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Securities and Exchange Commission (S.E.C.)

\*1 Investment Company Act of 1940

Securities Act of 1933

June 9, 1972

GUIDELINES FOR THE PREPARATION OF FORM S-4 AND S-5 INCLUDING THE PROSPECTUS FOR  
A MANAGEMENT INVESTMENT COMPANY

Consistent with the Commission's practice of publishing the views of the staff to assist issuers, their counsel, accountants and others concerned in complying with the provisions of the Federal Securities Laws, this release sets forth Guidelines prepared by the Division of Corporate Regulation for use in preparation and filing of registration statements pursuant to the Securities Act of 1933 for both open-end and closed-end management investment companies on Forms S-4 and S-5.

On March 11, 1969 the Commission published for comment Proposed Guidelines for the Preparation of Form S-4 and S-5 (Investment Company Act Release No. 5634, Securities Act Release No. 4953). A considerable number of helpful comments were received in response, and all comments have been carefully considered in the preparation of the definitive version of the Guidelines which is attached. Certain changes have been made in the Guidelines as a result of the staff's review of the comments and as a result of its further consideration of the various matters involved.

The Commission is today also publishing (Investment Company Act Release No. 7221, Guidelines for the Preparation of Form N-8B-1).

The Guidelines are not specifically intended for variable annuity companies, which in certain respects present different disclosure problems under the Act. However, to the extent that the Form S-5 calls for disclosures which are also appropriate for variable annuity companies, the Guidelines are applicable.

It is anticipated that adherence to these Guidelines will substantially expedite the examination by the Dividend's staff of registration statements on Forms S-4 and S-5. The policies embodied in these Guidelines will be changed should experience or altered factual situations require or should the Forms be changed. These Guidelines are not meant to be a complete guide for the preparation of Form S-4 or S-5, and it is contemplated that additional guidelines will be published from time to time as may be warranted. Interested persons are invited to submit, at any time, suggestions for modifications or for the publication of guidelines covering additional matters. All views or comments should be submitted in writing to the Securities and Exchange Commission, Washington, D.C. 20549. All communications will be available for public inspection.

Registrants are advised that while of course, the responses set forth in these guidelines are acceptable, other responses furnished by registrants may be equally acceptable. Further, the Commission wishes to caution that these Guidelines may have only limited applicability to companies with unusual features. For example, companies with highly speculative investment policies may require special disclosures in the prospectus.

(Cite as: 1972 WL 17490, \*2 (S.E.C.))

\*2 It should also be noted that the responses now being set forth in the prospectus by some companies may not in all respects meet these Guidelines. Accordingly, prospective companies should not rely upon disclosures in existing prospectuses.

The Guidelines cover only those items of Forms S-4 S-5 which the staff believes require further explanation at this time. These Guidelines are not rules of the Commission although some may later be incorporated in various rules and forms as experience and need suggest.

While the views expressed by the staff as set forth in this release are those of persons who are continually working with the provisions of the statutes and rules involved and can be relied upon as representing the views of the Division of Corporate Regulation, the public is cautioned that the opinions expressed in this release are not, and do not purport to be, an official expression of the Commission's views.

The terms used in these Guidelines have the same meaning as prescribed in the Investment Company Act of 1940 and the Rules thereunder.

The Guidelines should be read in conjunction with the Investment Company Act Releases cited herein in the 'Compilation of Releases, Commission Opinions, and Other Material dealing with matters frequently arising under the Investment Company Act of 1940' (October 1967), which may be obtained from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402--price 55 cents.

By the Commission.

Ronald F. Hunt  
Secretary

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## GUIDELINES FOR FORMS S-4 AND S-5

## General Comments

\*3 The prospectus should not be presented in fold-out or road-map type fashion. The use of colored print or pages is not objectionable so long as it does not detract from the prospectus presentation. Pictures of management may be used. Type size requirements, which are the minimum acceptable standard, are specified in Rule 420 under the Securities Act.

Where applicable, [FN1] a request for acceleration of the effective date of a registration statement pursuant to Rule 461 should be accompanied or preceded by the following information furnished to the Division: (1) the date of distribution of the preliminary prospectus; (2) the number of prospective underwriters and dealers to whom it has been furnished; (3) the number of prospectuses so distributed; and (4) the number of prospectuses distributed to others, identifying them in general terms. In addition, where it is contemplated that a stated number of shares will be offered in connection with an initial offering or a special offering when the Company has no effective registration statement under the Securities Act of 1933, the staff will raise

(Cite as: 1972 WL 17490, \*3 (S.E.C.))

questions in connection with any such request for acceleration that does not also specify that the last preliminary ('red herring') prospectus that was distributed reflected those staff comments which resulted in significant changes. [FN2]

#### PART I of FORMS S-4 and S-5

##### Cover Page

The front or back outside cover page (considering the prospectus as laid down on a table, ready to open in the fashion of a book, with the binding on the left) may contain the logotype of the issuer, its underwriter or investment adviser so long as it does not create a misleading impression. The logotype should not occupy more than 10 percent of the front cover page and should not obscure any textual material.

The outside front cover page of the prospectus should contain the following information:

1. The name, address, and telephone number (including the area code) of the Company.
2. The date of the prospectus.
3. A precise summary of the Company's investment objectives comparable to the communications permitted by Rule 134 under the Securities Act and Securities Act Release No 4709 (July 14, 1964). [FN3]
4. The name of the investment adviser and a reference to the page of the prospectus on which the adviser and its personnel are discussed. [FN4]
5. A statement of the maximum sales load as a percentage of the net amount invested in the Company, and a statement indicating whether lower sales loads are charged on purchases in excess of \$\_\_\_\_\_ [the first breakpoint]. [FN5] This should be followed by the statement: 'A sales charge of \_\_\_\_% [the maximum sales charge] of the amount invested in the Company is equivalent to a sales charge of \_\_\_\_% of the offering price.'
6. The minimum initial and subsequent investment in shares or dollars, if any.
7. The information required by Item 1 of Form S-4 and Item 1(c)(2) of Form S-5, whichever is applicable.
- \*4 8. The statement required by Rule 425 under the Securities Act.
9. A statement advising investors to retain the prospectus for future reference.

##### Inside Front Cover Page

10. An additional statement, which may appear on the inside cover, bordered with a line, such as the following:

Numerous investment companies continuously offer their shares to investors. Investment companies have different investment objectives and techniques and involve varying degrees of risk. Sales commissions which are paid to compensate persons who sell investment company shares vary as do management charges and expense ratios. For the last fiscal year, the Company's total operating expenses including advisory fees were approximately \_\_\_\_ percent of average annual net assets.

(Cite as: 1972 WL 17490, \*4 (S.E.C.))

In certain instances, there may be other matters concerning the Company or its affiliates which are of such critical importance that they should be disclosed on the cover page. The inside cover page may contain the Table of Contents [FN6]

### Summary Statement

The body of the prospectus should start with a clear and concise summary statement which should identify and discuss the nature of the Company, and the costs involved in investing in the Company including the applicable sales charge, as well as any other significant costs or charges inherent in the operations of the Company. There should also be a reference to the Company's objectives and policies.

The following is an example of an acceptable summary statement.

### What Is the Company

The Company is an investment company. In other words, it is an arrangement by which a number of persons invest in a company that itself invests in securities. The Company is an open-end investment company because, upon the demand of the investor, it has a legal duty to acquire the shares of the Company held by the investor and pay the investor the net asset value of the shares. (See discussion of computation of net asset value and redemption, page \_\_\_\_.) This type of investment company is commonly called a mutual fund. The Company was organized as a [corporation, trust, etc.] in the State of \_\_\_\_ on \_\_\_\_.

Investment companies operate pursuant to their objectives and policies. The Company's investment objectives and policies are set forth on page \_\_\_\_.

