

hub attachment flange in accordance with the Accomplishment Instructions, paragraphs 3.C.(1) through 3.C.(5), of the ASB, except contacting Sikorsky Aircraft Corporation is not required by this AD.

(d) If a crack is found as a result of any of the inspections, remove the shaft and replace it with an airworthy shaft that has been inspected in accordance with paragraph (a) of this AD before further flight.

(e) Before further flight, shafts, P/N 76351-09030-series, serial numbers with a prefix of "B" and numbers 015-00700 through 00706, must be removed from service.

(f) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Boston Aircraft Certification Office, FAA. Operators shall submit their requests through an FAA Principal Maintenance Inspector, who may concur or comment and then send it to the Manager, Boston Aircraft Certification Office.

Note 3: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Boston Aircraft Certification Office.

(g) Special flight permits may be issued in accordance with sections 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the helicopter to a location where the requirements of this AD can be accomplished.

(h) The fluorescent penetrant and visual inspections shall be done in accordance with the Accomplishment Instructions, paragraphs 3.A.(1) through 3.A.(8), 3.B.(1) through 3.B.(5), and 3.C.(1) through 3.C.(5), contained in Sikorsky Aircraft Corporation Alert Service Bulletin No. 76-66-31 (318B), Revision B, dated November 7, 2000. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from Sikorsky Aircraft Corporation, Attn: Manager, Commercial Tech Support, 6900 Main Street, Stratford, Connecticut 06614, phone (203) 386-7860, fax (203) 386-4703. Copies may be inspected at the FAA, Office of the Regional Counsel, Southwest Region, 2601 Meacham Blvd., Room 663, Fort Worth, Texas; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(i) This amendment becomes effective on February 16, 2001, to all persons except those persons to whom it was made immediately effective by Emergency AD 2000-23-52, issued November 9, 2000, which contained the requirements of this amendment.

Issued in Fort Worth, Texas, on January 19, 2001.

Henry A. Armstrong,

Manager, Rotorcraft Directorate, Aircraft Certification Service.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC-24828; File No. S7-11-97]

RIN 3235-AH11

Investment Company Names

AGENCY: Securities and Exchange Commission, (SEC).

ACTION: Final rule; request for comments on Paperwork Reduction Act burden estimate.

SUMMARY: The Securities and Exchange Commission is adopting a new rule under the Investment Company Act of 1940 to address certain broad categories of investment company names that are likely to mislead investors about an investment company's investments and risks. The rule requires a registered investment company with a name suggesting that the company focuses on a particular type of investment (e.g., an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80% of its assets in the type of investment suggested by its name. The rule also would address names suggesting that an investment company focuses its investments in a particular country or geographic region, names indicating that a company's distributions are exempt from income tax, and names suggesting that a company or its shares are guaranteed or approved by the United States government.

DATES: *Effective Date:* March 31, 2001.

Compliance Date: Registered investment companies must comply with § 270.35d-1 by July 31, 2002.

FOR FURTHER INFORMATION CONTACT: Paul G. Cellupica, Senior Special Counsel, or John L. Sullivan, Senior Counsel, Office of Disclosure Regulation, at (202) 942-0721, or, regarding accounting issues, Kenneth B. Robins, Office of the Chief Accountant, at (202) 942-0590, in the Division of Investment Management, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549-0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting new rule 35d-1 (17 CFR 270.35d-1) under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*) ("Investment Company Act").¹

¹ Unless otherwise noted, all references to "rule 35d-1" or any paragraph of the rule will be to 17 CFR 270.35d-1, as adopted by this release.

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I. Introduction

Section 35(d) of the Investment Company Act, as amended by the National Securities Markets Improvement Act of 1996, prohibits a registered investment company from using a name that the Commission finds by rule to be materially deceptive or misleading.² Before section 35(d) was amended, the Commission was required to declare by order that a particular name was misleading and, if necessary, obtain a federal court order prohibiting further use of the name. In amending section 35(d), Congress reaffirmed its concern that investors may focus on an investment company's name to determine the company's investments and risks, and recognized that investor protection would be improved by giving the Commission rulemaking authority to address potentially misleading investment company names.³

Today the Commission is adopting new rule 35d-1 to address certain investment company names that are likely to mislead an investor about a company's investment emphasis. The Commission believes that investors should not rely on an investment company's name as the sole source of information about a company's investments and risks.⁴ An investment

² 15 U.S.C. 80a-34(d); Pub. L. No. 104-290, § 208, 110 Stat. 3416, 3432 (1996).

³ See S. Rep. No. 293, 104th Cong., 2d Sess. 8-9 (1996).

⁴ See generally "Investor Protection: Tips from an SEC Insider," Remarks by Arthur Levitt, Chairman, SEC, before the Investors' Town Meeting at the Houstonian Hotel, Washington, D.C. (Apr. 12, 1995) ("An informed investor looks beyond the packaging of a fund, and also sees what's inside."); "The SEC and the Mutual Fund Industry: An Enlightened Partnership," Remarks by Arthur Levitt, Chairman,

Continued

company's name, like any other single piece of information about an investment, cannot tell the whole story about the investment company.⁵ As Congress has recognized, however, the name of an investment company may communicate a great deal to an investor.

The rule applies to all registered investment companies, including mutual funds, closed-end investment companies, and unit investment trusts ("UITs"), and requires an investment company with a name that suggests a particular investment emphasis to invest in a manner consistent with its name. The rule, for example, would require an investment company with a name that suggests that the company focuses on a particular type of security (e.g., an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80% of its assets in the type of security indicated by its name. An investment company seeking maximum flexibility with respect to its investments would be free to select a name that does not connote a particular investment emphasis.

Under current positions of the Division of Investment Management ("Division"), an investment company with a name suggesting that the company focuses on a particular type of investment generally is required to invest only 65% of its assets in the type of investment suggested by its name.⁶ In 1997, we proposed rule 35d-1 to replace the staff's positions with a rule codifying the Commission's views and to increase the 65% threshold to 80%.⁷

Today we are adopting rule 35d-1 and the 80% investment requirement to guard against the use of misleading investment company names and to

SEC, before the General Membership Meeting of the Investment Company Institute ("ICI") at the Washington Hilton Hotel, Washington, D.C. (May 19, 1995) ("some fund names can leave investors with the wrong impression about (the fund's) safety.").

⁵ See Herman, *The Confusion is Mutual: Buyers Beware When Funds Drift From Original Intent*, New York Daily News, Oct. 24, 1999, at 5; Millman, *First Pop The Hood: A Fund's Name May Tell You Nothing About How It Acts*, U.S. News & World Rep., Feb. 3, 1997, at 70.

⁶ The Division continues to take this position in reviewing investment company disclosure, although the Division's formal guidance in this area was rescinded as part of the general overhaul of Form N-1A in 1998. See Former Guide 1 to Form N-1A, Investment Company Act Release No. 13436 (Aug. 12, 1983) (48 FR 37928 (Aug. 22, 1983)) ("N-1A Guidelines Release") (rescinded by Investment Company Act Release No. 23064 (Mar. 13, 1998) (63 FR 13916 (March 23, 1998) at 13940 n.214) ("N-1A Amendments")).

⁷ Investment Company Act Release No. 22530 (Feb. 27, 1997) (62 FR 10955 (Mar. 10, 1997), correction 62 FR 24161 (May 2, 1997)) ("Proposing Release").

implement Congress's intent in amending section 35(d). Requiring an investment company to invest at least 80% of its assets in the type of investment suggested by its name will provide an investor greater assurance that the company's investments will be consistent with its name. The need for investment companies to invest in a manner consistent with their names is particularly important to retirement plan and other investors who place great emphasis on allocating their investment company holdings in well-defined types of investments, such as stocks, bonds, and money market instruments.⁸ As of the end of 1999, an estimated 82.8 million individuals in 48.4 million U.S. households held \$ 5.5 trillion in mutual fund assets.⁹ These investors face an increasingly diverse universe of investment companies when choosing a company suitable for their investment needs.¹⁰ The 80% investment requirement will help reduce confusion when an investor selects an investment company for specific investment needs and asset allocation goals.

