effective at such time as the Commission furnishes written notice thereof to the registrant. Any such suspension, so long as it is in effect, shall apply to any post-effective amendment that has been filed but has not, at the time of such suspension, become effective, and to any post-effective amendment that may be filed after the suspension. Any suspension shall apply only to the ability to file a post-effective amendment pursuant to paragraph (b) of this section and shall not otherwise affect any post-effective amendment. Following this action by the Commission the registrant may file with the Commission at any time a petition for review of the suspension. The Commission will order a hearing on the matter if a request for a hearing is included in the petition.

(3) A registrant's ability to file a post-effective amendment, other than an amendment filed solely for purposes of submitting an Interactive Data File, under paragraph (b) of this section is automatically suspended if a registrant fails to submit and post on its Web site any Interactive Data File exhibit as required by General Instruction C.3.(g) of Form N-1A (§§239.15A and 274.11A of this chapter). A suspension under this paragraph (c)(3) shall become effective at such time as the registrant fails to submit or post an Interactive Data File as required by General Instruction C.3.(g) of Form N-1A. Any such suspension, so long as it is in effect, shall apply to any post-effective amendment that is filed after the suspension becomes effective, but shall not apply to any post-effective amendment that was filed before the suspension became effective. Any suspension shall apply only to the ability to file a post-effective amendment pursuant to paragraph (b) of this section and shall not otherwise affect any post-effective amendment. Any suspension under this paragraph (c)(3) shall terminate as soon as a registrant has submitted and posted to its Web site the Interactive Data File as required by General Instruction C.3.(g) of Form N-1A.

(d) ***Subsequent Amendments.*** (1) Except as provided in paragraph (d)(2) of this section, a post-effective amendment that includes a prospectus shall not become effective under paragraph (a) of this section if a subsequent post-effective amendment relating to the prospectus is filed before such amendment becomes effective.

(2) A post-effective amendment that includes a prospectus shall become effective under paragraph (a) of this section notwithstanding the filing of a subsequent post-effective amendment relating to the prospectus, *Provided*, that the following conditions are met:

(i) the subsequent amendment is filed under paragraph (b) of this section; and

(ii) the subsequent amendment designates as its effective date either:

(A) the date on which the prior post-effective amendment was to become effective under paragraph (a) of this section; or

(B) a new effective date designated under paragraph (b)(1)(iii) of this section.

In this case the prior post-effective amendment filed under paragraph (a) of this section and any prior post-effective amendment filed under paragraph (b) of this section shall also become effective on the new effective date designated under paragraph (b)(1)(iii) of this section.

(3) Notwithstanding paragraphs (d)(1) and (d)(2) of this section, if another post-effective amendment relating to the same prospectus is filed under paragraph (a) of this section before the prior amendments filed pursuant to paragraphs (a) and (b) of this section have become effective, none of such prior amendments shall become effective under this section.

(e) ***Certain Separate Accounts.*** For purposes of this section, a post-effective amendment to a registration statement for an offering of securities by a registered open-end management investment company or unit investment trust as those terms are used in paragraphs (a), (b), and (e) of this section and as such amendments are referred to in paragraphs (c) and (d) of this section, shall include a post-effective amendment to an offering of securities by an insurance company funded through a separate account, as defined in section 2(a)(37) of the Investment Company Act of 1940 [15 U.S.C. 80a-2(a)(37)], where the separate account need not register under the Investment Company Act of 1940 under section 3(c)(11) thereof [15 U.S.C. 80a-3(c)(11)].

(f) ***Electronic Filers.*** When ascertaining the date of filing, electronic filers should not presume a registration statement has been accepted until notice of acceptance has been received from the Commission.

Note: To determine the date of automatic effectiveness, the day following the filing date is the first day of the time period. For example, a post-effective amendment filed under paragraph (a) of this section on November 1 would become effective on December 31.

Rule 486. Effective Date of Post-Effective Amendments and Registration Statements Filed by Certain Closed-End Management Investment Companies.

(a) ***Automatic Effectiveness.*** Except as otherwise provided in this section, a post-effective amendment to a registration statement, or a registration statement filed for the purpose of registering additional shares of common stock for which a registration statement filed on Form N-2 (§§239.14 and 274.11a-1 of this chapter) is effective, filed by a registered closed-end management investment company or business development company which makes periodic repurchase offers under §270.23c-3 of this chapter, shall become effective on the sixtieth day after the filing thereof, or a later date designated by the registrant on the facing sheet of the amendment or registration statement, which date shall not be later than eighty days after the date on which the amendment or registration statement is filed, *Provided*, that the Commission, having due regard to the public interest and the protection of investors, may declare an amendment or registration statement filed under this paragraph (a) effective on an earlier date.

(b) ***Immediate Effectiveness.*** Except as otherwise provided in this section, a post-effective amendment to a registration statement, or a registration statement for additional shares of common stock, filed by a registered closed-end management investment company or business development company which makes periodic repurchase offers under §270.23c-3 of this chapter, shall become effective on the date on which it is filed with the Commission, or a later date designated by the registrant on the facing sheet of the amendment or registration statement, which

date shall be not later than thirty days after the date on which the amendment or registration statement is filed, except that a post-effective amendment including a designation of a new effective date under paragraph (b)(1)(iii) of this section shall become effective on the new effective date designated therein, *Provided*, that the following conditions are met:

(1) It is filed for no purpose other than one or more of the following:

(i) Registering additional shares of common stock for which a registration statement filed on Form N-2 (§§239.14 and 274.11a-1 of this chapter) is effective;

(ii) Bringing the financial statements up to date under section 10(a)(3) of the Act [15 U.S.C. 77j(a)(3)] or rule 3-18 of Regulation S-X [17 CFR 210.3-18];

(iii) Designating a new effective date for a previously filed post-effective amendment or registration statement for additional shares under paragraph (a) of this section, which has not yet become effective, *Provided*, that the new effective date shall be no earlier than the effective date designated in the previously filed amendment or registration statement under paragraph (a) of this section and no later than thirty days after that date;

(iv) Disclosing or updating the information required by Item 9c of Form N-2 [17 CFR 239.14 and 274.11a-1];

(v) Making any non-material changes which the registrant deems appropriate; and

(vi) Any other purpose which the Commission shall approve.