With respect to the purchase and sale of investments, the Company receives investment advice from \_\_\_\_ Corporation, which is paid an advisory fee pursuant to contract. This fee on an annual basis is \_\_\_\_ percent of the Company's average net assets. (Also reflect performance fee if applicable.) See page \_\_\_\_ for a discussion of the investment adviser and the advisor contract.) In addition to the advisory fee, the Company pays other costs including its legal fees, brokerage, taxes, etc. [All major categories of expenses should be listed. [FN7]]

The value of the Company's shares fluctuates because the value of the securities in which it invests fluctuates. When the Company sells portfolio securities it may realize a gain or a loss, depending on whether it sells them for more or less than their cost. The Company will earn dividend or interest income to the extent that it receives dividends or interest from its investments. (For an explanation of the significance of these transactions for federal tax purposes set 'Dividends, Distributions, and Taxes', page \_\_\_\_.)

\*5 The Company's shares are sold to the public at net asset value plus a sales commission which is divided between the Company's principal underwriter and dealers who sell the Company's shares. (See discussion of 'How to Purchase Shares' at page \_\_\_\_.)

### Investment Objectives, Policies and Techniques

## General

The Company's investment objectives and policies (including the types of securities in which it will invest) should be clearly and concisely stated so that they may be readily understood by the investor. It is not necessary to provide specifically for every eventuality, and every effort should be made to avoid 'hedging' or evasive language. The discussion should include all the Company's investment policies, not merely those listed in the responses to Items 4 and 5 of Form N-8B-1. If the Company has charter or by-law authority to engage in some investment activity, but is not required to have a policy with respect to this and in fact has no policy regarding this activity, then such authority and the fact there is no present policy with respect to this authority should be disclosed. The non-use of a policy should be disclosed, as well as the Company's intention with respect to that policy in the coming year. This section should also contain a straightforward and meaningful discussion of the investment techniques to be employed to achieve the Company's objectives.

Particular attention should be given to the discussion of portfolio turnover. The discussion should include an uncomplicated definition of portfolio turnover and the probable effect which the investment techniques the Company will employ in pursuing its stated investment objectives may reasonably be expected to have on its rate of portfolio turnover. [FN8] New companies should estimate what rate of portfolio turnover will not be exceeded e.g. 50%, 100%, 150% etc. A Company already in existence should disclose the rate of portfolio turnover for each of the past three years (but not including the period prior to the date the Company's first registration statement under the Securities Act of 1933 became effective), computed as set forth in Item 1.25(a) of Form N-1R. [FN9] Further, if the Company has had a portfolio turnover of approximately 100% or more, or if the Company anticipates it will have such a portfolio turnover rate, the discussion should not fail to disclose the tax and brokerage consequences which such techniques are likely to have. Appropriate cross-reference to the sections of the prospectus which discuss income taxes and brokerage practices in detail should follow such discussion.

The following disclosure of a Company's investment objectives, policies and techniques is acceptable to the extent applicable:

### (A) Investment Objective

(1) The primary investment objective of the Company is long-term capital appreciation [capital appreciation solely]. Current income through the receipt of interest or dividends from investments is only a secondary objective [will merely be incidental to the Company's efforts in pursuing its aforementioned goal]. There can be no assurance that the Company will in fact achieve its objective[s].

\*6 (2) The Company's objective is to provide current income to shareholders. [Long-term capital appreciation will be only a secondary objective.] There can be no assurance that the Company will in fact achieve its objective[s].

(3) The Company's objectives are capital growth, conservation of principal,

(Cite as: 1972 WL 17490, \*6 (S.E.C.))

and production of current income through the receipt of interest or dividends from investments. There can be no assurance that the Company will in fact achieve its objectives. [This disclosure may be suitable for a 'balanced fund'.]

(B) Types of Securities

(1) The Company will invest substantially all its assets in common stock or securities convertible into common stock. In addition, interim investments in short-term debt securities may be made so as to receive a return on idle cash. When the Company believes there will be a market decline, it may sell its securities and invest all or part of the proceeds in investment grade corporate bonds, debentures or preferred stock, U.S. Government securities, state or municipal securities, or funds may be retained in cash.

(2) [To be used when a Company purports to be a 'balanced fund.']. Since the Company has multiple objectives, it will maintain a balance among debt securities, preferred stocks and common stocks. At least 25% of the value of the Company's assets will be invested in either debt securities, preferred stock, or both. [FN11] The debt securities and preferred stocks are intended to provide income and relative stability of capital, while the common stock is intended to provide possible increases in capital.

(3) [To be used when a company intends to invest 10% or more of its assets in foreign securities which are not publicly traded in the United States] The Company intends to invest 10% or more of its assets in foreign securities, that is, the securities of foreign governments [and foreign companies]. Such securities may be subject to additional federal taxes which would have the effect of increasing the cost of such investment and may be subject to foreign government taxes which could reduce the income yield on such securities. See p. \_\_\_\_ for a discussion of the tax aspects of such investments.

(4) [To be used when a company will invest a substantial portion of its assets in securities with a limited trading market.] The company will invest a substantial portion of its assets in securities with a limited trading market. For a discussion of these securities, see p. \_\_\_\_.

(5) [To be used when a company will invest in restricted securities.] The company will invest in securities which may not be sold publicly until first registered under the Securities Act of 1933. For a discussion of these securities, see p. \_\_\_\_\_. [FN12]

(C) Portfolio Policy and Techniques

(1) [Capital Appreciation Through Long-Term Investment]

It is the policy of the Company to purchase and hold securities which are believed to have potential for long-term capital appreciation. Investment income will be a secondary consideration in the selection of portfolio securities. The Company does not intend to obtain short-term trading profits. Accordingly, the Company expects that its annual portfolio turnover rate will be less than 50%.

(Cite as: 1972 WL 17490, \*6 (S.E.C.))

(2) [Capital Appreciation With Limited Short-Term Trading]

\*7 The policy of the Company is to purchase and hold securities for capital appreciation, although there may be a limited number of short-term transactions. Investment income, however, is not considered in the selection of portfolio securities. Because of this policy, it is anticipated that the annual portfolio turnover will normally be in the range of 50-75%.

(3) [Capital Appreciation With Substantial Short-Term Trading]

It is the policy of the Company to seek possible capital appreciation. It is intended that the Company will be engaged to a substantial extent in short-term trading. The Company intends to engage in trading operations based upon short-term market considerations as distinct from long-term investment based upon fundamental valuation of securities. This investment policy involves substantial risk and may be considered speculative. Any investment income received from portfolio securities will be entirely incidental, and an investor should not consider a purchase of the Company's shares as equivalent to a complete investment program.

Since the Company intends to purchase securities for the short-term, it can be expected that the annual portfolio turnover rate will generally be in the range 100-150% [or 150-200%]. [FN13] A 100% turnover rate would occur, for example, if all the shares in the Company's portfolio were replaced in a period of one year. A 100% portfolio turnover rate is greater than that of many other investment companies, including many which emphasize capital appreciation as a basic policy. Increased portfolio turnover necessarily results in correspondingly heavier brokerage costs which the Company must pay. To the extent that short-term trading results in realization of gains in securities held less than six months, shareholders will be taxed on any such gains at ordinary income tax rates.

(4) [Capital Appreciation through Short-Term Trading]

It is the policy the Company to seek possible capital appreciation through short-term trading. The Company intends to make investments based substantially upon short-term considerations and to engage in in-and-out short-term trading of securities. Because of this policy, portfolio securities will be sold without regard to the length of time held. There will be little or no investment income, as securities will be purchased solely for capital appreciation possibilities. Therefore, it is expected that the portfolio turnover rate will generally be in the range of 200-300%.

A 200% turnover rate would occur, for example, if all of the securities in the Company's portfolio were replaced every six months (twice in a period of one year). A 200% portfolio turnover rate is substantially greater than that of most other investment companies, including those with a policy of capital appreciation.