II. Discussion

The Commission received 28 letters commenting on proposed rule 35d-1.¹¹ Most of the commenters supported the proposal, asserting that an investment company with a name indicating that it will invest in a particular security or industry should follow an overall investment strategy consistent with its name. Many commenters recommended revisions to the proposed rule. In addition, the Commission has received five rulemaking petitions urging adoption of the proposed rule.¹² The

⁸ See, e.g., Vickers, *A Price of Success: An Unbalanced Portfolio*, N.Y. Times, Jan. 12, 1997, at F6; Glassman, *With New Year, Stock Up a 401(k) for the Long Term*, Wash. Post, Jan. 1, 1997, at C13. The amount of retirement assets invested in mutual funds totaled \$2.5 trillion at the end of 1999, representing an increase of \$553 billion, or 29%, over the 1998 year-end total of \$1.9 trillion. ICI, *Mutual Fund Fact Book 49-50* (2000). This \$2.5 trillion in mutual fund retirement plan assets represented 36% of all mutual fund assets at year-end 1999. *Id.* at 49. The ICI estimates that, in 1998, 77% of fund shareholders invested primarily for retirement purposes. ICI, *1998 Profile of Mutual Fund Shareholders* (1999).

⁹ *Id.* at 41.

¹⁰ According to Division estimates based on data from the ICI and Lipper Analytical Services, between September 1985 and July 2000, investment company assets increased from \$591 billion to \$7.4 trillion, and the number of investment companies (including the individual series of registered mutual funds) increased from 9,200 to 32,403.

¹¹ A summary of the comments prepared by the staff of the Division of Investment Management is available in the public comment file for S7-11-97.

¹² Rulemaking Petition by the Financial Planning Association (June 28, 2000); Rulemaking Petition by Fund Democracy, LLC (June 28, 2000); Rulemaking Petition by Consumer Federation of America, *et al.*

Commission is adopting rule 35d-1 with the modifications described below that address commenters' concerns.

A. General

1. Names Indicating an Investment Emphasis in Certain Investments or Industries

We are adopting, substantially as proposed, the requirement that an investment company with a name that suggests that the company focuses its investments in a particular type of investment (e.g., the ABC Stock Fund or XYZ Bond Fund) or in investments in a particular industry (e.g., the ABC Utilities Fund or the XYZ Health Care Fund) invest at least 80% of its assets in the type of investment suggested by the name.¹³ The 80% requirement will allow an investment company to maintain up to 20% of its assets in other investments. In the case of mutual funds, these assets, for example, could include cash and cash equivalents that could be used to meet redemption requests. While many commenters supported setting the investment

(Aug. 8, 2000); Rulemaking Petition by National Association of Investors Corporation (Oct. 9, 2000); Rulemaking Petition by the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") (Dec. 20, 2000). The rulemaking petitions are available for inspection and copying in File No. 4-439 in the Commission's Public Reference Room.

¹³ Rule 35d-1(a)(2). A mutual fund that uses a name suggesting that it is a money market fund would continue to be subject to the maturity, quality, and diversification requirements of rule 2a-7 under the Investment Company Act, and its name would be deemed misleading under section 35(d) of the Investment Company Act if it did not comply with these requirements. (17 CFR 270.2a-7(b) & (c)).

The language of the proposal would have required an investment company with a name that suggests that the company focuses its investments in a particular type of security to invest at least 80% of its assets in the indicated securities. Proposed rule 35d-1(a)(2). We have modified this language to require that an investment company with a name that suggests that the company focuses its investments in a particular type of investment invest at least 80% of its assets in the indicated investments. Rule 35d-1(a)(2). In appropriate circumstances, this would permit an investment company to include a synthetic instrument in the 80% basket if it has economic characteristics similar to the securities included in that basket.

We note that, for purposes of applying the 80% investment requirement, an investment company may "look through" a repurchase agreement to the collateral underlying the agreement (typically, government securities), and apply the repurchase agreement toward the 80% investment requirement based on the type of securities comprising its collateral. Cf. *Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities*, Investment Company Act Release No. 24050 (Sept. 23, 1999) ((64 FR 52476 (Sept. 29, 1999)) (proposing rule that would codify prior staff positions permitting investment companies to "look through" counterparties to certain repurchase agreements and treat securities comprising the collateral as investments for certain purposes under the Act).

requirement at 80%, some commenters opposed the level of the investment requirement, arguing that it would unduly restrict legitimate portfolio strategies and result in decreased diversification and increased risk and deter investment companies from using descriptive names.

The Commission disagrees with these commenters. Investment companies are not required to adopt names that describe their investment policies. Those investment companies that do not adopt such a name are not subject to the 80% requirement. We believe that if an investment company elects to use a name that suggests its investment policy, it is important that the level of required investment be high enough that the name will accurately reflect the company's investment policy. Moreover, we believe that certain modifications to the proposed rule (*e.g.*, allowing an investment company to have a policy that it will notify its shareholders 60 days prior to a change in its investment policy, rather than requiring that the investment policy be fundamental) will maintain the rule's flexibility and prevent the percentage investment requirement from being too restrictive.¹⁴

One commenter recommended that the Commission adopt an additional requirement that the remaining 20% of an investment company's assets be invested in securities that are substantially equivalent to its primary investments. We are not adopting the commenter's recommendations because we do not believe that an investment company's name, standing alone, can be expected to fully inform investors about all of the investments of the company.¹⁵

¹⁴ See *infra* note and accompanying text (discussing notice alternative).

¹⁵ See, *e.g.*, Item 2(b) of Form N-1A (requiring a mutual fund's prospectus to identify its principal investment strategies, including the types of securities in which the fund invests principally). We note that an investment company that is covered by the rule should disclose its policy to invest its assets in accordance with the 80% investment requirement suggested by its name as one of its principal investment strategies in the prospectus. We would not object if mutual funds that change an existing investment policy from 65% to 80% to comply with rule 35d-1 file an amendment to a registration statement disclosing the 80% investment policy pursuant to rule 485(b) under the Securities Act of 1933, provided that the post-effective amendment otherwise meets the conditions for immediate effectiveness under the rule. 17 CFR 230.485(b). This also would apply to closed-end interval funds filing post-effective amendments pursuant to rule 486(b) under the Securities Act. 17 CFR 230.486(b). In other circumstances, mutual funds must determine whether an amendment to a registration statement that discloses changes in investment policy should be filed pursuant to rule 485(a) or may be filed pursuant to rule 485(b) under the Securities Act. 17 CFR 230.485(a) and 230.485(b). Likewise, closed-

Further, we are concerned that restricting the investment of the remaining 20% of an investment company's assets would unnecessarily reduce the manager's flexibility without providing significant additional benefit to shareholders.

We note, however, that the 80% investment requirement is not intended to create a safe harbor for investment company names. A name may be materially deceptive and misleading even if the investment company meets the 80% requirement. Index funds, for example, generally would be expected to invest more than 80% of their assets in investments connoted by the applicable index. Similarly, a UIT with a name indicating that its distributions are tax-exempt may have a misleading name even if it invests 80% of its assets in tax-exempt investments.¹⁶

We are modifying the requirement in the proposal that the 80% investment requirement be a fundamental policy of the investment company, *i.e.*, a policy that may not be changed without shareholder approval.¹⁷ Most commenters opposed the fundamental policy requirement, arguing that it would be too burdensome for investment companies, constraining their ability to respond efficiently to market events or to new regulatory requirements, and discouraging them from using descriptive names.

The Commission is persuaded by the commenters' arguments, and the rule, as adopted, generally will provide investment companies with an alternative to the fundamental policy requirement. In lieu of adopting the 80% investment requirement as a fundamental policy, an investment company may adopt a policy that it will provide notice to shareholders at least 60 days prior to any change to its 80% investment policy.¹⁸ This notice

end interval funds filing post-effective amendments in other circumstances must determine whether they must file pursuant to rule 486(a) or may file pursuant to rule 486(b) of the Securities Act. 17 CFR 230.486(a) and 230.486(b).