(2) The registrant represents that the amendment is filed solely for one or more of the purposes specified in paragraph (b)(1) of this section and that no material event requiring disclosure in the prospectus, other than one listed in paragraph (b)(1) or one for which the Commission has approved a filing under paragraph (b)(1)(vi) of this section, has occurred since the latest of the following three dates:

(i) the effective date of the registrant's registration statement;

(ii) the effective date of its most recent post-effective amendment to its registration statement which included a prospectus; or

(iii) the filing date of a post-effective amendment or registration statement filed under paragraph (a) of this section which has not become effective; and

(3) The amendment or registration statement recites on the facing sheet thereof that the registrant proposes that the amendment or registration statement will become effective under paragraph (b) of this section.

(4) The representations of the registrant referred to in paragraph (b)(2) of this section shall be made by certification on the signature page of the post-effective amendment or registration

statement that the amendment or registration statement meets all of the requirements for effectiveness under paragraph (b) of this section. If counsel prepared or reviewed the post-effective amendment or registration statement filed under paragraph (b) of this section, counsel shall furnish to the Commission at the time the amendment or registration statement is filed a written representation that the amendment or registration statement does not contain disclosure which would render it ineligible to become effective under paragraph (b) of this section.

(c) Incomplete or Inaccurate Amendments; Suspension of Use of Paragraph (b) of this section.

(1) No amendment or registration statement shall become effective under paragraph (a) of this section if, prior to the effective date of the amendment or registration statement, it should appear to the Commission that the amendment or registration statement may be incomplete or inaccurate in any material respect, and the Commission furnishes to the registrant written notice that the effective date of the amendment or registration statement is to be suspended. Following such action by the Commission, the registrant may file with the Commission at any time a petition for review of the suspension. The Commission will order a hearing on the matter if a request for such a hearing is included in the petition. If the Commission has suspended the effective date of an amendment or registration statement, the amendment or registration statement shall become effective on such date as the Commission may determine, having due regard to the public interest and the protection of investors.

(2) The Commission may, in the manner and under the circumstances set forth in this paragraph (c)(2), suspend the ability of a registrant to file a post-effective amendment or registration statement under paragraph (b) of this section. The notice of such suspension shall be in writing and shall specify the period for which such suspension shall remain in effect. The Commission may issue a suspension if it appears to the Commission that a registrant which files a post-effective amendment under paragraph (b) of this section has not complied with the conditions of that paragraph. Any suspension under this paragraph shall become effective at such time as the Commission furnishes written notice thereof to the company. Any such suspension, so long as it is in effect, shall apply to any post-effective amendment or registration statement that has been filed but has not, at the time of such suspension, become effective, and to any post-effective amendment or registration statement that may be filed after the suspension. Any suspension shall apply only to the ability to file a post-effective amendment or registration statement under paragraph (b) of this section and shall not otherwise affect any post-effective amendment or registration statement. Following this action by the Commission, the registrant may file with the Commission at any time a petition for review of the suspension. The Commission will order a hearing on the matter if a request for a hearing is included in the petition.

(d) ***Subsequent Amendments.*** (1) Except as provided in paragraph (d)(2) of this section, a post-effective amendment or registration statement which includes a prospectus shall not become effective under paragraph (a) of this section if a subsequent post-effective amendment or registration statement relating to the prospectus is filed before such amendment or registration statement becomes effective.

(2) A post-effective amendment or registration statement which includes a prospectus shall become effective under paragraph (a) of this section notwithstanding the filing of a subsequent post-effective amendment or registration statement relating to the prospectus, *Provided*, that the following conditions are met:

(i) the subsequent amendment or registration statement is filed under paragraph (b) of this section; and

(ii) the subsequent amendment or registration statement designates as its effective date either:

(A) the date on which the prior post-effective amendment or registration statement was to become effective under paragraph (a) of this section or

(B) a new effective date designated under paragraph (b)(1)(iii) of this section,

in this case the prior post-effective amendment or registration statement filed under paragraph (a) of this section and any prior post-effective amendment or registration statement filed under paragraph (b) of this section shall also become effective on the new effective date designated under paragraph (b)(1)(iii) of this section.

(3) Notwithstanding paragraphs (d)(1) and (d)(2) of this section, if another post-effective amendment or registration statement relating to the same prospectus is filed under paragraph (a) of this section before the prior amendments or registration statements filed under paragraphs (a) and (b) of this section have become effective, none of such prior amendments or registration statements shall become effective under this section.

(e) ***Condition to Use of Paragraphs (a) or (b).*** A post-effective amendment or new registration statement shall not become effective under paragraphs (a) or (b) of this section unless within two years prior to the filing thereof a post-effective amendment or registration statement relating to the common stock of the registrant has become effective.

(f) ***Electronic Filers.*** When ascertaining the date of filing, electronic filers should not presume a registration statement has been accepted until notice of acceptance has been received from the Commission.

NOTE: To determine the date of automatic effectiveness, the day following the filing date is the first day of the time period. For example, a post-effective amendment filed under paragraph (a) on November 1 would become effective on December 31.

Rule 487. Effectiveness of Registration Statements Filed by Certain Unit Investment Trusts.

(a)(1) A unit investment trust registered under the Investment Company Act of 1940 that files a registration statement pursuant to the Act in connection with the offering of the securities of a series of the unit investment trust, except the first series of such trust, may designate a date

and time for such registration statement to become effective. If the registrant complies with the conditions set forth in paragraph (b) of this section, the registration statement shall become effective in accordance with such designation.

(2) The registrant may designate the date and time of effectiveness in the registration statement or in any pre-effective amendment thereto. A pre-effective amendment to a registration statement with respect to which such a designation is properly made shall be deemed to have been filed with the consent of the Commission and shall accordingly be treated as part of the registration statement.