The Company's policy regarding portfolio turnover involves correspondingly heavier brokerage commissions and taxes which ultimately must be borne by the Company's shareholders. To the extent that short-term trading results in realization of gains in securities held less than six months, shareholders

(Cite as: 1972 WL 17490, \*7 (S.E.C.))

will be taxed on any such gains at ordinary income tax rates.

\*8 This investment policy is highly speculative and as noted on the cover page of the prospectus, the securities offered by the prospectus involve a higher degree of special risks to an investor considering the purchase of investment company shares.

(D) Leverage and Short Sales

In order to increase the amount of its investment in securities believed to have appreciation potential, the Company intends to borrow money on which it will have to pay interest. The Company also intends to sell securities 'short'. It is important for investors to read and understand the sections entitled 'Short Sales' and 'Leverage', which describe these techniques and the attendant risks and expenses. (See 'Leverage', p. 9, and 'Short Sales', p. 9.)

(E) Securities with a Limited Trading Market [FN14]

The Company will assume substantial positions in securities with a limited trading market. The Company's position in such securities as related to the market for such securities may be of such size as to affect adversely the liquidity and marketability of such securities and the Company may not be able to dispose of its holdings in these securities at the current market price.

There are other investment companies and other investment media which acquire securities with a limited trading market; and to the extent that these organizations will be attempting to dispose of the same securities at the same time, the Company may be forced to dispose of its holdings at prices lower than would otherwise be obtained, because of the possibly limited number of potential buyers.

Per Share Income and Capital Changes (Item 1(c) Form S-5)

It is inappropriate to set forth in the schedule of per share income and capital changes in the prospectus figures relating to any period prior to the effective date of the Company's first Securities Act registration, that is, the effective date of the first Securities Act registration after registering as an investment company.

Leverage

If the Company intends to borrow money except for temporary or emergency purposes as part of its investment policy, the prospectus as well as the Form N-8B-1 [FN15] should disclose this policy and the extent to which the Company can borrow. An example of such a disclosure follows:

Leverage

In order to raise additional cash for investment, the Company intends to borrow money from banks [if a closed-end company, indicate from what other

(Cite as: 1972 WL 17490, \*8 (S.E.C.))

sources, if any, borrowing will be made] and may pay interest thereon.

Any investment gains made with the additional monies in excess of interest paid will cause the net asset value of the Company's common shares to rise faster than would otherwise be the case. On the other hand, if the investment performance of the additional securities purchased fails to cover their cost (including any interest paid on the money borrowed) to the Company, the net asset value of the Company will decrease faster than would otherwise be the case. This is the speculative factor known as 'leverage'.

#### Extent to which the Company may Borrow Money

\*9 The amount of money the Company may borrow is limited by the Investment Company Act of 1940 so that immediately after such borrowing the amount borrowed may not exceed 33 1/3% of the value of the Company's assets (including the amount borrowed) less its liabilities (not including any borrowings but including the fair market value at the time of computing of any securities with respect to which there are open short positions). If, due to market fluctuations or other reasons, the value of the Company's assets falls below the coverage requirement of the statute, the Company, within three business days, will reduce its bank debt to the extent necessary. To do this, the Company may have to sell a portion of its investment at a time when it may be disadvantageous to do so.

The amount of any borrowing will also be limited by the applicable margin limitations imposed by regulations adopted by the Federal Reserve Board. Any such borrowing will be secured by not more than \_\_\_\_% of the value of the Company's assets.

#### Short Sales

If the Company intends to sell securities short, the prospectus should explain the investment technique. The discussion should cover:

1. an explanation of what a short sale is;
2. the risks, including timing, involved in short selling;
3. an explanation of the circumstances under which the Company will sell short;
4. an explanation of the collateral--segregated account requirement (see p.6 of Guidelines to Form N-8B-1);
5. the maximum percentage of the value of the Company'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.
6. the impact that short sales may have on income taxes.

The following is a satisfactory prospectus discussion, to the extent applicable, of points 1, 4 and 5 above:

The Company intends from time to time to sell securities short. Short sales are effected when it is believed that the price of a particular security will decline, and involves the sale of a security which the Company does not own in the hope of purchasing the same security at a later date at a lower price. To make delivery to the buyer, the Company must borrow the security, and the Company is obligated to return the security to the lender, which is

(Cite as: 1972 WL 17490, \*9 (S.E.C.))

accomplished by a later purchase of the security by the Company.

When the Company makes a short sale, it must leave the proceeds from the short sale with the broker and it must also deposit with the broker a certain amount of cash or government securities to collateralize its obligation to replace the borrowed securities which have been sold. In addition, the Company must put in a segregated account (not with the broker) an amount of cash or U.S government securities equal to the difference between the market value of the securities sold short at the time they were sold short and any cash or government securities deposited as collateral with the broker in connection with the short sale (not including the proceeds from the short sale). In addition, until the Company replaces the borrowed security, it will daily maintain the segregated account at a level so that (1) the amount deposited in it plus the amount deposited with the broker (not including the proceeds from the short sale) will equal the current market value of the securities sold short, (2) the amount deposited in it plus the amount deposited with the broker (not including the proceeds from the short sale) will not be less than the market value of the securities at the time they were sold short. As a result of these requirements, the Company will not gain any leverage merely by selling short, except to the extent that it earns interest on the immobilized cash or government securities while also being subject to the possibility of gain or loss from the securities sold short. The amount of the Company's net assets that will at any time be in the type deposits described above (that is, collateral deposits or segregated accounts) will not exceed \_\_\_\_ percent. These deposits do not have the effect of limiting the amount of money the Company may lose on a short sale--the Company's possible losses may exceed the total amount of deposits.

\*10 The Company will incur a loss as a result of the short sale if the price of the security increases between the date of the short sale and the date on which the Company purchases the security to replace the borrowed security. The Company will realize a gain if the security declines in price between those dates. The amount of any gain will be decreased and the amount of any loss increased by any premium or interest the Company may be required to pay in connection with a short sale. It should be noted that possible losses from short sales differ from those that could arise from a cash investment in a security in that the former may be limitless while the latter can only equal the total amount of the Company's investment in the security. For example, if the Company purchases a \$10 security, the most that can be lost is \$10. However, if the Company sells a \$10 security short, it may have to purchase the security for return to the lender when the market value is \$50, thereby incurring a loss of \$40.

If the Company intends to make short sales 'against the box', the following disclosure is suggested:

The Company may make short sales '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 securities identical to those sold short at no added cost.

#### Diversification

The extent to which the Company proposes to diversify its portfolio among

(Cite as: 1972 WL 17490, \*10 (S.E.C.))

securities of different issuers should be disclosed. It may not call itself a diversified company unless it meets the minimum requirements of the Act.

[FN16] If a company in operation does not meet those requirements but intends to do so in the future, its intention in this regard and its estimate of the time required to implement such intent should be specifically disclosed.

#### Concentration [FN17]

The Company's policy on concentration in various industries should be disclosed as follows:

Concentrated (where name does not imply an industry or industries)

The Company will concentrate in the \_\_\_\_\_ industry (industries). At least 25 percent of the value of the Company's assets will be invested in that industry. [FN18]

Concentrated (where name implies an industry or industries)

Note less than 80 percent of the value of the Company's assets will be invested in companies engaged in the \_\_\_\_\_ industry (industries).

#### Not Concentrated

The Company does not intend to concentrate its investments in any particular industry nor will it purchase a security if, as a result of such purchase more than 25% of its assets will be invested in a particular industry.

If a Company in operation which has employed a policy of concentration 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. (See Section 13(a)(3) of the Investment Company Act regarding changes in concentration policy.)