¹⁶ The Division currently applies a 95% investment requirement to tax-exempt UITs. *Cf.* Guide 1 of Proposed Form N-7, Investment Company Act Release No. 15612 (Mar. 9, 1987) (52 FR 8268 (Mar. 17, 1987) at 8295) (proposing release for Form N-7, proposed form for registration of UITs) ("The staff takes the position that a (tax-exempt) trust must have at least 95% of its net assets invested in tax-exempt securities in order to have substantially all of its net assets so invested.").

¹⁷ See section 8(b)(3) of the Investment Company Act, 15 U.S.C. 80a-8(b)(3) (regarding policies deemed fundamental by an investment company), and section 13(a)(3) of the Investment Company Act, 15 U.S.C. 80a-13(a)(3) (requiring shareholder approval to change a policy deemed fundamental under section 8(b)(3)).

¹⁸ Rule 35d-1(a)(2)(ii) and (a)(3)(iii). The notice must be in plain English in a separate written

alternative will ensure that when shareholders purchase shares in an investment company based on its name, and with the expectation that it will follow the investment policy suggested by that name, they will have sufficient time to decide whether to redeem their shares in the event that the investment company decides to pursue a different investment policy.¹⁹ Any investment company that changes its 80% investment policy would, of course, also be required to change its name, as necessary to comply with the requirements of rule 35d-1 in light of its new investment policy.

We are, however, adopting, as proposed, the provision that the 80% investment requirement be adopted as a fundamental policy for tax-exempt investment companies. This requirement is consistent with the long-standing Division position that a tax-exempt fund may not change its tax-exempt status without shareholder approval.²⁰ The Commission believes that the 80% investment requirement should continue to be a fundamental policy for a tax-exempt investment company because of the critical importance of the tax-exempt status to its investors.

document. See rule 35d-1(c)(1). Securities Act rule 421(d)(2) (17 CFR 230.421(d)(2)) lists the following plain English principles: (i) Short sentences; (ii) definite, concrete, everyday words; (iii) active voice; (iv) tabular presentation or bullet lists for complex material, whenever possible; (v) no legal jargon or highly technical terms; and (vi) no multiple negatives. The notice, as well as the envelope containing the notice, also must contain a prominent statement such as "Important Notice Regarding Change in Investment Policy." As an alternative to this requirement, if the notice is sent in a separate mailing, the prominent statement may appear either on the envelope or on the notice itself. See rule 35d-1(c)(2) and (3).

¹⁹ We believe that an investment company should update its prospectus to reflect an upcoming change in its 80% investment policy by means of an amendment to its registration statement or a prospectus supplement or "sticker" no later than the time that it provides notice to its current shareholders of the change in policy. In addition, after an investment company and/or its investment adviser have taken steps that will result in a change in the company's 80% investment policy but before the time when notice to current shareholders is required by rule 35d-1, it may be materially misleading for an investment company to sell its shares to investors without prospectus disclosure of the upcoming change. The time at which prospectus disclosure is required depends on all the facts and circumstances, including the degree of certainty that the change will occur and the steps that have been taken to effect the change.

²⁰ See Certain Matters Concerning Investment Companies Investing in Tax-Exempt Securities, Investment Company Act Release No. 9785 (May 31, 1977) (42 FR 29130 (June 7, 1977)); Letter to Matthew P. Fink, Senior Vice President and General Counsel, ICI, from Mary Joan Hoene, Deputy Director, Division of Investment Management, SEC (pub. avail. Dec. 3, 1987) ("Fink Letter").

2. Names Indicating an Investment Emphasis in Certain Countries or Geographic Regions

We are modifying our proposal to require investment companies with names that suggest that they focus their investments in a particular country (e.g., The ABC Japan Fund) or in a particular geographic region (e.g., The XYZ Latin America Fund) to meet a two-part 80% investment requirement.²¹ Rule 35d-1, as adopted, requires that an investment company with a name that suggests that it focuses its investments in a particular country or geographic region adopt a policy to invest at least 80% of its assets in investments that are tied economically to the particular country or geographic region suggested by its name.²² The investment company also must disclose in its prospectus the specific criteria that are used to select investments that meet this standard.²³

As proposed, rule 35d-1 would have required these investment companies to invest in securities that met one of three criteria specified in the rule.²⁴ Most commenters addressing this aspect of the proposed rule opposed the two-part test, arguing that the specific criteria would be too restrictive because there

²¹ The language of the proposal would have required an investment company with a name that suggests that the company focuses its investments in a particular country or geographic region to invest at least 80% of its assets in *securities of issuers* that are tied economically to that country or region. Proposed rule 35d-1(a)(3). We have modified this language to require that such an investment company invest at least 80% of its assets in *investments* that are tied economically to the particular country or geographic region suggested by its name. Rule 35d-1(a)(3)(i). See *supra* note 13.

²² Rule 35d-1(a)(3)(i). The term "geographic region" includes one or more states of the United States or a geographic region within the United States.

One commenter expressed concern that the rule, by its terms, would apply to an investment company with a long-standing trade name that includes a geographic location, such as the city where the company is headquartered, but which is not intended to refer to the geographic region in which the company invests. We do not intend that rule 35d-1 would require an investment company to change its name in these circumstances, where the connotation of the name is clear through long-standing usage and there is no risk of investor confusion.

²³ Rule 35d-1(a)(3)(iii).

²⁴ Proposed rule 35d-1(a)(3). Specifically, the investment would have to have been in: (i) securities of issuers that are organized under the laws of the country or of a country within the geographic region suggested by the company's name or that maintain their principal place of business in that country or region; (ii) securities that are traded principally in the country or region suggested by the company's name; or (iii) securities of issuers that, during the issuer's most recent fiscal year, derived at least 50% of their revenues or profits from goods produced or sold, investments made, or services performed in the country or region suggested by the company's name or that have at least 50% of their assets in that country or region.

may be additional securities that would not meet any of the criteria but would expose an investment company to the economic fortunes and risks of the country or geographic region indicated in the company's name. We are persuaded by these comments, which are consistent with the historical position of the Division of Investment Management.²⁵ The disclosure approach that we are adopting will allow an investment company the flexibility to invest in additional types of investments that are not addressed by the three proposed criteria, but expose the company's assets to the economic fortunes and risks of the country or geographic region indicated by its name.²⁶

3. Tax-Exempt Investment Companies

We are adopting substantially as proposed the requirement that an investment company that uses a name suggesting that its distributions are exempt from federal income tax or from both federal and state income taxes adopt a fundamental policy: (i) to invest at least 80% of its assets in investments the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; ²⁷ or (ii) to invest its assets so that at least 80% of the income that it distributes will be exempt, as applicable, from federal income tax or from both federal and state income tax.

²⁵ Cf. Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 22, 1993) at I.I.A. (rescinded by N-1A Amendments, *supra* note 6, at 13940 n.214) (using substantially the same three proposed criteria, but indicating that the Division would consider other criteria).

²⁶ For example, an investment company may invest in a foreign stock index futures contract traded on a U.S. commodities exchange, which may not meet any of the three proposed criteria but could expose the investment company to the economic fortunes and risks of the geographic region covered by the index. We note, however, that if an investment company uses a criterion that requires qualifying investments to be in issuers that derive a specified proportion of their revenues or profits from goods produced or sold, investments made, or services performed in the applicable country or region, or that have a specified proportion of their assets in that country or region, the Division, consistent with its current position, would expect the proportion used to be at least 50%, in order for the investments to be deemed to be tied economically to the country or region.

²⁷ Rule 35d-1(a)(4)(i). The language of the proposal would have required an investment company with a name that suggests that the company's distributions are exempt from federal income tax or from both federal and state income tax to invest at least 80% of its assets in *securities* the income from which is exempt from the applicable taxes. Proposed rule 35d-1(a)(4). We have modified this language to require that such an investment company invest at least 80% of its assets in *investments* the income from which is exempt from the applicable taxes. See *supra* note 13.