(b) Availability of effectiveness of a registration statement in accordance with paragraph (a) of this section is conditioned upon compliance with the following:

(1) The registrant is not engaged in the business of investing in securities issued by one or more open-end management investment companies;

(2) The designation provided for in paragraph (a) of this section is set forth on the facing sheet of such registration statement or a pre-effective amendment thereto;

(3) The registrant identifies one or more previous series of the trust for which the effective date of the registration statement was determined by the Commission or its staff, and makes the following representations:

(i) That the portfolio securities deposited in the series with respect to which the registration statement or pre-effective amendment is being filed do not differ materially in type or quality from those deposited in such previous series identified by the registrant; and

(ii) That, except to the extent necessary to identify the specific portfolio securities deposited in, and to provide essential financial information for, the series with respect to which the registration statement or pre-effective amendment thereto is being filed, the registration statement or pre-effective amendment thereto does not contain disclosures that differ in any material respect from those contained in the registration statement of such previous series identified by the registrant;

(4) The registrant represents that it has complied with rule 460 under the Act (17 CFR 230.460);

(5) The identification and representations provided for in paragraphs (b)(3) and (b)(4) of this section are made on the signature page of the registration statement or a pre-effective amendment thereto; and

(6) If counsel prepared or reviewed such registration statement or a pre-effective amendment thereto, such counsel shall furnish to the Commission at the time the registration statement or pre-effective amendment thereto is filed a written representation that such registration statement or pre-effective amendment does not contain disclosures which would render such registration statement ineligible to become effective pursuant to paragraph (a) of this section.

(c)(1) The Commission may, in the manner and under the circumstances set forth in paragraph (c)(2) of this section, suspend the ability of a unit investment trust to designate the date and time of effectiveness of a series of such trust. Any such suspension, so long as it is in effect, shall apply to any registration statement that has been filed but has not, at the time of such suspension, become effective, and to any registration statement with respect to any series of such trust that may be filed after such suspension. Any suspension shall apply only to the ability to designate the date and time of effectiveness pursuant to paragraph (a) of this section and shall not otherwise affect any registration statement.

(2) Any suspension pursuant to paragraph (c)(1) of this section shall become effective at such time as the Commission furnishes written notice thereof to the company or the sponsor of the unit investment trust. The notice of such suspension shall be in writing and shall specify the period for which such suspension shall remain in effect. The Commission may issue such suspension if it appears to the Commission that any registration statement containing a designation pursuant to this section is incomplete or inaccurate in any material respect, whether or not such registration statement has become effective, or that the registrant has not complied with the conditions of this section. Following such action by the Commission, the registrant may file with the Commission at any time a petition for review of the suspension. The Commission will order a hearing on the matter if a request for a hearing is included in the petition.

(d) When ascertaining the date of filing, electronic filers should not presume a registration statement has been accepted until notice of acceptance has been received from the Commission.

Rule 488. Effective Date of Registration Statements Relating to Securities to Be Issued in Certain Business Combination Transactions.

(a) A registration statement filed on Form N-14 by a registered open-end management investment company for the purpose of registering securities to be issued in an exchange offer or other business combination transaction pursuant to Rule 145 under the Securities Act of 1933 [15 U.S.C. 77a et seq.] shall become effective on the thirtieth day after the date upon which it is filed with the Commission, or such later date designated by the registrant on the facing sheet of the registration statement, which date shall be not later than fifty days after the date on which the registration statement is filed, unless the Commission having due regard to the public interest and the protection of investors declares such amendment effective on an earlier date, provided the following conditions are met:

(1) Any prospectus filed as a part of the registration statement does not include disclosure relating to any other proposal to be acted on at a meeting of the shareholders of either company other than proposals related to an exchange offer, or a business combination transaction pursuant to Rule 145(a), and any other proposal relating to: (i) uncontested election of directors, (ii) ratification of the selection of accountants, (iii) the continuation of a current advisory contract, (iv) increases in the number or amount of shares authorized to be issued by the registrant; and (v) continuation of any current contract relating to the distribution of shares issued by the registrant; and

(2) The registration statement recites on the facing sheet that the registrant proposes that the filing become effective pursuant to this rule.

(b) No registration statement shall become effective pursuant to paragraph (a) of this section if, prior to the effective date of the registration statement, it should appear to the Commission that the registration statement may be incomplete or inaccurate in any material respect and the Commission furnishes to the registrant written notice that the effective date is to be suspended. Following such action by the Commission, the registrant may file with the Commission at any time a petition for review of the suspension. The Commission will order a hearing on the matter if a request for such a hearing is included in the petition. If the Commission has suspended the effective date of the registration statement, it shall become effective on such date as the Commission may determine, having due regard to the public interest and the protection of investors.

(c) When ascertaining the date of filing, electronic filers should not presume a registration statement has been accepted until notice of acceptance has been received from the Commission.

Rule 489. Filing of form by foreign banks and insurance companies and certain of their holding companies and finance subsidiaries.

(a) The following foreign issuers shall file Form F-N [17 CFR 239.43] under the Act appointing an agent for service of process when filing a registration statement under the Act:

(1) A foreign issuer that is a foreign bank or foreign insurance company excepted from the definition of investment company by rule 3a-6 (17 CFR 270.3a-6) under the Investment Company Act of 1940 (the "1940 Act");

(2) A foreign issuer that is a finance subsidiary of a foreign bank or foreign insurance company, as those terms are defined in rule 3a-6 under the 1940 Act, if the finance subsidiary is excepted from the definition of investment company by rule 3a-5 [17 CFR 270.3a-5] under the 1940 Act; or

(3) A foreign issuer that is excepted from the definition of investment company by rule 3a-1 (17 CFR 270.3a-1) under the 1940 Act because some or all of its majority-owned subsidiaries are foreign banks or insurance companies excepted from the definition of investment company by rule 3a-6 under the 1940 Act.

(b) The requirements of paragraph (a) of this section shall not apply to:

(1) A foreign issuer that has filed Form F-X (17 CFR 239.42) under the Securities Act of 1933 with respect to the securities being offered; and

(2) A foreign issuer filing a registration statement relating to debt securities or non-voting preferred stock that has on file with the Commission a currently accurate Form N-6C9 (17 CFR 274.304, rescinded) under the 1940 Act.

(c) Six copies of Form F-N, one of which shall be manually signed, shall be filed with the Commission at its principal office.

Rule 495. Preparation of registration statement.

(a) A registration statement on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter), shall consist of the facing sheet of the applicable form; a prospectus containing the information called for by such form; the information, list of exhibits, undertakings and signatures required to be set forth in such form; financial statements and schedules; exhibits; and other information or documents filed as part of the registration statement; and all documents or information incorporated by reference in the foregoing (whether or not required to be filed).

