

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239 and 274

[Release Nos. 33–8343; IC–26287; File No. S7–26–03]

RIN 3235–A199

Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

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

DATES: Comments must be received on or before February 6, 2004.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method only. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: rule-comments@sec.gov. All

comment letters should refer to File No. S7–26–03; this file number should be included in the subject line if electronic mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Electronically submitted comment letters also will be posted on the Commission's Internet Web site (<http://www.sec.gov>).¹

FOR FURTHER INFORMATION CONTACT:

Kieran G. Brown, Attorney, or Sanjay Lamba, Attorney, Office of Disclosure Regulation, Division of Investment Management, (202) 942–0721, at the Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is proposing for comment amendments to Form N–1A [17 CFR 239.15A and 274.11A], Form N–3 [17 CFR 239.17a and 274.11b], Form N–4 [17 CFR 239.17b and 274.11c], and Form N–6 [17 CFR 239.17c and 274.11d], registration forms used by investment companies to register under the Investment Company Act of 1940 ("Investment Company Act") and to offer their securities under the Securities Act of 1933 ("Securities Act").

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¹ We do not edit personal identifying information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

I. Introduction and Background

Millions of individual American investors hold shares of open-end management investment companies ("mutual funds"), relying on these funds for their retirements, their children's educations, and their other basic financial needs.² The tremendous growth of mutual funds reflects the trust that investors have placed in funds and the regulatory protections provided by the federal securities laws.

Recent allegations regarding late trading and abusive market timing, however, point to instances where it appears that some in the mutual fund industry, and some intermediaries that sell fund shares, have lost sight of their obligations to investors.³ These allegations relate to abuses in at least three areas:

- "Late trading," the practice of placing orders to buy or redeem mutual fund shares after 4 p.m., Eastern time, as of which most funds calculate their net asset value ("NAV"), but receiving the price based on the 4 p.m. NAV;
- Abuses related to "market timing," including the alleged overriding of stated market timing policies by fund executives to benefit large investors at the expense of small investors, or to benefit the fund's investment adviser; and

- The selective disclosure by some fund managers of their funds' portfolio holdings in order to curry favor with large investors.

The Commission is extremely concerned by the abuses that have surfaced in the mutual fund industry, and we have taken vigorous enforcement action where abuses have been uncovered.⁴ We also believe,

² A management investment company is an investment company other than a unit investment trust or face-amount certificate company. See section 4 of the Investment Company Act [15 U.S.C. 80a–4]. Management investment companies typically issue shares representing an undivided proportionate interest in a changing pool of securities, and include open-end and closed-end companies. See T. Lemke, G. Lins, A. Smith III, Regulation of Investment Companies, Vol. I, ch. 4, § 4.04, at 4–5 (2002). An open-end company is a management company that is offering for sale or has outstanding any redeemable securities of which it is the issuer.

³ See, e.g., Riva D. Atlas, *Another Fund Faces Inquiry Over Trading*, NEW YORK TIMES, October 22, 2003, at C4; Tom Lauricella, *Two-Tier System: For Staid Mutual Fund Industry, Growing Probe Signals Shake Up—Investigators Find Indications of Widespread Abuses Hurting Small Investors—Unfair Pricing for Big Players*, WALL STREET JOURNAL, October 20, 2003, at A1; Brooke A. Masters, *Spitzer Alleges Mutual Fund Improprieties*, WASHINGTON POST, September 4, 2003, at E1.

⁴ See, e.g., *In the Matter of Putnam Investment Management, LLC*, Release No. IC–26255 (Nov. 13, 2003) (investment adviser violated antifraud provisions of the federal securities laws by failing to disclose potentially self-dealing short-term