Consistent with current Division positions, the requirements would apply to a company's investments or distributions that are exempt from federal income tax under both the regular tax rules and the alternative minimum tax rules.²⁸

One commenter recommended that single state tax-exempt money market funds be exempt from the requirements of rule 35d-1, arguing that in several states, the supply of tax-free instruments that are eligible for purchase by money market funds is severely limited and, as a result, some of these funds may not be able to meet the 80% investment requirement. The Commission has determined not to provide this exemption. We note that a single state tax-exempt money market fund, like other tax-exempt investment companies, will be subject to the 80% investment requirement "under normal circumstances."²⁹ Thus, a single state tax-exempt fund could deviate from the 80% requirement in limited circumstances, such as a temporary shortage of securities of appropriate quality that distribute income that is tax-exempt in that particular state.³⁰ If, however, the supply of such securities is so limited that the fund cannot meet the 80% requirement under normal circumstances, we believe that the investment company should not use a name suggesting that it is a single state tax-exempt fund.³¹

²⁸ See Fink Letter, *supra* note 20.

²⁹ Rule 35d-1(a)(4)(i) and (ii). See *infra* notes 37-38 and accompanying text (discussing "under normal circumstances" requirement).

³⁰ Under rule 35d-1, a single state tax-exempt fund may include a security of an issuer located outside of the named state in the 80% basket if the security pays interest that is exempt from both federal income tax and the tax of the named state, provided that the fund discloses in its prospectus that it may invest in tax-exempt securities of issuers located outside of the named state. Investors are generally more interested in the tax-exempt nature of an issuer's distributions than the issuer's location. Cf. Rule 2a-7(a)(23) (defining a single state fund by reference to the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state, rather than the location of the issuers in which it invests).

³¹ Rule 2a-7(a)(23), by contrast, defines a single state fund as a tax-exempt fund "that holds itself out as *seeking to maximize* the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state." (emphasis added) Rule 2a-7 provides relief from its diversification requirements to single state funds in recognition of the fact that such a fund may have difficulty in meeting these standards without sacrificing credit quality, and this relief is appropriate when a fund is seeking to maximize its distributions that are tax-exempt in a particular state. We do not, however, believe that it is appropriate for a fund to suggest, through its name, that it is a single state tax-exempt money market fund unless it complies with the 80% investment requirement.

4. Applying the 80% Investment Requirement

Time of Application

The 80% investment requirement generally applies, as proposed, at the time when an investment company invests its assets.³² We are, however, including a grandfather provision so that a UIT that has made an initial deposit of securities prior to the rule's compliance date will not be required to comply with the 80% investment requirement.³³ Because of the fixed nature of UIT portfolios, such UITs would not be able to adjust their portfolios to comply with the rule.

Assets to Which Requirement Applies

As adopted, the 80% investment requirement will be based on an investment company's net assets plus any borrowings for investment purposes.³⁴ This is a modification from the proposed requirement that would have based the 80% investment requirement on a company's net assets plus any borrowings that are senior securities under section 18 of the Investment Company Act.³⁵

The use of net assets rather than total assets was intended to reflect more closely an investment company's portfolio investments. Commenters were generally supportive of the proposed use of net assets. Several commenters, however, recommended that the 80% investment requirement be applied to net assets plus borrowings used for investment purposes, arguing that this modification would more closely track the Commission's stated objective of preventing an investment company from circumventing the 80% investment requirement by investing borrowed funds in investments that are not consistent with its name. The Commission agrees with these commenters, and has modified the proposal accordingly.³⁶

³² The rule would require an investment company that no longer meets the 80% investment requirement (e.g., as a result of changes in the value of its portfolio holdings or other circumstances beyond its control) to make future investments in a manner that would bring the company into compliance with the 80% requirement. However, an investment company subject to the requirement would not have to sell portfolio holdings that have increased in value. See Proposing Release, *supra* note 7, at 10958 n.28 and accompanying text.

³³ Rule 35d-1(b).

³⁴ Rule 35d-1(d)(2).

³⁵ 15 U.S.C. 80a-18. See proposed rule 35d-1(b)(2)(ii).

³⁶ Whether a particular transaction is considered borrowing for investment purposes would depend on all of the facts and circumstances. For purposes of this provision, however, a typical securities lending transaction (in which an investment company lends its portfolio securities and enters an agreement with a lending agent to reinvest cash

Temporary Departure From 80% Requirement

Consistent with current Division positions, the rule, as adopted, will require investment companies to comply with the 80% investment requirement "under normal circumstances."³⁷ This is a modification of the proposed rule, which contemplated that an investment company may depart from the 80% requirement in order to take a "temporary defensive position" to avoid losses in response to adverse market, economic, political, or other conditions.³⁸ We are persuaded by the commenters who argued that the "temporary defensive position" exception was too narrow and did not give investment companies sufficient flexibility to manage their portfolios, particularly in the case of large cash inflows or anticipated large redemptions.

The "under normal circumstances" standard will provide funds with flexibility to manage their portfolios, while requiring that they would normally have to comply with the 80% investment requirement. This standard will permit investment companies to take "temporary defensive positions" to avoid losses in response to adverse market, economic, political, or other conditions. In addition, it will permit investment companies to depart from the 80% investment requirement in other limited, appropriate circumstances, particularly in the case of unusually large cash inflows or redemptions. For example, a new investment company will be permitted to comply with the 80% investment requirement within a reasonable time after commencing operations. We remind investment companies, however, that in the Division's view, an investment company generally must not take in excess of six months to invest net proceeds in order to operate in accordance with its investment objectives and policies.³⁹ In addition, we would generally expect new mutual funds, which typically invest in relatively liquid assets and which receive cash from share purchases on an ongoing basis, to be fully invested

collateral in highly liquid fixed-income securities, such as U.S. government securities) would not be considered borrowing for investment purposes.

³⁷ See former Guide 1 in the N-1A Guidelines Release, *supra* note (applying 65% investment requirement "under normal circumstances").

³⁸ Proposed rule 35d-1(b)(3).

³⁹ See Guide 1 to Form N-2, Registration Statement of Closed-End Management Investment Companies.

within a much shorter time.⁴⁰ We emphasize that an investment company should not use a name subject to the rule unless it intends to, and does, comply with the 80% investment requirement absent unusual circumstances.

B. Names Suggesting Guarantee or Approval by the U.S. Government

Consistent with the requirements of section 35(a) of the Investment Company Act, rule 35d-1, as adopted, prohibits an investment company from using a name that suggests that the company or its shares are guaranteed or approved by the United States government or any United States government agency or instrumentality.⁴¹ The prohibited types of names include names that use the words "guaranteed" or "insured" or similar terms in conjunction with the words "United States" or "U.S. government."

C. Other Investment Company Names

1. General

Rule 35d-1, as adopted, does not codify positions of the Division of Investment Management with respect to investment company names including the terms "balanced," "index," "small, mid, or large capitalization," "international," and "global."⁴² In

⁴⁰ In very limited circumstances, it may be appropriate for a closed-end fund that invests in securities whose supply is limited to take longer than six months to invest offering proceeds. See Guide 1 to Form N-2, Registration Statement of Closed-End Management Investment Companies (may be appropriate for a closed-end fund investing in a single foreign country or small businesses to take up to two years to invest offering proceeds).

⁴¹ Rule 35(d)-1(a)(1).

⁴² See Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 25, 1994) at I.D. (rescinded by N-1A Amendments, *supra* note 6, at 13940 n.214) ("small, medium, and large capitalization"); Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Jan. 17, 1992) at II.A. (rescinded by N-1A Amendments, *supra* note 6, at 13940 n.214) ("index"); Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Jan. 3, 1991) at II.A. (rescinded by N-1A Amendments, *supra* note 6, at 13940 n.214) ("international" and "global").