(b) All general instructions, instructions to items of the form, and instructions as to financial statements, exhibits, or prospectuses are to be omitted from the registration statement in all cases.

(c) In the case of a registration statement filed on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter), Parts A and B shall contain the information called for by each of the items of the applicable Part, except that unless otherwise specified, no reference need be made to inapplicable items, and negative answers to any item may be omitted. Copies of Parts A and B may be filed as part of the registration statement in lieu of furnishing the information in item-and-answer form. Wherever such copies are filed in lieu of information in item-and-answer form, the text of the items of the form is to be omitted from the registration statement, as well as from Parts A and B, except to the extent provided in paragraph (d) of the section.

(d) In the case of a registration statement filed on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter), where any item of those forms calls for information not required to be included in Parts A and B (generally Part C of such form), the text of such items, including the numbers and captions thereof, together with the answers thereto, shall be filed with Parts A or B under cover of the facing sheet of the form as part of the registration statement. However, the text of such items may be omitted, provided the answers are so prepared as to indicate the coverage of the item without the necessity of reference to the text of the item. If any such item is inapplicable, or the answer thereto is in the negative, a statement to that effect shall be made. Any financial statements not required to be included in Parts A and B shall also be filed as part of the registration statement proper, unless incorporated by reference pursuant to Rule 411.

(e) ***Electronic Filings.*** When ascertaining the date of filing, electronic filers should not presume a registration statement has been accepted until notice of acceptance has been received from the Commission.

Rule 496. Contents of prospectus and statement of additional information used after nine months.

In the case of a registration statement filed on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter), there may be omitted from any prospectus or Statement of Additional Information used more than 9 months after the effective date of the registration statement any information previously required to be contained in the prospectus or the Statement of Additional Information insofar as later information covering the same subjects, including the latest available certified financial statements, as of a date not more than 16 months prior to the use of the prospectus or the Statement of Additional Information is contained therein.

Rule 497. Filing of Investment Company Prospectuses—Number of Copies.

(a) Five copies of every form of prospectus sent or given to any person prior to the effective date of the registration statement that varies from the form or forms of prospectus included in the registration statement filed pursuant to §230.402(a) shall be filed as part of the registration statement not later than the date that form of prospectus is first sent or given to any person, except that an investment company advertisement under §230.482 shall be filed under this paragraph (a) (but not as part of the registration statement) unless filed under paragraph (i) of this section.

(b) Within 5 days after the effective date of a registration statement or the commencement of a public offering after the effective date of a registration statement, whichever occurs later, 10 copies of each form of prospectus used after the effective date in connection with such offering shall be filed with the Commission in the exact form in which it was used.

(c) For investment companies filing on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter), within five days after the effective date of a registration statement or the commencement of a public offering after the effective date of a registration statement, whichever occurs later, ten copies of each form of prospectus and form of Statement of Additional Information used after the effective date in connection with such offering shall be filed with the Commission in the exact form in which it was used. Investment companies filing on Form N-1A must, if applicable pursuant to General Instruction C.3.(g) of Form N-1A, include an Interactive Data File (§ 232.11 of this chapter).

(d) After the effective date of a registration statement no prospectus which purports to comply with section 10 of the Act and which varies from any form of prospectus filed pursuant to paragraph (b) or (c) of this rule shall be used until 10 copies thereof have been filed with, or mailed for filing to, the Commission.

(e) For investment companies filing on Form N-1A (§239.15A and §274.11A of this chapter), Form N-2 (§239.14 and §274.11a-1 of this chapter), Form N-3 (§239.17a and §274.11b of this chapter), Form N-4 (§239.17b and §274.11c of this chapter), or Form N-6 (§239.17c and §274.11d of this chapter), after the effective date of a registration statement, no prospectus that purports to comply with Section 10 of the Act (15 U.S.C. 77j) or Statement of Additional Information that varies from any form of prospectus or form of Statement of Additional Information filed pursuant to paragraph (c) of this section shall be used until five copies thereof have been filed with, or mailed for filing to the Commission. Investment companies filing on Form N-1A must, if applicable pursuant to General Instruction C.3.(g) of Form N-1A, include an Interactive Data File (§ 232.11 of this chapter).

(f) Every prospectus consisting of a radio or television broadcast shall be reduced in writing. Five copies of every such prospectus shall be filed with the Commission in accordance with the requirements of this section.

(g) Each copy of a prospectus under this rule shall contain in the upper right hand corner of the cover page the paragraph of this rule under which the filing is made and the file number of the registration statement to which the prospectus relates. In addition, each investment company advertisement deemed to be a Section 10(b) prospectus pursuant to §230.482 of this chapter shall contain in the upper right hand corner of the cover page the legend "Rule 482 ad." The information required by this paragraph may be set forth in longhand, provided it is legible.

(h) No later than the second business day following the earlier of the date of the determination of the offering price or the date it is first used after effectiveness in connection with a public offering or sales, ten copies of every form of prospectus and Statement of Additional Information, where applicable, that discloses the information previously omitted from the prospectus filed as part of an effective registration statement in reliance upon Rule 430A under the Securities Act [§230.430A of this chapter] shall be filed with the Commission in the exact form in which it is used, or transmitted by a means reasonably calculated to result in filing with the Commission by that date.

(i) An investment company advertisement deemed to be a Section 10(b) prospectus pursuant to §230.482 of this chapter shall be considered to be filed with the Commission upon filing with a national securities association registered under Section 15A of the Securities Exchange Act of 1934 [15 U. S. C. 78 *o*] that has adopted rules providing standards for the investment company advertising practices of its members and has established and implemented procedures to review that advertising.

(j) In lieu of filing under paragraph (b) or (c) of this section, a registrant may file a certification that:

(1) the form of prospectus and Statement of Additional Information that would have been filed under paragraph (b) or (c) of this section would not have differed from that contained in the most recent registration statement or amendment, and

(2) the text of the most recent registration statement or amendment has been filed electronically.

(k) ***Summary Prospectus filing requirements.*** This paragraph (k), and not the other provisions of Rule 497, shall govern the filing of summary prospectuses under Rule 498. Each definitive form of a summary prospectus under § 230.498 shall be filed with the Commission no later than the date that it is first used.