#### Restricted Securities [FN19]

\*11 The usual limit on aggregate holdings by an open-end company of illiquid assets of all kinds including restricted securities, is 10% of the value of its net assets. If a Company has a policy of investing in restricted securities which amounts to 2% of the value of its net assets, this should be clearly stated. When as a result of either the increase in the value of some or all of the restricted securities held or the diminution in the value of unrestricted securities in the portfolio, the restricted securities come to represent a larger percentage of the value of the Company's assets serious liquidity questions may arise. Accordingly, if the fair value of restricted securities increases beyond 10%, it would be desirable for the open-end company to consider appropriate steps to protect maximum flexibility. The statement should include a discussion in general terms of what a restricted security is, the limitations upon the sale of such securities, the procedure established for valuing such securities, and a discussion of the special risks involved in a program of purchasing securities which may not be publicly sold without

(Cite as: 1972 WL 17490, \*11 (S.E.C.))

registration. In any event, as to any restricted security held in the portfolio, the following information should be set forth in a note to the Schedule of Investments portion of the financial statements:

1. Identification of any restricted securities, and their date of acquisition.
2. The cost of such securities and the market quotation for unrestricted securities of the same class both on the day the purchase price was agreed to (the so-called 'handshake date'), and on the day the Company first obtained an enforceable right to acquire such securities.
3. The method used in valuing each of such securities both at the date of acquisition and the date of the financial statement.
4. The aggregate value of such investments and their percentage of net asset value at the date of the financials.
5. A statement, with respect to each such security, as to whether the Company may require the issuer to register such securities, whether the Company may include its securities in a registration the issuer is making ('piggyback rights'), or whether the Company has neither of these rights. It should also be indicated who will bear the costs, should there be a registration.
6. When there is a readily available market quotation for unrestricted securities of the same class as the restricted securities, the market price (or if there are no sale quotations, the mean between the bid and asked prices), on the date of valuation, of each of the unrestricted securities.

#### Policies and Investment Restrictions

All policies or investment restrictions which cannot be changed without shareholder approval should be concisely set forth under this heading, together with any other investment restrictions. [FN20] The prospectus should disclose which policies or restrictions may not be changed without shareholder approval, and which may be changed without such approval. While this discussion should be consistent with the responses to Form N-8B-1, the prospectus disclosures should include additional explanation of such policies and their effect on risk, taxes and brokerage commissions. The statutory provisions regarding determination of shareholder approval should be explained. For example:

\*12 The Company is subject to the following restrictions which may not be changed without the approval of the lesser of (i) 67 percent or more of the voting securities present at a meeting if the holders of more than 50 percent of the outstanding voting securities of the Company are present or represented by proxy, or (ii) more than 50 percent of the outstanding voting securities of the Company.

However, if state statute, by-law or other authority requires a higher standard for changing investment policies or restrictions that fact should be disclosed.

Examples of acceptable disclosures with respect to certain policies and investment restrictions are set forth below:

The Company may not:

1. Purchase the securities of any one issuer if immediately after and as a result of such purchase (a) the value of the holdings of the Company in the securities of such issuer exceeds \_\_\_\_% of the value of the Company's total

(Cite as: 1972 WL 17490, \*12 (S.E.C.))

assets, or (b) the Company owns more than \_\_\_\_% of the outstanding voting securities or of any one class of securities of such issuer; [FN21]

2. Purchase securities of other investment companies. [FN22]

3. Concentrate its investments, that is, invest more than 25% of the value of its assets, in any particular industry.

4. Purchase or sell real estate or other interests in real estate, nor interests in real estate investment trust [however, the Company may purchase interests in real estate investment trusts whose securities are registered under the Securities Act of 1933 and are readily marketable]

5. Write, purchase or sell puts, calls or combinations thereof.

6. Make loans, except the Company may lend money to businesses through the purchase of privately offered short-term [and/or long-term] debt securities. Any such loans will be restricted to companies which (including predecessors) have been in business for at least \_\_\_\_ years and have assets of \$\_\_\_\_, at the time of the loan. Up to \_\_\_\_ percent [FN23] of the value of the Company's assets may be invested in such securities. The purchase of a portion of an issue of publicly distributed bonds, debentures or other debt securities will not be considered the making of a loan.

7. Purchase securities on margin or sell short.

8. Borrow money except that, as a temporary measure for extraordinary or emergency purposes and not for investment purposes, the Company may borrow up to 5% of the value of its total assets.

9. The Company will not mortgage, pledge, hypothecate, or in any manner transfer, as security for indebtedness, any securities owned or held by the Company.

10. Participate on a joint or a joint and several basis in any trading account in securities.

11. Invest in companies for the purpose of exercising control or management.

12. Act as an underwriter of securities of other issuers, except that the Company may invest up to \_\_\_\_% [FN24] of the value of its assets (at time of investment) in portfolio securities which the Company might not be free to sell to the public without registration of such securities under the Securities Act of 1933. (See p.12) [Open-end companies add: If through the appreciation of restricted securities or the depreciation of unrestricted securities, the Company should be in a position where more than 10% of the value of its net assets are invested in illiquid assets, including restricted securities, a question arises with respect to liquidity and accordingly the company will consider appropriate steps to protect maximum flexibility.]

\*13 Should a company adopt a policy on certain other matters, the following statements may be used as a guide in disclosing such policies.

The Company may not:

1. Investment more than \_\_\_\_% of the value of its assets in securities of foreign issuers under circumstances that would subject it to the Federal Interest Equalization Tax.

2. Purchase from or sell to any officer, director or employee of the Company, or its adviser or underwriter, or any of their officers or directors, any securities other than shares of the Company's capital stock.

3. Purchase or retain the securities of any issuer if those officers and directors of the Company, its adviser or underwriter owning individually more

(Cite as: 1972 WL 17490, \*13 (S.E.C.))

than \_\_\_\_% of the securities of such issuer together own more than \_\_\_\_% of the securities of such issuer.

4. Invest more than \_\_\_\_% of the value of its total assets in securities of companies having a record of less than three years' continuous operation.

The Company may borrow up to 10% of the value of its total assets as a temporary measure for extraordinary or emergency purposes.

## Identification of Management

### Board of Directors

In listing the officers and directors of the Company in the prospectus, the complete list of directors should precede the listing of any officers who are not also directors. If the Company has an executive or investment committee, its members should be identified, and there should be a concise statement of the duties and functions of such committee. The business mailing address of all directors and three executive officers [FN25] should be listed, and the number of shares of the Company beneficially owned by each should be included. There should be disclosed family relationships [FN26] between directors who are not interested persons of the Company and (a) directors who are interested persons of the Company, and (b) officers or managerial-level employees of the Company or its Adviser. If a director who is not an interested person of the Company performs or has performed services (or is a partner, officer or employee of a company which had done so) on a regular basis for the Company, its Adviser, officers of the Company or its Adviser, or another board member of the Company who is an interested person of the Company (or for a company of which such board members is an affiliated person), this fact should be disclosed in this section. Certain interests of counsel in the Company or its affiliates should also be disclosed--see p. 28 infra.

### Investment Adviser

This section should contain the following information:

- (1) the material provisions of the advisory contract, including:
  - (a) a description of which, if any, fees and expenses of the Company are to be paid by the adviser;
  - (b) the method of computing the advisory fee.

Where the fee is computed or paid on other than an annual basis, only the annual rate should be set forth, in a manner consistent with the following example:

**\*14** As compensation for its services, the Company will pay the adviser an annual fee of approximately one-half of one percent of the Company's average net assets. This fee is computed on a \_\_\_\_ [e.g., daily] basis and paid \_\_\_\_ [e.g., quarterly].

If the fee varies depending on the Company's investment performance in relation to some standard, then the fee schedule should be set forth in tabular form, showing the maximum rate the adviser would earn at various levels of Company performance. [FN27] There should also be some examples of how the fee is computed under varying hypotheses.