The terms "small, mid, or large capitalization" and "index" suggest a focus on a particular type of investment, and investment companies that use these terms will be subject to the 80% investment requirement of the rule. The term "balanced," however, does not suggest a particular investment focus, but rather a particular type of diversification among different investments, and "balanced" funds will not be subject to the rule. The Division takes the position that an investment company that holds itself out as "balanced" should invest at least 25% of its assets in fixed income senior securities and should invest at least 25% of its assets in equities. Cf. Former Guide 4 in the N-1A Guidelines Release, *supra* note 6 (rescinded by N-1A Amendments, *supra* note 6, at 13940 n.214) (requiring an

addition, the rule does not apply to fund names that incorporate terms such as "growth" and "value" that connote types of investment strategies as opposed to types of investments. The Division will continue to scrutinize investment company names not covered by the proposed rule.⁴³ In determining whether a particular name is misleading, the Division will consider whether the name would lead a reasonable investor to conclude that the company invests in a manner that is inconsistent with the company's intended investments or the risks of those investments.⁴⁴

2. Names and Average Weighted Portfolio Maturity and Duration

Investment companies investing in debt obligations often seek to distinguish themselves by limiting the maturity of the instruments they hold. These investment companies may call themselves, for example, "short-term," "intermediate-term," or "long-term" bond or debt funds. Historically, the Division of Investment Management has required investment companies with these types of names to have average weighted portfolio maturities of specified lengths. In particular, the Division has required an investment company that included the words "short-term," "intermediate-term," or "long-term" in its name to have a dollar-weighted average maturity of, respectively, no more than 3 years, more

investment company that purports to be "balanced" to maintain at least 25 percent of the value of its assets in fixed income senior securities).

The term "foreign" indicates investments that are tied economically to countries outside the United States, and an investment company that uses this term would be subject to the 80% requirement. The terms "international" and "global," however, connote diversification among investments in a number of different countries throughout the world, and "international" and "global" funds will not be subject to the rule. We would expect, however, that investment companies using these terms in their names will invest their assets in investments that are tied economically to a number of countries throughout the world. See Proposing Release, *supra* note 7, at 10960 n.38 and accompanying text ("The Division no longer distinguishes the terms 'global' and 'international.'").

⁴³ As a general matter, an investment company may use any reasonable definition of the terms used in its name and should define the terms used in its name in discussing its investment objectives and strategies in the prospectus. See Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC (Feb. 25, 1994) at II.D (rescinded by N-1A Amendments, *supra* note 6, at 13940 n.214) (using this approach for investment companies that include the words "small, mid, or large capitalization" in their names).

⁴⁴ See *In re Alliance North Am. Gov't Income Trust, Inc. Securities Litigation*, No. 95 Civ. 0330 (LMM), 1996 U.S. Dist. LEXIS 14209, at *8 (S.D.N.Y. Sept. 27, 1996); *The Private Investment Fund for Governmental Personnel, Inc.*, 37 S.E.C. 484, 487-88 (1957).

than 3 years but less than 10 years, or more than 10 years.⁴⁵ Although the Proposing Release stated that the Division did not intend to continue to use these criteria, the Division has re-evaluated this position in light of its subsequent experience and the comments received on the Proposing Release. The Division has concluded that it will continue to apply these maturity criteria to investment companies that call themselves "short-term," "intermediate-term," or "long-term" because they provide reasonable constraints on the use of those terms.

We note, however, that there may be instances where the average weighted maturity of an investment company's portfolio securities may not accurately reflect the sensitivity of the company's share prices to changes in interest rates.⁴⁶ The Commission and the Division, therefore, do not intend compliance with the Division's maturity guidelines to act as a safe harbor in determining whether a name is misleading. In a case, for example, where an investment company's name was consistent with the Division's maturity guidelines, but the "duration" of the company's portfolio was inconsistent with the sensitivity to interest rates suggested by the company's name, the name may be misleading.⁴⁷

D. Compliance Date

Rule 35d-1 will become effective March 31, 2001. The Commission proposed to allow an investment company up to one year from the effective date of the proposed rule to comply with the rule's requirements. The Commission is persuaded by commenters that additional time may be required to make portfolio adjustments; internal compliance system changes;

⁴⁵ See Investment Company Act Release No. 15612 (Mar. 9, 1987) (52 FR 8268 (Mar. 17, 1987) at 8301) (proposing to codify these positions in a guideline).

⁴⁶ In 1994, some investors did not anticipate how certain investment companies would perform when interest rates declined over a relatively short period of time. See, e.g., Antilla, *A New Concept in Fund Ads: Truth*, N.Y. Times, July 10, 1994, at C13 (regarding the performance of certain short-term bond funds).

⁴⁷ In view of the shortcomings associated with analyzing interest rate volatility based on average weighted maturity, investment companies and investment professionals increasingly evaluate bond portfolios based on "duration," which reflects the sensitivity of an investment company's return to changes in interest rates. See, e.g., Wright, *Duration: The Second Step*, Morningstar Mutual Funds 1-2 (Sept. 12, 1997); Rekenhaller, *Duration Arrives*, Morningstar Mutual Funds 1-2 (Jan. 21, 1994). Whether a name was misleading in the circumstances outlined above would depend on all the facts and circumstances, including other disclosures to investors.

and, for those companies that do not wish to be subject to the rule, to adopt name changes. Therefore, the Commission will permit an investment company until July 31, 2002, to comply with the rule's requirements.

III. Cost/Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. The Commission did not solicit any comments on the costs and benefits associated with the rule and did not receive any comments addressing the costs and benefits. While it is difficult to quantify the costs and benefits related to the rule, the Commission notes that the commenters generally supported the proposed rule.

Rule 35d-1 will provide significant benefits to investors, by helping to ensure that an investment company that has a name suggesting that it focuses on a particular type of investment, or in investments in a particular industry, invests at least 80% of its assets in the type of investment suggested by its name. The 80% investment threshold represents an increase from the staff's current position that an investment company with a name suggesting that the company focuses on a particular type of investment only needs to invest 65% of its assets in the type of investment suggested by its name. By increasing the investment requirement from 65% to 80%, the rule will enable investors to more efficiently compare one fund with another before making investment decisions, which will tend to promote competition among investment companies, and will reduce the time that investors must spend searching for an investment company that meets their particular needs. In addition, the rule will benefit investors by reducing the amount of time and resources that they must devote to monitoring whether the investment companies that they have invested in are continuing to follow their stated investment objectives. Further, by decreasing the likelihood that an investment company will deviate from the investment objective and policy suggested by its name, and invest in ways that do not correspond with investors' individual investment needs and asset allocation goals, the rule will also lower the costs imposed on investors by inefficient allocation of their assets.

Moreover, the rule will enable an investment company affected by the rule to adopt a policy that it will notify its investors before changing its investment policy; such a policy would allow investors more time to reallocate their assets if the company's investment

focus changes. The rule will thereby help to ensure that investors' assets in mutual funds and other investment companies are invested in accordance with their expectations, and will enhance the efficiency and accuracy with which investors can design their fund portfolios to meet their individual investment needs.

We believe the benefits to investors resulting from the rule are significant, although they are difficult to quantify. The Commission estimates that total investment company assets are \$7.4 trillion.⁴⁸ We estimate that approximately \$ 429.9 billion of these assets are invested in investment companies that would be affected by the rule and that do not currently meet an 80% investment threshold.⁴⁹ We estimate that investors in these investment companies would receive benefits from the imposition of an 80% investment requirement under the rule equivalent to one basis point (0.01%) of assets invested in these investment companies, or \$43.0 million.⁵⁰

Rule 35d-1 will also impose certain costs on investment companies and therefore indirectly on investors. First, an investment company affected by the rule that currently has less than 80% of its investments in the type of investments indicated by its name will have to take one of two actions in order to comply with the 80% investment requirement of the rule. It may increase its investments in the type of investments described by its name to 80% or more. Alternatively, it may choose to change its name.

The Commission estimates that there are currently 8,675 open-end management investment companies, series of such companies, or closed-end management investment companies that are registered with the Commission and would fall within the definition of "Fund" contained in rule 35d-1.⁵¹ Of this total, the Commission estimates that

7,200, or 83%, have descriptive names that would be covered by the rule.

The Commission estimates that 6,696, or approximately 93%, of these 7,200 investment companies and series would currently meet or exceed an 80% investment threshold.⁵² Of the 504 investment companies and series that the Commission estimates do not currently meet this 80% threshold, the Commission estimates that approximately 30%, or 151, fail to meet the threshold principally because of large cash positions; presumably, these cash positions are temporary, and these investment companies would intend to reduce these cash positions and would in all probability satisfy the 80% investment threshold in the near future.