Rule 498. Summary Prospectuses for open-end management investment companies.

(a) Definitions. For purposes of this section:

(1) *Class* means a class of shares issued by a Fund that has more than one class that represent interests in the same portfolio of securities under Rule 18f-3 of this chapter or under an order exempting the Fund from sections 18(f), 18(g), and 18(i) of the Investment Company Act.

(2) *Exchange-Traded Fund* means a Fund or a Class, the shares of which are traded on a national securities exchange, and that has formed and operates pursuant to an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission.

(3) *Fund* means an open-end management investment company, or any Series of such a company, that has, or is included in, an effective registration statement on Form N-1A and that has a current prospectus that satisfies the requirements of section 10(a) of the Act.

(4) *Series* means shares offered by a Fund that represent undivided interests in a portfolio of investments and that are preferred over all other series of shares for assets specifically allocated to that series in accordance with Rule 18f-2(a) of this chapter.

(5) *Statement of Additional Information* means the statement of additional information required by Part B of Form N-1A.

(6) *Statutory Prospectus* means a prospectus that satisfies the requirements of section 10(a) of the Act.

(7) *Summary Prospectus* means the summary prospectus described in paragraph (b) of this section.

(b) *General requirements for Summary Prospectus.* This paragraph describes the requirements for a Fund's Summary Prospectus. A Summary Prospectus that complies with this paragraph (b) will be deemed to be a prospectus that is authorized under section 10(b) of the Act and section 24(g) of the Investment Company Act for the purposes of section 5(b)(1) of the Act.

(1) *Cover page or beginning of Summary Prospectus.* Include on the cover page of the Summary Prospectus or at the beginning of the Summary Prospectus:

(i) The Fund's name and the Class or Classes, if any, to which the Summary Prospectus relates.

(ii) The exchange ticker symbol of the Fund's shares or, if the Summary Prospectus relates to one or more Classes of the Fund's shares, adjacent to each such Class, the exchange ticker symbol of such Class of the Fund's shares. If the Fund is an Exchange-Traded Fund, also identify the principal U.S. market or markets on which the Fund shares are traded.

(iii) A statement identifying the document as a "Summary Prospectus."

(iv) The approximate date of the Summary Prospectus's first use.

(v) The following legend:

Before you invest, you may want to review the Fund's prospectus, which contains more information about the Fund and its risks. You can find the Fund's prospectus and other information about the Fund online at [ ]. You can also get this information at no cost by calling [ ] or by sending an e-mail request to [ ].

(A) The legend must provide an Internet address, other than the address of the Commission's electronic filing system; toll free (or collect) telephone number; and e-mail address that investors can use to obtain the Statutory Prospectus and other information. The Internet Web site address must be specific enough to lead investors directly to the Statutory Prospectus and other materials that are required to be accessible under paragraph (e)(1) of this section, rather than to the home page or other section of the Web site on which the materials are posted. The Web site could be a central site with prominent links to each document. The legend may indicate, if applicable, that the Statutory Prospectus and other information are available from a financial intermediary (such as a broker-dealer or bank) through which shares of the Fund may be purchased or sold.

(B) If a Fund incorporates any information by reference into the Summary Prospectus, the legend must identify the type of document (e.g., Statutory Prospectus) from which the information is incorporated and the date of the document. If a Fund incorporates by reference a part of a document, the legend must clearly identify the part by page, paragraph, caption, or otherwise. If information is incorporated from a source other than the Statutory Prospectus, the legend must explain that the incorporated information may be obtained, free of charge, in the same manner as the Statutory Prospectus. A Fund may modify the legend to include a statement to the effect that the Summary Prospectus is intended for use in connection with a defined contribution plan that meets the requirements for qualification under section 401(k) of the Internal Revenue Code, a tax-deferred arrangement under section 403(b) or 457 of the Internal Revenue Code, or a variable contract as defined in section 817(d) of the Internal Revenue Code, as applicable, and is not intended for use by other investors.

(2) *Contents of the Summary Prospectus.* Except as otherwise provided in this paragraph (b), provide the information required or permitted by Items 2 through 8 of Form N-1A, and only

that information, in the order required by the form. A Summary Prospectus may omit the explanation and information required by Instruction 2(c) to Item 4(b)(2) of Form N-1A.

(3) *Incorporation by reference.*

(i) Except as provided by paragraph (b)(3)(ii) of this section, information may not be incorporated by reference into a Summary Prospectus. Information that is incorporated by reference into a Summary Prospectus in accordance with paragraph (b)(3)(ii) of this section need not be sent or given with the Summary Prospectus.

(ii) A Fund may incorporate by reference into a Summary Prospectus any or all of the information contained in the Fund's Statutory Prospectus and Statement of Additional Information, and any information from the Fund's reports to shareholders under § 270.30e-1 that the Fund has incorporated by reference into the Fund's Statutory Prospectus, provided that:

(A) The conditions of paragraphs (b)(1)(v)(B) and (e) of this section are met;

(B) A Fund may not incorporate by reference into a Summary Prospectus information that paragraphs (b)(1) and (2) of this section require to be included in the Summary Prospectus; and

(C) Information that is permitted to be incorporated by reference into the Summary Prospectus may be incorporated by reference into the Summary Prospectus only by reference to the specific document that contains the information, not by reference to another document that incorporates such information by reference.

(iii) For purposes of Rule 159, information is conveyed to a person not later than the time that a Summary Prospectus is received by the person if the information is incorporated by reference into the Summary Prospectus in accordance with paragraph (b)(3)(ii) of this section.

(4) *Multiple Funds and Classes.* A Summary Prospectus may describe only one Fund, but may describe more than one Class of a Fund.

(c) *Transfer of the security.* Any obligation under section 5(b)(2) of the Act to have a Statutory Prospectus precede or accompany the carrying or delivery of a Fund security in an offering registered on Form N-1A is satisfied if:

(1) A Summary Prospectus is sent or given no later than the time of the carrying or delivery of the Fund security;

(2) The Summary Prospectus is not bound together with any materials, except that a Summary Prospectus for a Fund that is available as an investment option in a variable annuity or variable life insurance contract may be bound together with the Statutory Prospectus for the contract and Summary Prospectuses and Statutory Prospectuses for other investment options available in the contract, provided that:

(i) All of the Funds to which the Summary Prospectuses and Statutory Prospectuses that are bound together relate are available to the person to whom such documents are sent or given; and

(ii) A table of contents identifying each Summary Prospectus and Statutory Prospectus that is bound together, and the page number on which it is found, is included at the beginning or immediately following a cover page of the bound materials;

(3) The Summary Prospectus that is sent or given satisfies the requirements of paragraph (b) of this section at the time of the carrying or delivery of the Fund security; and

(4) The conditions set forth in paragraph (e) of this section are satisfied.

