

detering frequent purchases and redemptions of fund shares, and any arrangements to permit frequent purchases and redemptions of fund shares; and

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

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

As noted above, the Commission also is proposing to require mutual funds, and insurance company managed separate accounts that offer variable annuities, to disclose their policies with respect to disclosure of portfolio holdings information. The proposals would:

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

A. Reasons for, and Objectives of, Proposed Amendments

Recent allegations regarding late trading, abusive market timing, and other abuses 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. The proposed amendments include disclosure reforms intended to shed more light on market timing and selective disclosure of portfolio holdings information. The proposals 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 restriction will not apply. The proposals would require similar disclosure by insurance company separate accounts that offer variable insurance contracts, with respect to the restrictions, if any, that they place on frequent transfers among sub-accounts. This additional disclosure would enable investors to assess mutual funds' and

insurance company separate accounts' risks, policies, and procedures in this area and determine if the policies and procedures are in line with their expectations. The proposed amendments also are intended to provide greater transparency of mutual fund and insurance company managed separate account practices with respect to the disclosure of a fund's portfolio holdings, and to reinforce funds' and advisers' obligations to prevent the misuse of material, non-public information. The proposals are part of a package of rule amendments intended to address abuses that have surfaced in the areas of late trading, market timing, and selective disclosure.

B. Legal Basis

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

C. Small Entities Subject to the Rule

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.⁷⁸ Approximately 145 investment companies registered on Form N-1A meet this definition.⁷⁹ We estimate that few, if any, registered separate accounts registered on Form N-3, N-4, or N-6 are small entities.⁸⁰

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would require a mutual fund to disclose in its prospectus both the risks to shareholders of the frequent purchase and redemption of fund shares, and the fund's policies and procedures with respect to frequent purchases and redemptions of fund shares. The

proposals would require similar prospectus disclosure for insurance company separate accounts issuing variable insurance contracts. The proposed amendments would also clarify that all mutual funds and insurance company managed separate accounts that issue variable annuities, other than money market funds, are required to explain both the circumstances under which they will use fair value pricing, and the effects of using fair value pricing. Finally, the proposals would require mutual funds and insurance company managed separate accounts that issue variable annuities to disclose their policies and procedures with respect to the disclosure of their portfolio securities to any person and any ongoing arrangements to make available information about their portfolio securities.

The Commission estimates some one-time formatting and ongoing costs and burdens that would be imposed on all funds, including funds that are small entities. We note, however, that in many cases funds currently provide disclosure in their prospectuses of the limitations that they place on frequent trading in order to discourage market timing. For purposes of the Paperwork Reduction Act, we have estimated that the proposed new disclosure requirements would increase the hour burden per portfolio per filing of an initial registration statement on Form N-1A by 10 hours and would increase the hour burden per portfolio per filing of a post-effective amendment to a registration statement by 4 hours. We estimate that this additional burden would increase total internal costs of an initial filing by \$452.50 per mutual fund portfolio annually, and would increase total costs of filing a post-effective amendment by \$181 per mutual fund portfolio annually.⁸¹

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

⁷⁸ 17 CFR 270.0-10.

⁷⁹ This estimate is based on analysis by the Division of Investment Management staff of information from databases compiled by third-party information providers, including Morningstar, Inc. and Lipper.

⁸⁰ This estimate is based on figures compiled by Division of Investment Management staff regarding separate accounts registered on Forms N-3, N-4, and N-6. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are aggregated with the assets of their sponsoring insurance companies. Rule 0-10(b) under the Investment Company Act [17 CFR 270.0-10(b)].

⁸¹ These figures are based on an estimated hourly wage rate of \$45.25. See *supra* note 76.