The remaining estimated 353 investment companies and series would need to take steps to meet the 80% investment requirement in the rule, by either changing their name or changing their investments. Although the costs to these investment companies of either changing their investments or their names cannot be quantified, we believe they will be relatively small. We note that investment companies do not have to be in compliance with the rule until July 31, 2002. Those investment companies that choose to change their investment policy in order to have 80% of their investments consistent with their names will incur brokerage costs in connection with adjusting their investments. However, many of these investment companies normally experience substantial portfolio turnover each year, so it is unclear whether they would incur brokerage costs in order to comply with the rule that they would not be incurring otherwise. Investment companies that choose to change their names in order to comply with the rule may incur certain limited legal and administrative expenses, which we estimate would be \$1,000 for each affected investment company or series, exclusive of printing and mailing costs. The Commission estimates that the average number of shareholder accounts in investment companies or series of investment companies that are likely to be affected by the rule is 28,000. The Commission estimates that printing and mailing costs in connection with a name change are \$.25 per shareholder, or \$7,000

(28,000×\$.25) for an average-sized investment company series.⁵³

Second, after the compliance date, investment companies subject to rule 35d-1(a)(2), (a)(3) and (a)(4) may want to monitor their investment activity on an ongoing basis to confirm that they are in compliance with the rule. We believe these monitoring costs will be quite limited. The 80% investment requirement of these sections of the rule will apply to net assets, plus borrowings for investment purposes.⁵⁴ Investment companies already have to calculate net assets daily. In addition, investment companies may already monitor their investment activity in order to comply with the Division's current 65% investment requirement.

Third, there may also be costs associated with the rule in the event that an investment company affected by the rule seeks to change its 80% investment policy subsequent to the compliance date.⁵⁵ By the compliance date, an investment company that chooses to comply with rule 35d-1(a)(2) and (a)(3) will have to adopt either an 80% investment policy as a fundamental policy, or a policy to notify investors 60 days prior to any change in its 80% investment policy. We believe that most investment companies will choose the latter option. The Commission estimates that in the event that such an investment company decides to change its investment policy, the required notice would take approximately 20 hours for an investment company to prepare, and would cost \$1,260, based on an estimated hourly wage rate of \$63 for in-house legal counsel.⁵⁶

⁵³ These estimates of the cost to an investment company of changing its name or the name of one of its series are based on information provided to the staff by a large mutual fund complex. An investment company that changes the name of one of its series may need to provide a prospectus supplement or "sticker" to shareholders. Based on information provided to the staff by this mutual fund complex, we estimated that the "sticker" would cost \$.25 per shareholder to print and mail.

⁵⁴ An investment company affected by Rule 35d-1(a)(4) (applying to tax-exempt funds) will either have to invest 80% of its assets, as defined by the rule, in securities the income from which is exempt from federal income tax or federal and state income tax, or will have to invest its assets so that at least 80% of the income that it distributes is so exempt.

⁵⁵ An investment company that changes its 80% investment policy would also be required to change its name, as necessary to comply with the requirements of rule 35d-1 in light of its new investment policy. It would therefore also incur estimated legal and administrative expenses of \$1,000 and estimated printing and mailing costs of \$7,000. See *supra* note and accompanying text.

⁵⁶ See Section V., *infra*. The wage rate used is based on salary information for the securities industry compiled by the Securities Industry Association. See Securities Industry Association,

Continued

⁴⁸ See *supra* note 10.

⁴⁹ We estimate that approximately 83% of investment companies, with \$6.142 trillion in assets, have names that would be covered by the rule. We estimate further that 7% of investment companies with names covered by the rule currently meet the Division's 65% investment requirement, but would not meet an 80% threshold.

⁵⁰ This estimate is based on an estimate of the total savings resulting from reductions in the costs of monitoring these investment companies, and the costs to investors of inefficient asset allocation.

⁵¹ An additional 11,922 investment companies and series of investment companies would fall within the definition of "Fund" in the rule, but are unlikely to be significantly affected by the rule. The vast majority of these 11,922 investment companies and series are UITs or UIT offerings that are largely exempted from the 80% investment requirement by a grandfather provision. See Rule 35d-1(b).

⁵² This estimate, and the estimate of the percentage of investment companies with descriptive names, are based on the Commission's analysis of a database of mutual fund annual and semi-annual reports and other data concerning portfolio holdings of funds, compiled by a large mutual fund data provider.

Printing costs and the costs of mailing or otherwise providing the prior notice to shareholders will vary for each investment company, depending on the number of shareholders who are affected. However, because the notice may be a brief one-page document, and could be enclosed in the same envelope with other printed matter (e.g., an account statement, prospectus, or report), the Commission believes that this cost of the notice will be less than \$.25 per shareholder, or \$7,000 for an average-sized investment company or series, which we estimate has 28,000 shareholder accounts.⁵⁷ While it is impossible to predict accurately how many investment companies and series would send out notice in connection with a change in their investment policies, the Commission believes that a reasonable estimate over a three-year period is 72, or one percent of the estimated number of investment companies and series with descriptive names (7,200). Thus, we estimate the total cost to the investment company industry of providing prior notice to shareholders of changes in their 80% investment policies under the notice policy provision of the rule will be \$594,720 over three years, or \$198,240 annually.⁵⁸

Fourth, an investment company with a name suggesting that it focuses its investments in a particular country or geographic region must disclose in its prospectus the specific criteria that are used to select investments that meet this standard. The staff has estimated that incorporating the required disclosure into the prospectus would take approximately two hours for each of the affected 202 open-end investment companies or series registered or to be registered on Form N-1A, and each of 26 affected closed-end investment companies registered on Form N-2, for a total annual industry burden of 456 hours.⁵⁹ The Commission, using an

Report on Management & Professional Earnings in the Securities Industry 1999 (Sept. 1999).

⁵⁷ This estimate is based on the Commission's estimate that the "sticker" that an investment company would have to provide to its shareholders, notifying them of a name change, would cost \$.25 per shareholder. See *supra* note. We estimate that the notice that would be provided to shareholders of a change in investment policy would be a similarly brief document.

⁵⁸ The total cost of \$594,720 was reached by adding printing and mailing costs of \$7,000 (28,000 accounts × \$.25 per shareholder) and the \$1,260 cost of preparing the notice, and multiplying the total cost of \$8,260 by the number of investment companies that are estimated to send out notice over a three-year period (72).

⁵⁹ These totals are based on an estimate of 193 open-end management investment companies or series currently registered on Form N-1A that have names suggesting an investment focus in a

particular country or geographic region, and an estimate of 9 new open-end management investment companies or series with such names that are registered annually; and an estimate of 26 closed-end management investment companies that register annually with the Commission on Form N-2 that have names suggesting an investment focus on a particular country or geographic region. See Section V., *infra*.

IV. Summary of Final Regulatory Flexibility Analysis

A summary of the Initial Regulatory Flexibility Analysis ("IRFA") regarding proposed rule 35d-1, which was prepared in accordance with 5 U.S.C. § 603, was published in the Proposing Release. No comments were received on the IRFA. We have prepared a Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. § 604 relating to the adopted rule.

The FRFA discusses the need for, and objectives of, the new rule. The FRFA explains that the rule requires a registered investment company with a name suggesting that the company focuses on a particular type of investment to invest at least 80% of its assets in the type of investment suggested by its name. The FRFA also explains that the rule is intended to address investment company names that are likely to mislead investors about an investment company's investments and risks.

The FRFA discusses the impact of the rule on small entities, which are defined, for the purposes of the Investment Company Act, as investment companies with net assets of \$50 million or less as of the end of the most recent fiscal year (17 CFR 270.0-10). As of June 2000, there were approximately 4,387 registered investment companies.⁶¹ Of these 4,387, approximately 215 (4.9%) are investment companies that meet the Commission's definition of small entity for purposes of the Investment Company Act. The Commission estimates that 83% of these 215 small entities, or 179,

particular country or geographic region, and an estimate of 9 new open-end management investment companies or series with such names that are registered annually; and an estimate of 26 closed-end management investment companies that register annually with the Commission on Form N-2 that have names suggesting an investment focus on a particular country or geographic region. See Section V., *infra*.