(d) *Sending communications.* A communication relating to an offering registered on Form N-1A sent or given after the effective date of a Fund's registration statement (other than a prospectus permitted or required under section 10 of the Act) shall not be deemed a prospectus under section 2(a)(10) of the Act if:

(1) It is proved that prior to or at the same time with such communication a Summary Prospectus was sent or given to the person to whom the communication was made;

(2) The Summary Prospectus is not bound together with any materials, except as permitted by paragraph (c)(2) of this section;

(3) The Summary Prospectus that was sent or given satisfies the requirements of paragraph (b) of this section at the time of such communication; and

(4) The conditions set forth in paragraph (e) of this section are satisfied.

(e) *Availability of Fund's Statutory Prospectus and certain other Fund documents.*

(1) The Fund's current Summary Prospectus, Statutory Prospectus, Statement of Additional Information, and most recent annual and semi-annual reports to shareholders under Rule 30e-1 are publicly accessible, free of charge, at the Web site address specified on the cover page or at the beginning of the Summary Prospectus on or before the time that the Summary Prospectus is sent or given and current versions of those documents remain on the Web site through the date that is at least 90 days after:

(i) In the case of reliance on paragraph (c) of this section, the date that the Fund security is carried or delivered; or

(ii) In the case of reliance on paragraph (d) of this section, the date that the communication is sent or given.

(2) The materials that are accessible in accordance with paragraph (e)(1) of this section must be presented on the Web site in a format, or formats, that:

(i) Are human-readable and capable of being printed on paper in human-readable format;

(ii) Permit persons accessing the Statutory Prospectus or Statement of Additional Information to move directly back and forth between each section heading in a table of con-

tents of such document and the section of the document referenced in that section heading; provided that, in the case of the Statutory Prospectus, the table of contents is either required by § 230.481(c) or contains the same section headings as the table of contents required by § 230.481(c); and

(iii) Permit persons accessing the Summary Prospectus to move directly back and forth between:

(A) Each section of the Summary Prospectus and any section of the Statutory Prospectus and Statement of Additional Information that provides additional detail concerning that section of the Summary Prospectus; or

(B) Links located at both the beginning and end of the Summary Prospectus, or that remain continuously visible to persons accessing the Summary Prospectus, and tables of contents of both the Statutory Prospectus and the Statement of Additional Information that meet the requirements of paragraph (e)(2)(ii) of this section.

(3) Persons accessing the materials specified in paragraph (e)(1) of this section must be able to permanently retain, free of charge, an electronic version of such materials in a format, or formats, that meet each of the requirements of paragraphs (e)(2)(i) and (ii) of this section.

(4) the conditions set forth in paragraphs (e)(1), (e)(2), and (e)(3) of this section shall be deemed to be met, notwithstanding the fact that the materials specified in paragraph (e)(1) of this section are not available for a time in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section, provided that:

(i) the Fund has reasonable procedures in place to ensure that the specified materials are available in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section; and

(ii) the Fund takes prompt action to ensure that the specified documents become available in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section, as soon as practicable following the earlier of the time at which it knows or reasonably should have known that the documents are not available in the manner required by paragraphs (e)(1), (e)(2), and (e)(3) of this section.

(f) *Other requirements.*

(1) *Delivery upon request.* If paragraph (c) or (d) of this section is relied on with respect to a Fund, the Fund (or a financial intermediary through which shares of the Fund may be purchased or sold) must send, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means, a paper copy of the Fund's Statutory Prospectus, Statement of Additional Information, and most recent annual and semi-annual reports to shareholders to any person requesting such a copy within three business days after receiving a request for a paper copy. If paragraph (c) or (d) of this section is relied on with respect to a Fund, the Fund (or a financial intermediary through which shares of the Fund may be purchased or sold) must send, at no cost to the requestor and by e-mail, an electronic copy of the Fund's Statutory Prospectus, Statement

of Additional Information, and most recent annual and semi-annual reports to shareholders to any person requesting such a copy within three business days after receiving a request for an electronic copy. The requirement to send an electronic copy of a document by e-mail may be satisfied by sending a direct link to the document on the Internet; provided that a current version of the document is directly accessible through the link from the time that the e-mail is sent through the date that is six months after the date that the e-mail is sent and the e-mail explains both how long the link will remain useable and that, if the recipient desires to retain a copy of the document, he or she should access and save the document.

(2) *Greater prominence.* If paragraph (c) or (d) of this section is relied on with respect to a Fund, the Fund's Summary Prospectus shall be given greater prominence than any materials that accompany the Fund's Summary Prospectus, with the exception of other Summary Prospectuses, Statutory Prospectuses, or a Notice of Internet Availability of Proxy Materials under §240.14a-16 of this chapter.

(3) *Convenient for reading and printing.* If paragraph (c) or (d) of this section is relied on with respect to a Fund:

(i) The materials that are accessible in accordance with paragraph (e)(1) of this section must be presented on the Web site in a format, or formats, that are convenient for both reading online and printing on paper; and

(ii) Persons accessing the materials that are accessible in accordance with paragraph (e)(1) of this section must be able to permanently retain, free of charge, an electronic version of such materials in a format, or formats, that are convenient for both reading online and printing on paper.

(4) *Information in Summary Prospectus must be the same as information in Statutory Prospectus.* If paragraph (c) or (d) of this section is relied on with respect to a Fund, the information provided in response to Items 2 through 8 of Form N-1A in the Fund's Summary Prospectus must be the same as the information provided in response to Items 2 through 8 of Form N-1A in the Fund's Statutory Prospectus except as expressly permitted by paragraph (b)(2) of this section.

