SEWARD & KISSEL LLP

May 3, 2004

Memorandum to Our Mutual Fund Clients and Friends

Disclosure of Market Timing Policies and Selective Disclosure Policies

Introduction

The Securities and Exchange Commission (SEC) recently adopted amendments to Form N-1A under the Securities Act of 1933 (1933 Act) and the Investment Company Act of 1940 (1940 Act)[1] that require open-end management investment companies (funds) to disclose:

- in their prospectuses, the risks to shareholders of frequent purchases and redemptions of fund shares, and their policies and procedures with respect to frequent purchases and redemptions (Market Timing Policies);
- in their prospectuses, the circumstances under which they will use fair value pricing and the effects of using fair value pricing; and
- in their statements of additional information (SAIs), their policies and procedures with respect to the disclosure of their portfolio holdings (Selective Disclosure Policies), and any ongoing arrangements to make available information about their portfolio securities.

Compliance Dates

- Effective Date: **May 28, 2004**
- Compliance Date: **December 5, 2004**
  - Applies to all initial registration statements and post-effective amendments filed on or after December 5, 2004.
  - The SEC stated that post-effective amendments will need to be filed pursuant to Rule 485(a) under the 1933 Act because, according to the SEC, the disclosure requirements typically will involve a number of material changes that would not fall within the scope of Rule 485(b) under the 1933 Act.

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[1] *Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings*, SEC Rel. Nos. 33-8408 and IC-26418 (April 19, 2004)(Adopting Release). The Adopting Release may be accessed at www.sec.gov/rules/final/33-8408.htm.

New Disclosure Requirements

1. Market Timing Disclosure

The amendments require a fund to describe in its prospectus the risks, if any, that frequent purchases and redemptions of fund shares may present to shareholders of the fund. The description of these risks must be tailored to the fund's investment strategies and may include, for example, dilution in the value of fund shares held by long-term shareholders, interference with the efficient management of the fund's portfolio or increased brokerage costs.

The amendments also require a fund to disclose in its prospectus whether the fund's board of directors has adopted Market Timing Policies.[2] If the fund has adopted Market Timing Policies, the fund's prospectus must describe the policies in detail. This description must include a statement whether or not the fund discourages (or accommodates) frequent purchases and redemptions of fund shares by fund shareholders. If the fund has adopted Market Timing Policies to *deter* frequent purchases and redemptions of fund shares, the description must include the restrictions imposed by the fund to prevent or minimize the frequent purchases and redemptions of fund shares, including:

- any volume or number restrictions on purchases, redemptions and exchanges;
- any redemption or exchange fees;
- any other fees or charges that are imposed on shareholders engaged in frequent purchases, redemptions or exchanges of fund shares;
- any minimum holding period;
- any restrictions imposed on exchange and purchase requests submitted by overnight delivery, electronically, or email; and
- any right of the fund to reject, limit, delay, or impose other conditions on exchanges or purchases or to close or otherwise limit accounts based on frequent purchases, redemptions and exchanges of fund shares.

The SEC agreed with those commenters who objected to the proposed requirement to describe fund policies and procedures for detecting frequent purchases and redemptions of fund shares

[2] The SEC considers Market Timing Policies to be part of the compliance policies and procedures required by new Rule 38a-1 under the 1940 Act to be adopted and implemented by funds and approved by the board of directors. If a fund's board of directors has not adopted Market Timing Policies, the fund's prospectus must disclose the basis for the board's view that it is appropriate for the fund not to have Market Timing Policies.

and did not adopt this proposal. Commenters argued that the disclosure could be harmful to a fund because it might provide a road map on how to avoid detection. In addition, while a fund must describe its policies and procedures with some specificity, the SEC determined that funds need the flexibility to address abuses as they arise. Therefore a fund can reserve the right to reject a purchase or exchange request for any reason, if this policy is disclosed in the prospectus.

The description of the restrictions imposed by a fund to prevent or minimize the frequent purchases and redemptions of fund shares must also note whether the restrictions are applied uniformly or whether the fund permits exceptions. In addition, the fund must describe whether the restrictions apply to trades that occur through omnibus accounts at intermediaries, such as investment advisers, broker dealers, transfer agents, third party administrators, and insurance companies.[3]

Finally, the amendments require a fund to describe in its SAI any arrangements with any person that permit frequent purchases and redemptions of fund shares.[4] This description must include the identity of the persons or group of persons permitted to engage in frequent purchases and redemptions of fund shares and any compensation or other consideration received by the fund, its adviser or other party pursuant to the arrangements.