- (2) the dollar amounts paid to the adviser by the Company under the

(Cite as: 1972 WL 17490, \*14 (S.E.C.))

investment advisory contract for investment advice for each of last three fiscal years;

(3) the dollar amounts of brokerage commissions paid by the Company to the adviser or an affiliate of the Company, adviser or principal underwriter (the nature of the affiliation should be stated) for each of the last three fiscal years;

(4) the names of all affiliated persons of the Company who are also affiliated persons of the investment adviser. [FN28] The nature of each affiliation with the adviser should be disclosed. If an affiliated person of the Company is a controlling person [FN29] of the adviser, that fact should also be stated as such--it is not sufficient to state merely that such person is a holder of more than 25 percent of the outstanding voting securities of the adviser;

(5) the names and the percentages of all persons owning 5% or more of the adviser and the percentages held beneficially, and if any such person controls the adviser, that person's name and the fact that he or it controls the adviser;

(6) a summary of the material provisions and purpose of any other management-related contracts, such as a separate contract for administrative services or for 'housekeeping', between the Company and any other person performing such services.

(7) the termination and renewal provisions. Care should be taken to describe accurately the provisions relating to Sections 15(a) and 15(c) of the Investment Company Act and the procedure for renewal of the contract. For example:

The continuance of the agreement must be approved annually by vote of the Board of Directors of the Company, including a majority of those directors who are not parties to such contract or interested persons of any such party cast in person at a meeting called for the purpose of voting on such approval or by the vote of a majority of the outstanding voting securities of the Company and a majority of directors who are not parties to the contract, or interested persons of any such party. The investment advisory agreement will terminate automatically in the event of its assignment. In addition, the contract is terminable at any time without penalty by the Board of Directors of the Company or by vote of a majority of the Company's outstanding voting securities on not more than 60 days written notice to the adviser, and by the adviser on \_\_\_ days notice to the Company.

\*15 If the Company has a sub-adviser, the above disclosure also pertain to the sub-adviser.

#### BROKERAGE

This section should clearly and concisely state the Company's policy with respect to the practices employed in placing portfolio transactions for securities traded on national securities exchanges and in the over-the-counter market. In this connection see the Statement of the Securities and Exchange Commission on the Future Structure of the Securities Markets, dated February 2, 1972 (U.S. Government Printing Office: 1972, 0-457-477) and Securities Act Release No. 5250, Investment Company Act Release No. 7170, dated May 9, 1972.

If brokerage is assigned because certain services have been furnished to

(Cite as: 1972 WL 17490, \*15 (S.E.C.))

affiliated persons of the Company or to the adviser or principal underwriter under circumstances where the Company received no benefit therefrom the discussion should specify, in precise language, the manner in which the affiliates benefit from the assignment policy used.

The amounts of brokerage assigned for the last three fiscal years should be disclosed.

The section should also:

(1) indicate who, as among the investment adviser, directors of the Company or officers of the Company, is primarily responsible for making the Company's portfolio decisions;

(2) indicate who, as among the investment adviser, directors of the Company or officers of the Company, is primarily responsible for placing the Company's brokerage business and where applicable, negotiating the amount of the commission rate paid;

(3) describe the affiliation, if any, among, on the one hand, the Company's officers or directors, its investment adviser or its principal underwriter and, on the other hand, any broker-dealers who execute transactions for the Company or affiliated persons of such broker-dealers, and the policy of the Company with respect to placing portfolio orders with any such affiliated broker-dealer;

(4) disclose whether any such affiliated broker-dealer, or affiliated persons of any such broker-dealer, participate in commissions paid to unaffiliated broker-dealers on Company transactions and the basis for and extent of such participation;

(5) in case of a company already in existence, disclose, for each of the Company's last three fiscal years, (a) the total brokerage commissions paid and (b) the total brokerage commissions paid to any broker-dealer affiliated with the Company, or to any broker-dealer an affiliated person of which is an affiliated person of the Company or its investment adviser or principal underwriter, and (c) the total brokerage commissions paid to any unaffiliated broker-dealer in which any broker-dealer specified in (b) participates; and

(6) describe the nature of reciprocal services or other benefits performed for or provided to or on behalf of the Company's officers and directors, its investment adviser or its principal underwriter by broker-dealers who execute transactions for the Company. [FN30]

\*16 Examples of appropriate disclosure consistent with these general principles are set forth in Appendix B.

#### Computation of Net Asset Value

See 'Computation of Net Asset Value'--Item 30, Guidelines to Form N-8B-1. The acceptable response there is suitable for prospectus disclosure.

#### How to Purchase the Company's Shares

It is suggested that the prospectus explain how shares may be purchased as follows:

The Company's shares may be purchased at the public offering price through broker-dealers who are members of the National Association of Securities Dealers, Inc. and have sales agreements with \_\_\_\_\_ [the underwriter].

Pricing for Sales [FN31]

A Company may describe its pricing procedure as follows:

Once daily pricing: [FN32]

Purchases are made at net asset value next to be determined plus applicable sales charge. The public offering price (net asset value plus sales charge) is computed once daily on each day that the New York Stock Exchange is open, as of the close of trading on the Exchange New York City time. At the date of this prospectus, the close of trading is \_\_\_\_\_ p.m., but this time may be changed. The offering price so determined becomes effective at the New York Stock Exchange closing time. Orders for shares of the Company received by dealers prior to the New York Stock Exchange closing time are confirmed at the offering price effective at that time, provided the order is received by the underwriter prior to the underwriter's close of business. (It is the responsibility of the dealers to transmit such orders so that they will be received by the underwriter prior to such close of business.) [FN33] Orders received by dealers subsequent to the New York Stock Exchange closing time will be confirmed at the offering price effective at the closing time on the next day the New York Stock Exchange is open.

Sales Charge

The prospectus should include a table showing the sales charge for different breakpoints. In addition, dealer discounts should be shown at the highest level. The sales charge should be expressed as a percentage of the amount invested in the Company after deduction of the sales charge.

For example:

Sales charges on purchases of less than \$12,500 amount to 9.3% of the amount invested. Commissions to the selling dealer on transactions of this size are a maximum of \_\_\_\_%. Lower sales charges are applicable to larger transactions as indicated by the table set forth below.

| Amount of Purchase                          | Sales Charge<br>as<br>Percentage<br>of the<br>Amount<br>Invested | [Optional additional<br>disclosure: Sales<br>Charge as<br>Percentage of the<br>Offering Price |
|---------------------------------------------|------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|
| -----                                       | -----                                                            | -----                                                                                         |
| Less than \$12,500                          | 9.3%                                                             | %                                                                                             |
| \$12,500 or more but less than \$25,000     | %                                                                | %                                                                                             |
| \$25,000 or more but less than \$50,000     | %                                                                | %                                                                                             |
| \$50,000 or more but less than \$100,000    | %                                                                | %                                                                                             |
| \$100,000 or more but less than \$250,000   | %                                                                | %                                                                                             |
| \$250,000 or more but less than \$1,000,000 | %                                                                | %                                                                                             |
| \$1,000,000 and over                        | %                                                                | %]                                                                                            |

(Cite as: 1972 WL 17490, \*17 (S.E.C.))

\*17 NOTE: Where the underwriter provides that the dealer discount will be all of the sales charge, disclosure should be made of the fact that in such circumstances, dealers who sell the Company's shares may be deemed underwriters within the meaning of the Securities Act of 1933 for the purpose of assessing civil liability under that Act. See, in this connection, Section 2(11) of the Securities Act of 1933.

The total amounts of sales charge retained by the principal underwriter during each of the last three years should be set forth. Amounts allowed or paid to dealers who are affiliated persons of the underwriter or adviser or affiliated persons of such persons should be separately set forth.

#### Letters of Intent

Letters of intent should be described clearly in the prospectus and copies of any such form should be filed as an exhibit to Form S-5. [FN34] The prospectus should advise the investor considering signing a letter of intent to read the letter carefully.

A ninety-day back-dating period can be used in order to include earlier purchases valued either at current net asset value or the investor's cost, whichever is higher. The thirteen-month [FN35] period would then begin on the date of the first purchase during the ninety-day period.