⁶⁰ See *supra* note 56.

⁶¹ For purposes of determining the existing number of registered investment companies and the number of small entities in this analysis, the Commission did not count a series of an investment company as an entity separate from the investment company. Many investment companies have multiple series. Thus, the total of registered investment companies (4,387) is significantly smaller than the total of investment companies and series that would fall within the definition of "Fund" under the rule (8,675). See *supra* note 51 and accompanying text.

have descriptive names and would therefore be subject to rule 35d-1.⁶²

Only those investment companies that have names suggesting a particular investment emphasis are required to comply with the rule. In general, to comply with the rule, an investment company with a name that suggests that the company focuses on a particular type of investment will either have to adopt a fundamental policy to invest at least 80% of its assets in the type of investment suggested by its name or adopt a policy of notifying its shareholders at least 60 days prior to any change in its 80% investment policy. The 80% investment requirement will allow an investment company to maintain up to 20% of its assets in other investments. An investment company seeking maximum flexibility with respect to its investments will be free to use a name that does not connote a particular investment emphasis.

Additionally, an investment company with a name suggesting that it focuses its investments in a particular country or geographic region must disclose in its prospectus the specific criteria that are used to select investments that are tied economically to the particular country or region.

As stated in the FRFA, the Commission considered several alternatives to rule 35d-1 including, among others, establishing different compliance or reporting requirements for small entities or exempting them from all or part of the rule. Because an investment company could choose to use a name that does not suggest a particular investment, the Commission believes that the rule will not impose additional burdens on small entities and that separate treatment for small entities would be inconsistent with the protection of investors.

The FRFA is available for public inspection in File No. S7-11-97, and a copy may be obtained by contacting John L. Sullivan, Office of Disclosure Regulation, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549-0506.

V. Paperwork Reduction Act

Certain provisions of the rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), and the Commission has submitted the proposed collections of information to

⁶² The Commission also used this 83% figure to compute the number of open-end and closed-end management investment companies and series that have descriptive names. See *supra* note 51 and accompanying text.

the Office of Management and Budget for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The titles for the collections of information are (1) "Rule 35d-1 under the Investment Company Act of 1940, Investment Company Names"; (2) "Form N-1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies"; and (3) "Form N-2 under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Closed-End Management Companies." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Form N-1A (OMB Control No. 3235-0307) and Form N-2 (OMB Control No. 3235-0026) were adopted pursuant to section 8(a) of the Investment Company Act (15 U.S.C. 80a-8) and section 5 of the Securities Act (15 U.S.C. 77e). The Commission is proposing to create a new information collection entitled "Rule 35d-1 under the Investment Company Act of 1940, Investment Company Names." This information collection will encompass the rule's notice policy provision described below.

Rule 35d-1 is designed to address certain broad categories of investment company names that, in the Commission's view, are likely to mislead an investor about a company's investments and risks. The rule requires registered investment companies to invest at least 80% of their assets in the type of investments suggested by their names, if their names suggest investments in:

- A particular type of investment (e.g., the ABC Stock Fund, XYZ Bond Fund, or QRS U.S. Government Fund);
- A particular industry (e.g., the ABC Utilities Fund or XYZ Health Care Fund); and
- A particular country or geographic region (e.g., the ABC Japan Fund or XYZ Latin America Fund).

Rule 35d-1 also requires an investment company that uses a name suggesting that its distributions are exempt from federal income tax or from both federal and state income taxes to invest:

- At least 80% of its assets in securities the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; or
- Its assets so that at least 80% of the income that it distributes will be exempt, as applicable, from federal

income tax or both federal and state income tax.

The rule also prohibits investment company names that represent or imply that the investment company or the securities issued by it are guaranteed, sponsored, recommended, or approved by the U.S. government or any U.S. government agency or instrumentality.

The rule will generally require that, following the compliance date, the 80% investment requirement either must be a fundamental policy of an investment company affected by the rule, or the investment company must have adopted a policy to provide notice to shareholders at least 60 days prior to any change in its 80% investment policy in order for its name not to be deemed misleading under the rule. Additionally, an investment company with a name suggesting that it focuses its investments in a particular country or geographic region must disclose in its prospectus the specific criteria that are used to select investments that meet this standard.

Notice Policy Provision Under Rule 35d-1

The Commission anticipates that any notice provided to shareholders under a notice policy that meets the requirements of rule 35d-1 will typically be a short, one-page document that may be enclosed with other written materials sent to shareholders, such as prospectuses, annual and semi-annual reports, and account statements. The number of burden hours spent preparing and arranging delivery of these notices therefore will be low. The Commission estimates that the annual burden associated with the notice requirement of the rule would be 20 hours per affected investment company or series. The Commission anticipates that each affected respondent would incur these burden hours only once.

The Commission estimates that there are currently 7,200 open-end and closed-end management investment companies and series that have descriptive names that would be covered by the rule.⁶³ The Commission estimates that 72, or 1%, of these investment companies and series will at some point provide prior notice to their shareholders of a change in their investment policies pursuant to a policy

adopted in accordance with this rule. Of these estimated 72 investment companies and series that are expected to provide prior notice to their shareholders of a change in their investment policies, the Commission anticipates that 24, or one-third, will do so within one year of the rule's compliance date. The Commission estimates that each of these 24 investment companies and series will spend an average of 20 hours complying with the notice alternative provided by the rule, for an annual total of 480 hours.

Providing prior notice to shareholders under rule 35d-1 is not mandatory. An investment company may choose to have a non-descriptive name. Further, if an investment company has a descriptive name, it will only need to provide prior notice to shareholders of a change in its 80% investment policy if it first has adopted a policy to provide notice and then has decided to change this investment policy. There is no mandatory retention period associated with a notice policy that meets the requirements of the rule, and responses to such a notice policy will not be kept confidential.

Prospectus Disclosure

With respect to the prospectus disclosure regarding the specific criteria that are used to select investments for an investment company with a name suggesting that it focuses its investments in a particular country or geographic region, the Commission estimates that the annual burden will be two hours for each affected investment company and series of an investment company. The likely respondents to this information collection are open-end management investment companies registering with the Commission on Form N-1A and closed-end management investment companies registering with the Commission on Form N-2. Both Form N-1A and Form N-2 contain collection of information requirements. The purpose of Form N-1A and Form N-2 is to meet the registration and disclosure requirements of the Securities Act and Investment Company Act and to enable investment companies to provide investors with information necessary to evaluate an investment in the investment company.

Form N-1A

The Commission estimates that there are currently 193 open-end management investment companies or series registered with the Commission on Form N-1A that have names suggesting a focus on a particular country or geographic region. The Commission

⁶³ The Commission estimates that there are currently 8,675 open-end management investment companies, series of such investment companies, and closed-end investment companies that are registered with the Commission and would fall within the definition of "Fund" contained in rule 35d-1. Of this total, the Commission estimates that 83%, or 7,200, have descriptive names that would be covered by the rule. See *supra* notes 51-52 and accompanying text.

estimates that each of these investment companies and series will spend an average of two hours to prepare and incorporate the required disclosure into its annual update of its prospectus by post-effective amendment, for a total of 386 hours. In addition, we estimate that 298 open-end management investment companies and series file initial registration statements on Form N-1A annually. Based on the overall percentage of investment companies and series that have names suggesting a focus on a country or geographical region, we estimate that 9 of these registration statements annually will have to include disclosure required by the rule, at a cost of two hours per registrant, or 18 hours. Thus, we estimate that the required prospectus disclosure of rule 35d-1 will add 404 hours ((193 open-end management investment companies or series + 9 investment companies or series) x 2 hours) to the previous Form N-1A annual burden of 1,159,311, resulting in a new total Form N-1A annual hour burden, after adjusting for a decrease of 98 in the number of respondents filing on Form N-1A, of 1,145,843 hours.

