

**Securities Industry Association**

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June 6, 1997

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

Re: Proposed Rules to Revise Requirements for Mutual Fund Disclosure; Release Nos. IC-22528 and IC-22529 (File Nos. S7-10-97 and S7-18-96)

Dear Mr. Katz:

The Investment Company Committee of the Securities Industry Association ("SIA")¹ appreciates the opportunity to comment on the rule proposals described in the above referenced releases. Since the proposals contained in both releases have the common objective of improving the disclosure provided to mutual fund investors, and the Securities and Exchange Commission (the "SEC" or "Commission") refers to them as "companion" releases, we have concluded that it is appropriate to respond to both sets of proposals in one letter. There is a third release ² which is also described as a companion release, but since it is more narrowly focused on the issue of use of descriptive fund names, we have addressed it in a separate comment letter which is being contemporaneously filed with the SEC.

We have provided below our general comments applicable to both proposals which relate in turn to amendments to Form N-1A and the use of "profile" prospectuses. This is followed by separate discussions covering comments specific to each proposal. We trust you will find our comments helpful.

OVERVIEW

We believe the pending proposals are one more important example of the Division of Investment Management's willingness to reexamine and, as appropriate, revise rules which may no longer best serve the needs of the investing public or the industry which the Division regulates. The proposals, in many respects, provide more meaningful disclosure to mutual fund investors while enabling funds and broker/dealers to deliver such disclosure information in a more cost-effective and efficient manner.

We concur with the Commission's view that the sheer volume of detail contained in many prospectuses often obscures important information relating to fund investments and does not

always serve the information needs of the majority of fund investors. We also agree that the steps the Commission is proposing in allowing for use of a "profile" prospectus and movement of much of the technical and legalistic language from the prospectus to the Statement of Additional Information ("SAI") are important to improving clarity of disclosure. We further agree that providing investors with choice as to the amount of fund information they wish to review in connection with a fund purchase, will help insure that each investor bases an investment decision on the optimum amount of information.³ We are nonetheless concerned regarding potential legal liability that may flow from requiring less detailed disclosure to investors. While more complex and detailed disclosure in recent years has, to some extent, been engendered by the broader array of investment vehicles utilized by mutual funds, the risk of potential liability for failing to disclose all "material" information has also been a significant factor. Therefore, to encourage use of "profile" prospectuses and plain English, the final disclosure rules adopted by the Commission should clearly and explicitly reflect that adherence to such rules will create a "safe harbor" for mutual fund companies and distributors from liability for failure to disclose all material information. ⁴ As an alternative, the adopting release should address this point more directly and fully in its text to make clear the Commission's intention that simplified and more usable disclosure should not be the source of liability on matters as to which the Commission deems disclosure in the prospectus unnecessary.

FORM N-1A PROPOSALS

Standardized Fund Summaries

We share the Commission's view that standardized fund summaries, containing nine categories of information in a specific order, will improve an investor's ability to more efficiently compare different funds, and to make a more expeditious determination as to whether a fund meets his particular needs. We do not however, see any reason to require that a question and answer format be mandated with respect to the nine disclosure categories. We think that any mandate with regard to format might actually impair a fund's ability to present information in the most effective manner. It is best left to the fund to determine the most effective way to present the required information, so long as it is presented in the order specified in the rule so the investor can readily locate it.

Suitability Disclosure

Our industry has, and will continue to support meaningful fund disclosure of information which will assist investors in determining, (usually in consultation with their broker or other financial adviser) whether, and to what extent, a particular fund is appropriate for inclusion in their portfolio. Information such as fund investment objectives, risk factors, performance fees, and the like, are essential in this regard. For several reasons, however, we strongly oppose the proposed requirement that a fund identify or profile the "types" of investors for whom the fund would or would not be appropriate. First, as specified in New York Stock Exchange rule 405 and comparable rules of NASDR and other self regulatory organizations, such a determination should be based on a review of the essential and unique facts relating to each investor. The responsibility for such determination clearly rests with the broker and/or the investor, not with the fund, which is not in a position to know the essential facts relating to the investor. Therefore, any necessarily general categorization regarding suitability would not be helpful to investors and might misdirect them away from investments that might be appropriate in moderation. Second,

and more fundamentally, the proposal appears to be based on the questionable premise that particular funds are inherently appropriate or inappropriate for certain "types" of investors. That simply is not true. Even before the term "asset allocation" came into broad usage, portfolio diversification was an essential feature of a well-structured financial plan. Thus, while an aggressive investor may choose to invest a significant portion of his or her assets in growth funds, it may be just as appropriate for a conservative investor to invest a more modest percentage in such funds to achieve appropriate portfolio balance. Sweeping characterizations as to appropriateness are of little value, and might actually do a disservice to investors. It might also discourage investment professionals, fearful of legal liability, from recommending certain investments to their clients even though they believe that in moderation they should be included in the client's overall portfolio.