If an escrow arrangement is maintained for purchases made under a letter of intent, the arrangement should be described fully in the letter. Letters of intent should not provide that the amount of the intended purchase may be amended upward during the thirteen-month period without also providing for a retroactive reduction of the sales charge for purchases prior to the amendment. The letter should provide for one sales load applicable to a total dollar amount of shares to be purchased during the thirteen-month period and the prospectus should disclose that the letter is not a binding obligation upon the investor to purchase or the company to sell the full indicated amount. [FN36]

#### Investment Programs [FN37]

The prospectus should disclose that a purchaser under a voluntary investment program is under no obligation to purchase a specified amount of shares and that the program is terminable at will. If the program provides for automatic reinvestment of both capital gains distributions and dividends at net asset value, investors who are not under the program should also receive the privilege of reinvesting capital gain distributions and dividends at net asset value unless the program complies with Rule 22d-1(b)(2) or (c)(2) under the Investment Company Act of 1940.

The discussion of all investment programs should make clear whether the participant, the Company, the underwriter or the adviser will bear the costs of maintaining the program.

Where the Company offers an automatic withdrawal program it should be stated clearly that the program may involve the use of principal and, to the extent that it does so, depending upon the amount withdrawn, the investor's principal may be depleted. The language in the prospectus of a load Company relating to withdrawal programs should disclose that investors will be disadvantaged by

(Cite as: 1972 WL 17490, \*17 (S.E.C.))

making additional purchases of shares of the Company while their withdrawal program is in effect since duplication of sales charges will result. In addition, the withdrawal program should provide and the prospectus should state that an investor who has a withdrawal program ordinarily will not at the same time be permitted to make periodic purchases, and that single payment purchases, while they may be permitted, will be scrutinized by the Company for suitability. The discussion should disclose the minimum amount that may be withdrawn under the program but should also make clear that such amount is not a recommended amount.

#### Repurchase, Redemption and Market for shares

##### Repurchase

\*18 The Company should distinguish the procedure in effect for redemption and for repurchase of its shares. [FN38] Forward pricing is required by Rule 22c-1 under the Investment Company Act of 1940 for repurchases. [FN39]

If the Company or its underwriter has a repurchase arrangement whereby an investor may sell shares to the Company through a broker, disclosure should be made of the fact that such broker may charge the investor a brokerage commission for acting as his agent.

##### Redemption [FN40]

Forward pricing is required by Rule 22c-1 under the Investment Company Act of 1940 for redemptions. The following disclosure is suggested:

The Company will redeem shares from stockholders of record, without any charge, at the per share net asset value next to be determined after receipt of certificates endorsed by all parties (or trustees) in whose name the certificates are issued, and in form for transfer, at the office of the Company. If no certificates have been issued to the shareholder, redemption may be accomplished merely by signed written request that the Company do so. Such a request should be sent to the Company's office, should identify the account by number and should be signed by all parties (or trustees) in whose name the account is registered. It is suggested that all redemption requests by mail be sent Certified with return receipt. Payment for shares redeemed will be made by the Company within seven days of receipt of the certificates or the written redemption request. Redemption of shares or payment may be suspended at times (a) when the New York Stock Exchange is closed, (b) when trading on said Exchange is restricted, (c) when an emergency exists as a result of which disposal by the Company of securities owned by it is not reasonably practicable or it is not reasonably practicable for the Company fairly to determine the value of its net assets, or during any other period when the Securities and Exchange Commission, by order, so permits; provided that applicable rules and regulations of the Securities and Exchange Commission shall govern as to whether the conditions prescribed in (b) or (c) exist.

Any formal requirements for redemption, e.g., a signature guarantee, should be specifically disclosed. If a redemption charge is authorized by the Company's charter or by-laws, that fact should be disclosed even if the charge cannot be

(Cite as: 1972 WL 17490, \*18 (S.E.C.))

instituted except by vote of the Board of Directors. If shares of the Company may be redeemed in kind, that fact and the fact that redeeming shareholders may incur brokerage costs in converting the securities received into cash should be disclosed as follows:

The Company may pay the redemption price in whole or in part in portfolio securities if deemed advisable by the Board of Directors, in which case a shareholder would incur brokerage costs if he sold the securities received. If a Company wishes to reserve the right to redeem shareholdings in excess of a specified dollar value, or percentage of the Company's outstanding securities, that fact should be stated. For example:

\*19 The Company intends to exercise the right provided in its [Articles of Incorporation] to redeem at net asset value any portion of the shares owned beneficially or of record by any shareholder in excess of \_\_\_% of the outstanding shares of the Company. In such event [Underwriter] will [will not] refund the sales charges paid on such shares. [This right will not be exercised if a shareholder's percentage of ownership exceeds \_\_\_% of the outstanding shares at any time after his acquisition as a result of redemption by other stockholders or the reinvestment of any dividends or capital gains distributions.]

#### Market for Shares of Closed-end Companies

If the Company is closed-end, the prospectus should disclose whether the Company's shares are listed on a stock exchange, and if not, whether the Company intends to apply for listing. [FN41] If the Company's shares are publicly held, the prospectus should disclose whether the Company's shares have historically traded on the market for an amount equal to or exceeding net asset value, or less than net asset value. There should be presented in columnar form, by quarters for the last three years, the per share net asset value, the per share market prices and the volume of trading. The net asset value and market price as of a recent date should also be stated. If the Company's shares have no history of public trading, the prospectus should disclose that closed-end investment companies' shares frequently trade for amounts less than net asset value.

#### Income Dividends, Capital Gain Distributions and Taxes

If the Company qualifies as a regulated investment company under Subchapter M of the Internal Revenue Code, the tax treatment accorded the Company and its shareholders under Subchapter M should be disclosed.

The following example is suggested:

The Company's policy is to pay dividends from net investment income [indicate frequency] and make distributions of realized capital gains, if any, once a year. Any capital gain distributions will be made during the [last quarter of each fiscal year] first quarter following the end of each fiscal year. [FN42]

For Federal income tax purposes, dividends paid by the Company from interest or dividend income will generally qualify for the shareholder's \$100 dividends received exclusion. [Companies which anticipate substantial interest income should add the following sentence: In those years in which

(Cite as: 1972 WL 17490, \*19 (S.E.C.))

the Company's dividend income is less than 75% of its total gross income, only a percentage of the ordinary income dividends received by stockholders of the Company may be eligible for the dividend received exclusion or deduction. The percentage is based on (and equal to) the proportion that income derived by the Company from dividends of domestic corporations bears to the Company's total gross income. During the Company's last fiscal year, \_\_\_% of its income dividends was eligible for the dividend received exclusion or deduction.] Such dividends, together with distributions of any short-term capital gains, are taxable as ordinary income. Shareholders who are citizens or residents of the United States pay Federal taxes at capital gains rates on long-term realized capital appreciation which is distributed to them, whether or not reinvested in the Company, and regardless of the period of time such shares have been owned by the shareholders. Advice as to the tax status of each year's dividends and distributions will be mailed annually.

\*20 The following disclosures are acceptable:

The policies and objectives of the Fund permit investment in foreign securities up to \_\_\_% of the value of its net assets. When such an investment is made, the Fund may be subject to payment of the Federal Interest Equalization Tax. The Federal Interest Equalization Tax imposes a tax on purchases by 'United States persons' (as that term is defined in the law) from non-'United States persons' of certain foreign securities. If the Fund should purchase securities of foreign issuers on which the Tax has not previously been paid, it will incur such a tax at the present rate of 11.25% on stocks and a maximum rate of 11.25% on debt obligations, which would increase the cost of the securities and reduce the Fund's return on its investment. There is no assurance that the Fund would be able to recover any part of the tax by reselling the security to another 'United States person' at a price reflecting the payment by the Fund of such tax. It is the practice of the Fund to purchase foreign securities under circumstances which do not involve exposure to the Interest Equalization Tax except in cases where, in the opinion of management, the investment merits of the security justify payment of the tax. During the last fiscal year, the Fund incurred Federal Interest Equalization Tax in the aggregate amount of \$\_\_\_\_\_.