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[3] This requirement may be one of the most difficult to implement. A fund could, for example, try to impose on intermediaries restrictions similar to its own policies and procedures or otherwise require an undertaking from the intermediaries to monitor for market timing. It would be cumbersome for intermediaries that sell shares for various funds to comply with different policies. There are likely to be significant liability and cost issues associated with an intermediary's role in monitoring for market timing. (In its recent rule proposals discussing mandatory redemption fees, the SEC proposed three methods that a fund could use to collect redemption fees in connection with "omnibus accounts." The rule proposals may be accessed at www.sec.gov/rules/proposed/ic-26375a.htm.)

[4] The fund's prospectus must cross-reference the description of these arrangements in the fund's SAI.

2. *Fair Value Pricing Disclosure*

The SEC adopted amendments to clarify that funds, other than money market funds, are required to disclose in their prospectuses the circumstances under which the funds will use fair value pricing and the effects of using fair value pricing. As a reminder to funds, the SEC noted that a fund is required to use fair value prices any time that market quotations for portfolio securities are not readily available (or not reliable).

The fair value pricing disclosure must be specific to the circumstances of the fund. For example, a fund that invests in large capitalization, exchange-traded securities may disclose that there would be limited circumstances under which it would fair value its securities. A fund that invests primarily in securities traded overseas would be expected to have fuller disclosure. Based on concerns expressed by commenters that specific disclosure could assist arbitrageurs or restrict a fund's flexibility, the amendments require only general disclosure of the circumstances under which a fund may use fair value pricing and need not include a description of the specific methodologies and formulas that the fund uses to determine fair value prices.

3. *Selective Disclosure Policies*

The amendments require a fund to describe in its SAI its Selective Disclosure Policies.[5] The SEC emphasized that disclosure about a fund's portfolio securities must be consistent with the anti-fraud provisions of the federal securities laws and the fund's or adviser's fiduciary duties. Disclosure of nonpublic portfolio holdings is permissible according to the SEC if there is a legitimate business purpose and the recipient is subject to a duty of confidentiality. The description of the fund's Selective Disclosure Policies must include:

(i) how the Selective Disclosure Policies apply to different categories of persons (e.g., individual investors, institutional investors, intermediaries, third-party service providers, rating organizations, and affiliated persons of the fund);

(ii) any conditions or restrictions placed on the use of information about portfolio securities that is disclosed (e.g., requirements that the information be kept confidential or prohibitions on trading based on the information);

(iii) the frequency with which information about portfolio securities is disclosed;

(iv) any policies with respect to the receipt of compensation or other consideration by the fund, its investment adviser or any other party in connection with the disclosure of information about portfolio securities;

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[5] The fund's prospectus must note that a description of the fund's Selective Disclosure Policies is included in the fund's SAI and, if applicable, on its website.

(v) the individuals or categories of individuals who may authorize disclosure of the fund's portfolio securities;

(vi) the procedures that the fund uses to ensure that disclosure of information about portfolio securities is in the best interests of fund shareholders (e.g., procedures that address conflicts); and

(vii) the manner in which the board exercises oversight of disclosure of the fund's portfolio securities.

The amendments also require a fund to describe in its SAI any ongoing arrangements to make available information about the fund's portfolio securities to any person.[6] This description must include the identity of the persons who receive information pursuant to the arrangements and any compensation received by the fund, its investment adviser, or any other person in connection with the arrangements. The description must also include the information described in (ii), (iii) and (v) above.

The SEC stated that compensation received by the fund and others includes any agreement to maintain assets in the fund or in other investment companies or accounts managed by the fund's investment adviser. However, the SEC also stated that it was not aware of any situation where receipt of consideration by a fund's adviser in return for information about portfolio holdings would have a legitimate business purpose.

The SEC adopted two exceptions to the requirement that a fund describe any ongoing arrangements. A fund is not required to disclose an ongoing arrangement if:

- the portfolio holdings information is disclosed at the same time in a "required" filing with the SEC, i.e., a quarterly report on Form N-CSR or Form N-Q (a voluntary filing will not satisfy this requirement); or

- it discloses the same information provided in connection with an ongoing arrangement on its website no later than the day before it makes the information available and discloses in its prospectus that information provided in connection with ongoing arrangements will be available on its website.

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[6] The SEC did not agree with commenters who objected to this requirement being applied to ongoing arrangements with different types of recipients such as rating and ranking organizations and third-party service providers (e.g., providers of auditing, custody, proxy voting and other services). In determining not to modify the requirement, the SEC stated that it believed that investors had a significant interest in the number and type of parties with whom a fund shares portfolio holdings information.

If you have any questions or need more information, please contact us at (202) 737-8833.

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