(5) *Compliance with paragraph (f) not a condition to reliance on paragraphs (c) and (d).* Compliance with this paragraph (f) is not a condition to the ability to rely on paragraph (c) or (d) of this section with respect to a Fund, and failure to comply with paragraph (f) does not negate the ability to rely on paragraph (c) or (d).

APPENDIX VI

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

NOTIFICATION OF REGISTRATION
FILED PURSUANT TO SECTION 8(a) OF THE
INVESTMENT COMPANY ACT OF 1940

The undersigned investment company hereby notifies the Securities and Exchange Commission that it registers under and pursuant to the provisions of Section 8(a) of the Investment Company Act of 1940 and in connection with such notification of registration submits the following information:

Name:*_____

Address of Principal Business Office (No. & Street, City, State, Zip Code):

Telephone Number (including area code):

Name and address of agent for service of process:

Check Appropriate Box:

Registrant is filing a Registration Statement pursuant to Section 8(b) of the Investment Company Act of 1940 concurrently with the filing of Form N-8A: Yes ☐** No ☐

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 control number. Filing of this Form is mandatory. Section 8(a) of the Act and the rules thereunder require investment companies to file a notification of registration. The information collected on Form N-8A is publicly available. The Commission staff uses the information in its regulatory, disclosure review, inspection, and policy making roles. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate of this Form and any suggestions for reducing the burden of the Form. The collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. §3507.

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* *See footnote 1 to Item 1.*

** *See Instructions 4(b) and 4(f).*

INSTRUCTIONS FOR FORM N-8A

Read instructions carefully before preparing the notification of registration. A notification of registration will not be deemed acceptable as the notification of registration filed pursuant to Section 8(a) of the Investment Company Act of 1940 ("Act") unless it is prepared, executed and filed substantially in accordance with these instructions.

1. Rule as to use of form:

This form shall be used as the notification of registration filed with the Commission pursuant to Section 8(a) of the Act.

2. The registrant:

As used in this form the word "registrant" means the investment company filing the notification of registration.

Each investment company should file a separate notification of registration.

For purposes of the Act, unincorporated investment organizations, such as trusts, funds, or any organized groups of persons, are regarded as distinct entities. In such cases it is the trust, the fund or other unincorporated entity which is the "registrant." Each such trust, fund or other unincorporated entity must file an individual notification of registration. This is true even though such entities have been created under and pursuant to the same indenture of trust or contract of custodianship, or have the same corporate trustee, investment adviser, manager, depositor, or distributor of their securities.

Attention is further directed to the fact that a trust or other form of organization which issues periodic payment plan certificates and the assets of which are securities issued by an investment company is itself an investment company, and as such must file a notification of registration independent of that of the investment company the securities of which constitute its assets.

3. Application of General Rules and Regulations:

The general Rules and Regulations under the Act contain certain general requirements which are applicable to registration of any form. These general requirements should be carefully read and observed in the preparation and filing of a notification of registration on this form. Particular attention is directed to Regulation 8B which sets forth general requirements regarding matters such as the kind and size of paper to be used.

4. Preparation of form of notification of registration:

(a) This form is not to be used as a blank form to be filled in, but only as a guide in the preparation of the notification of registration on paper meeting the requirements of Rule 8b-12. The notification of registration shall contain the item numbers and the text of the items.

(b) If registrant is filing a registration statement as required by Section 8(b) of the Act concurrently with the filing of notification of registration, registrant need furnish only the information requested on the cover page and sign the form to effect registration. Otherwise, every item and subdivision of the form is to be answered fully and accurately. If an item or subdivision is not applicable to the registrant, indicate that fact by giving the answer "NOT APPLICABLE."

(c) Every item is to be answered as of the date the form is prepared, unless the context clearly indicates the contrary.

(d) All answers are to be typewritten or printed in ink. The reply should be centered on the page so that a margin will appear on both sides of the reply.

(e) Names shall be given in full. Initials or abbreviations will not suffice.

(f) Signature.

An original and three copies of each notification of registration shall be filed. The three copies of the notification of registration may have facsimile or typed signatures. If the registrant is an investment company having a board of directors, the original notification of registration shall be signed on behalf of the registrant by a director, officer or trustee. If the registrant has some other form of organization, such as a trust administered by a corporate trustee, a fund, etc., the original notification of registration shall be signed on behalf of the registrant by an officer or director of its sponsor. If no sponsor exists or is at present functioning with reference to the registrant, the signature may be made on behalf of the registrant by an officer or director of the trustee or custodian.

If registrant is concurrently filing a registration statement as required by Section 8(b) under the Act, the signature, which should conform to the appropriate form of signature shown on the final page of this form, may be placed on the cover page.

(g) Filing.

The notification of registration and all inquiries and communications with respect thereto shall be forwarded to the Securities and Exchange Commission, Washington, D.C. 20549.

(h) Fee.

There is no fee charged for filing the notification of registration.

(i) Specific instructions with respect to Item 5(b) of the notification of registration.

The determination of whether or not a company is a "diversified company or a non-diversified company" involves an evaluation of registrant's portfolio securities in relation to the value of its assets. Attention is directed to the definition of value in Section 2(a)(41) of the Act which provides, in general, that valuations for this purpose are to be taken as of the last preceding fiscal quarter except in respect of securities and other assets acquired since such quarter.

The Commission recognizes that registrant, on the date of preparation of the notification of registration, may not be able to determine its classification with accuracy and that an estimate may have to be made. If such an estimate proves to be erroneous, the registrant, as promptly as possible, should file an amendment to its notification of registration stating its correct classification.

Registration by an investment company in any classification in no sense constitutes a determination by the Securities and Exchange Commission that registrant is actually entitled to such classification under the Act.

Attention is further called to the provisions of Section 13 of the Act to the effect that no registered diversified investment company may change from a diversified to a non-diversified company without approval by a vote of a majority of its outstanding voting securities.