#### Pending Legal Proceedings [FN43]

Pending legal proceedings to be disclosed shall include proceedings arising under the Civil Rights Act, any debarment or other sanctions imposed under Executive Order 11246, Title VII of the Civil Rights Act of 1964, and any sanctions imposed for violation of the nondiscrimination rules of any Federal Regulatory agency, wherever such actions are material (See definition of 'material' in Rule 405 of the General Rules and Regulations under the Securities Act of 1933). If such an event has occurred but disclosure thereof is omitted on the ground that it is not material, the Company shall furnish as supplemental information and not as part of its filing, (1) description of the omitted information and (2) a statement of the reasons for its omission.

#### Interests of Counsel in the Company and Its Affiliates

(Cite as: 1972 WL 17490, \*20 (S.E.C.))

(Reserved for future publication)

## Charts

Any charts setting forth performance data should conform to the Commission's Statement of Policy on sales literature. [FN44]

## PART II of FORMS S-4 and S-5

## Undertakings

Undertakings in substantially the following form should be provided by newly registered companies:

1. Registrant undertakes to submit the investment advisory agreement to its shareholders for their approval pursuant to Section 15(a) of the Investment Company Act of 1940, at their first regular or special meeting following the initial offering and the sale and distribution of Registrant's common stock.

2. Registrant undertakes to submit the selection of its independent accountants, who are to certify financial statements to be filed with the Commission, to its shareholders for their ratification at their first annual or special meeting following the initial offering and the sale and distribution of Registrant's common stock.

\*21 3. Registrant undertakes to hold a meeting of shareholders no later than 180 days after the effective date of the registration statement for the purpose of electing directors. [Note: if a special or annual shareholders meeting has not been held prior to the meeting held 180 days after the effective date of the registration statement, then undertakings 1 and 2 above would require that there also be a vote on the advisory agreement and the selection of accountants at the 180 day meeting.]

4. When a Company has raised its initial capital from subscription by promoters, it should secure assurance from subscribers that their purchases were made for investment purposes without any present intention of redeeming or reselling. It should inform the staff in writing whether, apart from agreements filed with the Commission, there are any other agreements or understandings, made in consideration for providing the initial capital, between or among the Company, the underwriter, adviser, promoter or initial stockholders.

5. When a Company proposes to raise its initial capital pursuant to Section 14(a)(3) of the Investment Company Act, it should undertake to file a post-effective amendment with certified financials showing the initial capital received, before accepting subscriptions from any persons in excess of 25.

### Open-end Companies Only:

Registrant undertakes to file a post-effective amendment, using financials which need not be certified, within four to six months from the effective date of its Securities Act registration statement, or if earlier when \$\_\_\_\_\_ [one-half the dollar amount registered] has been raised from the public offering and has been substantially invested in portfolio securities (other than short-term U.S. Government obligations). The financial statements included in such post-effective amendment will be as of and for the time period ended on a date reasonably close or as soon as practicable to

(Cite as: 1972 WL 17490, \*21 (S.E.C.))

the date of the amendment. Registrant also undertakes that it will at the same time notify existing investors of its portfolio holdings.

#### Indemnification of Underwriters

The Commission's policy regarding indemnification of underwriters for Securities Act liability incorporated in the Note to Rule 460 under the Securities Act should be reflected in Part II of the registration statement.

FN1 See Rule 460(e) under the Securities Act of 1933.

FN2 See also Item 19, Securities Act Release No. 4936 (December 9, 1968).

FN3 If certain objective are primary and others secondary, it should be so indicated.

FN4 If the principal officers of the investment adviser have no prior significant experience in giving investment advice, this should be stated on the cover page.

FN5 In the case of a newly organized management investment company which will not redeem its shares for a period not to exceed 90 days (see 'Guidelines for Form N-8B-1', p. 2), the cover page should set forth the schedule required by Item 1 of Form S-4.

FN6 Rule 421 under the Securities Act requires the Table of Contents to appear in the forepart of the prospectus.

FN7 If there is an arrangement for the adviser to reimburse the Company for expenses, this should also be disclosed.

FN8 See Guidelines for Form N-8B-1, Acceptable Responses to Item 5(f), p. 18. For a Company already in existence, see p.6 infra. In this connection, the staff recognizes that stated anticipated or expected portfolio turnover rates may on occasion be exceeded because of unusual circumstances. In the staff's view this would not necessarily make the Company's estimate of portfolio turnover misleading.

FN9 Where a company has short sales, included with sales in (A) of the turnover calculations specified in Item 1.25 of Form N-1R, it should include the monthly average value of short positions in (B) and should state the basis of the calculations.

FN10 If the Company intends to invest in other investment companies, it would disclose whether or not it will invest only in registered companies, whether it will invest in a company if the sales cost exceeds the customary brokerage commission on open market purchases of other securities, and what percentage of its assets may be invested in such companies. (See Section 12(d)(1) of the Investment Company Act). Additional disclosure may be appropriate depending on the circumstances.

FN11 If convertible senior securities are included in the required 25%, only that portion of their value attributable to their fixed income characteristics can be used in calculating the 25% figure.

FNA 'balanced fund', or other fund which invests a substantial portion of its assets in both common stock and debt securities/preferred stock, should describe its portfolio policy with respect to the common stock portion of its portfolio separately from the discussion of its portfolio policy with respect to the other portion of its portfolio. With respect to the portfolio policy of a company seeking only current income, see Guidelines to Form N-8B-1, Item 5(f), acceptable response no. 5, which may be used as a guide for prospectus disclosure also.

FN12 In this connection, see Rule 144 under the Securities Act of 1933 (Securities Act Release No. 5223 dated January 11, 1972).

FN13 Portfolio turnover rates in excess of 200% may be stated within ranges of 100%, as appropriate.

FN14 In this connection, see Restricted Securities, p. 12 infra.

FN15 See Guidelines to Form N-8B-1, Item 4(b), p. 5.

FN16 Section 5(b) of the Investment Company Act of 1940. (See also Guidelines for Form N-8B-1, p. 2)

FN17 See Guidelines for Form N-8B-1, p. 9.

FN18 If the Company intends generally to have invested more than 25% in a specified industry or group of industries, the intended percentage should be disclosed.

FN19 See, Guidelines for Form N-8B-1, pp. 8-9 and Investment Company Act Release Nos. 5847 (October 21, 1969) 6026 (April 13, 1970) and 6121 (July 20, 1970). See also Rule 144 under the Securities Act of 1933 (Securities Act Release No. 5223, dated January 11, 1972).

FN20 See Investment Company Act Release No. 167 (July 24, 1941); Guidelines for Form N-8B-1, p. 3. As to certain matters, adoption of a definite policy and statements of these policies are required. See Section 8(b) of the Investment Company Act and Items 4 and 5 of Form N-8B-1. Section 8(b) and 13(a) of the Investment Company Act set forth matters which may not be changed without shareholder approval and further provide that other matters may be so designated that they may not be changed without shareholder approval.

FN21 See Section 5(b)(1) of the Act if the Company is classified as a diversified management company.

FN22 See Section 12(d)(1) of the Act.

FN23 Not more than 10% if an open-end company.

FN24 Not more than 10% if an open-end company including other illiquid assets (See P. 8 of N-8B-1 Guidelines).

FN25 See Form S-1, Item 16 for the definition of 'executive officers'.

FN26 For this purpose, family relationship means any relationship, by blood, marriage or adoption, not more remote than first cousin. As such, a father-in-law: son-in-law relationship, for example, should be disclosed. (This may be broader than the definition of 'member of the immediate family' contained in Section 2(a)(19) of the Investment Company Act.