Fees

We also wish to address a number of matters relating to fee disclosure. First of all, we note the proposed rules make reference to "sales fees." We would suggest that investors are more familiar with the term "sales charges" and that this terminology should be utilized, or at least permitted, in the final rule. Secondly, the release requested input on whether sub-advisory fees should be disclosed. We do not believe such disclosure should be required provided that the sub-advisory fees are paid by the adviser/manager. We further believe that omitting such information would be consistent with the goal of disclosure simplification. Sub-advisory fees paid by the adviser/manager, not by the fund, do not affect the end cost to the investor. Secondly, we believe that the disclosure of sub-advisory fees not separately paid by the fund are particularly meaningless to investors in cases where the sub-advisor is an affiliate of the adviser/manager. Thirdly, while we agree that investors should receive meaningful disclosure of the fact that 12b-1 fees are repetitive in nature, we believe that for reasons of economy and consistency with the manner in which other disclosures are addressed in the proposal, that disclosure should be confined to the fee table and not included in item 8 of the fund summary. We note in particular that disclosure of other recurring fees, such as management fees, are confined to the fee table, and different or duplicative treatment of some fees may confuse investors.

With regard to formatting of bar charts reflecting performance, we applaud the Commission's permitting their use without adjustment for sales charges. We believe that inclusion of sales charges would not enhance an investor's ability to compare performance, and given the wide variety of fee structures (such as with multi-class fund families) could be confusing.

Targeted Funds

We also applaud the flexibility provided in the proposals which would permit the deletion from prospectuses of certain information which would not be relevant for certain "targeted" funds (e.g., - deletion of tax consequences discussion for funds targeted to tax-deferred employee benefit plans). We would also suggest that the Commission give consideration to permitting purely mechanical and operational matters (such as procedural information related to purchase, redemption and withdrawal) to be addressed in a separate document. To the extent that such information is relatively standardized across a family of funds or among multi-class funds, a single document may enable numerous prospectuses to be reduced in size and complexity.

PROFILE PROSPECTUS

The Committee strongly endorses the adoption of a profile prospectus, and particularly appreciates the Commission's recognition of a profile's adaptability to electronic transmission.

We do believe that certain matters relating to the status of a profile prospectus should be clarified to better encourage its use. For example, it appears that the content of a profile prospectus should be sufficient to support the use of sales literature issued in accordance with rules 134 or 482 under the Securities Act of 1933, and the Commission should specifically state that such is the case. Also, as referred to earlier, we believe it imperative that funds and their distributors utilizing a profile prospectus have an explicit "safe harbor" from claims that they failed to provide all material information to the investor. Such safe harbor would be conditioned on the profile prospectus disclosing that additional material information is available through a full prospectus and/or SAI and how such document(s) can be obtained. Of course, such documents would have to fully and accurately disclose such additional material information.⁵ On a related matter we urge that with respect to Rule 498 the Commission consider another alternative to the "alternative" language regarding the availability of additional information. We believe an alternative without the reference to "material information" is preferable. We are concerned that use of the word "material" in this context could give rise to unintended consequences regarding the nature of the information in the prospectus, the profile or both. Instead, we recommend that the Commission consider a formulation that makes clear that the prospectus contains additional information that "may be important to an investor's investment decision." Use of this wording should be adequate to alert an investor to the significance of the additional available information and provide additional protection to funds against allegations that investors were not fully aware of all matters which may be important to their investment decision, while maintaining consistency with the overall approach reflected in three releases. We also respectfully suggest that the Commission's proposed language regarding how such information can be obtained be modified to include a reference to the availability of information through broker/dealers, since many investors effect purchases through a broker/dealer intermediary who would generally be in a position to provide such documents in an expeditious fashion.

CONCLUSION

The Commission's proposals in large measure should accomplish the joint objectives of improving the quality of investor disclosure while removing regulatory burdens on funds and distributors which do not significantly enhance investor protection. The proposals will also enable funds to more fully avail themselves of advanced technologies which enhance investor communication and reduce costs. While the clarifications and modifications we are seeking are few, we believe they are critical, and their implementation is essential if the Commission's proposals are to achieve their objectives.

Thank you again for the opportunity to comment. If members of the staff have any questions regarding this letter they should contact either Michael D. Udoff, Staff Adviser to SIA's Investment Company Committee at 212-618-0509, or myself at 212-783-5984.

Sincerely,

Lawrence H. Kaplan, Chairman

Investment Company Committee

cc: Barry P. Barbash, Esq.
Jonathan F. Cayne, Esq.
John M. Ganley, Esq.
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Footnotes

1 The Securities Industry Association brings together the shared interests of more than 760 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, specialists, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the U.S., SIA members collectively account for approximately 90 percent, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans.

2 IC-22530

3 The investor may base an investment decision on a profile prospectus alone with a full prospectus accompanying the purchase confirmation, or may additionally request one or both of the full prospectus and SAI before making an investment decision.

4 This presumes that where investors make purchases based upon the profile or a full prospectus such document informs them of the availability of additional material information in the full prospectus and/or the SAI, as the case may be. While footnote 254 to Release IC -2528 notes that Section 19(a) of the 1933 Act protects a fund from liability for actions taken in good faith in conformity with SEC rules, Section 19(a) does not provide assurance that any particular disclosure methodology will constitute good faith. In addition, this provision alone has not proven helpful to date in enabling funds to avoid liability.

5 We believe that footnote 76 to Release IC-22529 is intended to reflect that a "safe harbor" would exist if these conditions are met, but additional clarification from the Commission would be helpful.