5. Definitions:

All words and terms used in the form for notification of registration have the same meaning as in the Act. A list of these terms and the sections of the Act in which they are defined follows:

"closed-end company"	Section 5(a)(2)
"company"	Section 2(a)(8)
"diversified company"	Section 5(b)(1)
"face-amount certificate company"	Section 2(a)(13)
"investment adviser"	Section 2(a)(20)
"investment company"	Section 3(a)
"management company"	Section 4(3)
"non-diversified company"	Section 5(b)(2)
"open-end company"	Section 5(a)(1)
"security"	Section 2(a)(36)
"short-term paper"	Section 2(a)(38)
"underwriter"	Section 2(a)(40)
"unit investment trust"	Section 4(2)
"value"	Section 2(a)(41)
"voting security"	Section 2(a)(42)

In addition the following definitions apply: The term "director" is defined in Section 2(a)(12) of the Act. In general the term includes only directors of a corporation, trustees of a common law trust who are natural persons, and natural persons performing similar functions with respect to any organization whether incorporated or unincorporated such as a board of directors or managers of a joint stock company or association.

The term "sponsor" means the depositor or manager of an investment company not having a board of directors as defined above.

6. Failure to file a registration statement required by Section 8(b) of the Act:

Registrant's attention is directed to Rule 8b-5 promulgated under Section 8(b) of the Act. Rule 8b-5 provides that an investment company shall file a registration statement with the Commission within three months after the filing of notification of registration under Section 8(a) of the Act. In addition, the rule provides that if the fiscal year of such company ends within the three-month period, its registration statement may be filed within three months after the end of such fiscal year. Unless an application for an extension of time pursuant to Rule 8b-25 is granted, a registrant's failure to comply with Section 8(b) and Rule 8b-5 thereunder may result in immediate Commission action either to revoke registration under the Act pursuant to Section 8(e) or to institute deregistration proceedings on its own motion pursuant to Section 8(f) of the Act.

When any registrant (1) indicates in Item 9(e) that its outstanding securities are held by fewer than 100 beneficial owners, (2) fails to comply with Rule 8b-5, and (3) fails to file a registration statement under the Securities Act of 1933 with respect to a proposed public offering within 90 days after the filing of Form N-8A or has withdrawn any such registration statement filed within such 90-day period, the Commission may use such information as the basis for a decision that such registrant has abandoned its intentions of engaging in business as an investment company. Such a determination may be used as a basis for a finding by the Commission that such registrant has ceased to be an investment company and for an order, pursuant to Section 8(f) of the Act, declaring that the registration of such registrant shall cease to be in effect.

In addition to completing the cover page, a registrant must complete the following items unless it has indicated on the cover page that it is filing the registration statement required pursuant to Section 8(b) of the Investment Company Act of 1940 concurrently with the filing of Form N-8A:

Item 1. Exact name of registrant.[1]

Item 2. Name of state under the laws of which registrant was organized or created and the date of such organization or creation.

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[1]*Section 35(d) of the Act should be considered in connection with the registrant's name, as should the following: (a) a review of the current List of Companies Registered under the Investment Company Act of 1940, published by the Commission, to ascertain if the name is similar to that of any existing company; and (b) if the corporate name implies a particular investment medium, industry emphasis or objective, the investment policy should be consistent with the name.*

Item 3. Form of organization of registrant (for example, corporation, partnership, trust, joint stock company, association, fund).

Item 4. Classification of registrant (face-amount certificate company, unit investment trust, or management company).

Item 5. If registrant is a management company:

(a) state whether registrant is a "closed-end" company or an "open-end" company;

(b) state whether registrant is registering as a "diversified" company or a "non-diversified" company (read Instruction 4(i) carefully before replying).

Item 6. Name and address of each investment adviser of registrant.[2]

Item 7. If registrant is an investment company having a board of directors, state the name and address of each officer and director of registrant.[3]

Item 8. If registrant is an unincorporated investment company not having a board of directors:

(a) state the name and address of each sponsor of registrant;

(b) state the name and address of each officer and director of each sponsor of registrant;

(c) state the name and address of each trustee and each custodian of registrant.

Item 9. (a) state whether registrant is currently issuing and offering its securities directly to the public (yes or no).

(b) If registrant is currently issuing and offering its securities to the public through an underwriter, state the name and address of such underwriter.

(c) If the answer to Item 9(a) is "no" and the answer to Item 9(b) is "not applicable," state whether registrant presently proposes to make a public offering of its securities (yes or no).

(d) State whether registrant has any securities currently issued and outstanding (yes or no).

(e) If the answer to Item 9(d) is "yes," state as of a date not to exceed ten days prior to the filing, of this notification of registration the number of beneficial owners of registrant's outstanding securities (other than short-term paper) and the name of any company owning 10 percent or more of registrant's outstanding voting securities.

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[2]*The term "investment adviser" of an investment company is defined in Section 2(a)(20) of the Act. It should be noted that under this definition any person who pursuant to contract "regularly performs substantially all of the duties" undertaken by an investment adviser to an investment company is also deemed to be an investment adviser to the investment company. Thus, if registrant has a sub-adviser, the name and address of each such sub-adviser should be included in the response to this item.*

[3]*The response to this item should include the full names, not initials, of all officers and directors, and, if all positions on the board are not filled, the number of vacancies should be indicated. Registrant's attention is also directed to Sections 10(a), 10(b), 10(c) and 10(d) of the Act regarding the makeup of the board of directors.*

Item 10. State the current value of registrant's total assets.

Item 11. State whether registrant has applied or intends to apply for a license to operate as a small business investment company under the Small Business Investment Act of 1958 (yes or no).

Item 12. Attach as an exhibit a copy of the registrant's last regular periodic report to its security holders, if any.

SIGNATURES

1. Form of signature if registrant is an investment company having a board of directors:

Pursuant to the requirements of the Investment Company Act of 1940, the registrant has caused this notification of registration to be duly signed on its behalf of the city of and state of on the day of 20 .

(SEAL)

Signature _____
(Name of Registrant)

BY _____
(Name of director, trustee or officer signing on behalf of Registrant)

Attest: _____
(Name)

Attest: _____
(Title)

2. Form of signature if registrant is an unincorporated investment company not having a board of directors.

Pursuant to the requirements of the Investment Company Act of 1940 the

_____
(sponsor, trustee or custodian)

of the registrant has caused this notification of registration to be duly signed on behalf of the registrant in the city of and the state of on the day of , 20 .

(SEAL)

Signature _____
(Name of Registrant)

BY _____
(Name of sponsor, trustee or custodian)

BY _____
(Name of officer of sponsor, trustee or custodian)

Attest: _____
(Name)

Attest: _____ _____
(Title) (Title)

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B-GIMREGOFMF 02.2017