FN27 See Section 205 of the Investment Advisers Act of 1940, as amended. See also Investment Company Act Release No. 7113, dated April 6, 1972.

FN28 See Guidelines for Form N-8B-1, Item 22, p. 23. See also Section 2(a)(3) of the Investment Company Act of 1940.

FN29 See Section 2(a)(9) of the Investment Company Act of 1940.

FN30 In this connection, see Securities Exchange Act Release Nos. 7684 (Imperial Financial Services; August 26, 1965), 8128 (Delaware Management Co. et al.; July 19, 1967), 8542 (Consumer-Investor Planning Corp. et al.; February 20, 1969), 8557 (Hubshman Management Corp. et al.; March 20, 1969), 8702 (Dishy, Easton & Co. et al.; September 23, 1969), 8874 (Hertz, Warner & Co. et al.; April 29, 1970), 8980 (Winfield & Co., Inc. et al.; September 16, 1970), and 9028 (Provident Management Corp. et al.; December 1, 1970); Investment Company Act Release No. 6700 (First Multifund of America, Inc. et al.); and Securities Exchange Act Release No. 9478 (Winfield & Co., Inc. et al.; February 9, 1972).

FN31 See Guidelines for Form N-8B-1, pp. 24-25.

FN32 If the Company intends to have more frequent price computations, it should contact the staff for appropriate disclosures.

FN33 See Investment Company Act Release No. 5569 (December 27, 1968).

FN34 Letters of Intent should be consistent with the NASD's Notice to Underwriters and Distributors dated January 15, 1959, and Rule 22d-1 under the Investment Company Act of 1940.

FN35 See Rule 22d-1(a)(3) under the Investment Company Act of 1940.

FN36 The latter statement should appear in the text of the letter itself in bold print.

FN37 Copies of any forms of investment programs in use should be filed as

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exhibits to Form S-5.

FN38 See discussion of Item 30 in the Guidelines for Form N-8B-1, pp. 24-26.

FN39 See Investment Company Act Release Nos. 5519 (October 16, 1968) and 5569 (December 27, 1968).

FN40 In connection with redemptions, see Rule 18 f-1 under the Investment Company Act of 1940.

FN41 This latter disclosure should generally be made only if there is reasonable assurance that the Company's securities will be acceptable to a securities exchange for listing.

FN42 See Rule 19b-1 under the Investment Company Act, as amended.

FN43 See Securities Act of 1933 Release No. 5170, dated July 19, 1971.

FN44 Investment Company Act Release No. 2621 (October 31, 1957).

#### APPENDIX A

Suggested Disclosure for an Open-end Management Investment Company Which Does Not Qualify Under Subchapter M of the Internal Revenue Code

\*22 The Company did not meet the requirements under the Internal Revenue Code to qualify as a regulated investment company in (year) because \_\_\_\_\_. Accordingly, it will be taxed as an ordinary corporation for such year. Therefore, in determining net asset value in the accompanying financial statements, appropriate provision is made for Federal income taxes which would be payable if the unrealized appreciation of investments were realized. This will continue to be done until it appears to the Board of Directors that the Company will be in a position to qualify as a regulated investment company. In the event that the Company does qualify as a regulated investment company, and meets certain other tests, net assets of the Company would be increased by an amount equal to the provision for such taxes previously made. [The statement should also disclose the Company's future intention to qualify under the Code.]

#### APPENDIX B

Brokerage (Suggested to the extent applicable)

Decisions to buy and sell securities for the Company and assignment of its portfolio business and negotiation of its commission rates, where applicable, are made pursuant to recommendations by \_\_\_\_\_ Corporation, the Company's investment adviser [the executive committee of the Company, all members of which are officers and directors of the investment adviser]. It is the Company's policy to obtain the best security price available, and, in doing so, it will assign portfolio executions and negotiate commission rates in accordance with the reliability and quality of a broker's services and their

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value and expected contribution to the performance of the Company. Where commissions paid reflect services furnished to the Company in addition to execution, the Company will stand ready to demonstrate that such services were bona fide and rendered for the benefit of the Company. [Decisions to buy and sell securities for the Company and assignment of its portfolio business and negotiation of its commission rates, where applicable, are made by the investment adviser. It is the adviser's policy to obtain the best security price available, and, in doing so, it will assign portfolio executions and negotiate commission rates in accordance with the reliability and quality of a broker's services and their value and expected contribution to the performance of the Company. Where commissions paid reflect services furnished in addition to execution, the adviser will stand ready to demonstrate that such services were bona fide and rendered for the benefit of the Company.]

Messrs. \_\_\_\_\_ and \_\_\_\_\_ control [are officers or directors of] the adviser or principal underwriter and are also partners (officers or directors) of \_\_\_\_\_ & Company, a brokerage firm.

A portion [the greater portion] of the Company's portfolio transactions is placed with \_\_\_\_\_ & Company [whose partners (officers or directors) are affiliated with the Company's investment adviser or principal underwriter]. With respect to any transactions to which competitively determined rates are applicable, the execution will not be placed with \_\_\_\_\_ & Company at a commission rate less favorable than its contemporaneous charges for its other most favored, but unaffiliated, customers and, in addition, a good faith judgment will be made that \_\_\_\_\_ & Company is qualified to obtain the best price on the particular transaction and that the commission in respect to such transaction is at least as favorable to the Company as that charged by other qualified brokers. Further, although there is no duty or obligation to seek competitive bidding for the most favorable negotiated commission rate applicable to such transaction, consideration will be given to such 'posted' commission rates, if any, as may be applicable to the transaction, as well as any other information available at the time as to the level of commissions known to be charged on comparable transactions by other qualified brokerage firms (and it will be able to demonstrate that it has considered such factors). Since the obligation already exists to provide management, which would include elements of research and related skills, brokerage commissions paid to \_\_\_\_\_ & Company will not reflect anything other than payment for the execution services performed on the particular transaction.

\*23 [The Company and \_\_\_\_\_ & Company have made an arrangement whereby \_\_\_\_\_% of the net profit from brokerage commissions earned on Company transactions placed with \_\_\_\_\_ & Company is returned to the Company by \_\_\_\_\_ (describe the mechanism through which the Company benefits, e.g. a reduction in the advisory fee).]

When the Company purchases or sell a security 'over-the-counter', the transaction takes place directly with a principal market-maker, without the use of a broker, except in those circumstances where in the opinion of the Company better prices and executions will be achieved through the use of a broker.

Figures pertaining to the Company's brokerage for the last three fiscal years are presented in the following table:

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| Annual<br>Portfolio<br>Turnover<br>Rate | Total<br>Brokerage<br>Commissions<br>Paid | Brokerage<br>Commissions<br>Paid to _____<br>& Company the<br>underwriter or<br>adviser, or<br>affiliate<br>thereof | Brokerage Paid to<br>Broker-Dealers<br>not Affiliated<br>with Adviser or<br>Underwriter for |
|-----------------------------------------|-------------------------------------------|---------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|
|-----------------------------------------|-------------------------------------------|---------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|

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Sales [FN\*]  
Services [FN\*\*]  
Other [FN\*\*\*]

1970  
1971  
1972

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FN1\* If portfolio transactions are allocated for sales of the Company's shares, this should be disclosed in the text of the prospectus which discusses the practices employed in placing portfolio transactions. In this connection, attention is directed to the Statement of the Securities and Exchange Commission on the Future Structure of the Securities Markets of February 2, 1972, in which the Commission concluded that the practice of placing an investment company's portfolio executions with broker-dealers in consideration of their sales of that investment company shares should be eliminated.

FN1\*\* Service includes research and statistical information furnished to the investment adviser.

FN\*\*\* Explain. Include and explain brokerage paid to unaffiliated broker-dealers in which the principal underwriter of the Company, an affiliated person of the Company, or its adviser or principal underwriter participates.