Form N-2

The Commission estimates that 130 closed-end management investment companies file registration statements annually on Form N-2. We estimate that approximately 20% of these closed-end management investment companies, or 26, have names suggesting a focus on a particular country or geographic region. We believe that the disclosure burden of two hours will be the same for Form N-2 as for an open-end management investment company or series.⁶⁴ Thus, we estimate that the required prospectus disclosure of rule 35d-1 will add 52 hours (26 closed-end management investment companies x two hours) to the current Form N-2 annual burden of 61,760 hours, resulting in a total Form N-2 annual hour burden of 61,812 hours.

The prospectus disclosure required by the rule in Form N-1A and Form N-2 is mandatory for an investment company suggesting that it focuses its investments in a particular country or geographic region. There is no mandatory retention period for the information disclosed, and responses to the disclosure requirement will not be kept confidential.

⁶⁴ Closed-end management investment companies, however, generally do not file post-effective amendments.

Request for Comments

We request your comments on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 3208, New Executive Office Building, Washington, D.C. 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609, with reference to File No. S7-11-97. Request for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-11-97, and be submitted to the Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, Attention: Records Management, Office of Filings and Information Services. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release.

VI. Statutory Authority

The Commission is adopting rule 35d-1 pursuant to the authority set forth in sections 8, 30, 34, 35, and 38 of the Investment Company Act (15 U.S.C. 80a-8, 80a-29, 80a-33, 80a-34, and 80a-37). The authority citations for the rule precede the text of the amendments.

List of Subjects in 17 CFR Part 270

Investment companies, Securities.

Text of Rule

For the reasons set out in the preamble, Title 17, Chapter II of the

Code of Federal Regulations is amended as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, 80a-39 unless otherwise noted.

2. Section 270.35d-1 is added to read as follows:

§ 270.35d-1 Investment company names.

(a) For purposes of section 35(d) of the Act (15 U.S.C. 80a-34(d)), a materially deceptive and misleading name of a Fund includes:

(1) *Names suggesting guarantee or approval by the United States government.* A name suggesting that the Fund or the securities issued by it are guaranteed, sponsored, recommended, or approved by the United States government or any United States government agency or instrumentality, including any name that uses the words "guaranteed" or "insured" or similar terms in conjunction with the words "United States" or "U.S. government."

(2) *Names suggesting investment in certain investments or industries.* A name suggesting that the Fund focuses its investments in a particular type of investment or investments, or in investments in a particular industry or group of industries, unless:

(i) The Fund has adopted a policy to invest, under normal circumstances, at least 80% of the value of its Assets in the particular type of investments, or in investments in the particular industry or industries, suggested by the Fund's name; and

(ii) Either the policy described in paragraph (a)(2)(i) of this section is a fundamental policy under section 8(b)(3) of the Act (15 U.S.C. 80a-8(b)(3)), or the Fund has adopted a policy to provide the Fund's shareholders with at least 60 days prior notice of any change in the policy described in paragraph (a)(2)(i) of this section that meets the requirements of paragraph (c) of this section.

(3) *Names suggesting investment in certain countries or geographic regions.* A name suggesting that the Fund focuses its investments in a particular country or geographic region, unless:

(i) The Fund has adopted a policy to invest, under normal circumstances, at least 80% of the value of its Assets in investments that are tied economically to the particular country or geographic region suggested by its name;

(ii) The Fund discloses in its prospectus the specific criteria used by the Fund to select these investments; and

(iii) Either the policy described in paragraph (a)(3)(i) of this section is a fundamental policy under section 8(b)(3) of the Act (15 U.S.C. 80a-8(b)(3)), or the Fund has adopted a policy to provide the Fund's shareholders with at least 60 days prior notice of any change in the policy described in paragraph (a)(3)(i) of this section that meets the requirements of paragraph (c) of this section.

(4) *Tax-exempt Funds.* A name suggesting that the Fund's distributions are exempt from federal income tax or from both federal and state income tax, unless the Fund has adopted a fundamental policy under section 8(b)(3) of the Act (15 U.S.C. 80-8(b)(3)):

(i) To invest, under normal circumstances, at least 80% of the value of its Assets in investments the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; or

(ii) To invest, under normal circumstances, its Assets so that at least 80% of the income that it distributes will be exempt, as applicable, from federal income tax or from both federal and state income tax.

(b) The requirements of paragraphs (a)(2) through (a)(4) of this section apply at the time a Fund invests its Assets, except that these requirements shall not apply to any unit investment trust (as defined in section 4(2) of the Act (15 U.S.C. 80a-4(2))) that has made an initial deposit of securities prior to July 31, 2002. If, subsequent to an investment, these requirements are no longer met, the Fund's future investments must be made in a manner that will bring the Fund into compliance with those paragraphs.

(c) A policy to provide a Fund's shareholders with notice of a change in a Fund's investment policy as described in paragraphs (a)(2)(ii) and (a)(3)(iii) of this section must provide that:

(1) The notice will be provided in plain English in a separate written document;

(2) The notice will contain the following prominent statement, or similar clear and understandable statement, in bold-face type: "Important Notice Regarding Change in Investment Policy"; and

(3) The statement contained in paragraph (c)(2) of this section also will appear on the envelope in which the notice is delivered or, if the notice is delivered separately from other communications to investors, that the statement will appear either on the

notice or on the envelope in which the notice is delivered.

(d) For purposes of this section:

(1) *Fund* means a registered investment company and any series of the investment company.

(2) *Assets* means net assets, plus the amount of any borrowings for investment purposes.

Dated: January 17, 2001.

By the Commission.

Jonathan G. Katz,

Secretary.

[FR Doc. 01-1967 Filed 1-31-01; 8:45 am]

BILLING CODE 8010-01-P

DEPARTMENT OF EDUCATION

34 CFR Part 606

Developing Hispanic-Serving Institutions Program; Delay of Effective Date

AGENCY: Department of Education.

ACTION: Final regulations; delay of effective date.

SUMMARY: In accordance with the memorandum of January 20, 2001, from the Assistant to the President and Chief of Staff, entitled "Regulatory Review Plan," this regulation temporarily delays the effective date of the regulations entitled Developing Hispanic-Serving Institutions Program published in the **Federal Register** on January 8, 2001 (66 FR 1262).

EFFECTIVE DATE: The effective date of the regulations amending 34 CFR Part 606 published at 66 FR 1262, January 8, 2001, is delayed 60 days until April 8, 2001.

FOR FURTHER INFORMATION CONTACT: Kenneth C. Depew, Acting Assistant General Counsel for Regulations, Office of the General Counsel, U.S. Department of Education, 400 Maryland Avenue, SW., room 6E227, FB-6, Washington, DC 20202-2241. Telephone: (202) 401-8300.

If you use a telecommunications device for the deaf (TDD), you may call the Federal Information Relay Service (FIRS) at 1-800-877-8339.

Dated: January 24, 2001.

Rod Paige,

Secretary of Education.

[FR Doc. 01-2779 Filed 1-31-01; 8:45 am]

BILLING CODE 4000-01-P

FEDERAL COMMUNICATIONS COMMISSION

47 CFR Part 51

[FCC 01-21]

Procedures for Arbitrations Conducted in Accordance With the Communications Act of 1934

AGENCY: Federal Communications Commission.

ACTION: Final rule.

SUMMARY: The Commission amends on its own motion a section of the rules in which FCC arbitrators are granted additional discretion when arbitrating interconnection disputes.

DATES: Effective February 1, 2001.

FOR FURTHER INFORMATION CONTACT: William Kehoe, Special Counsel, Common Carrier Bureau, Policy and Program Planning Division, (202) 418-1580.

SUPPLEMENTARY INFORMATION: This is a summary of the amendment to 47 CFR 51.807 in the Commission's *Order*, FCC 01-21, adopted January 17, 2001 and released January 19, 2001. The complete text of this Order is available for inspection and copying during regular business hours in the FCC Reference Information Center, Courtyard Level, 445 12th Street, SW., Washington, DC, and also may be purchased from the Commission's copy contractor, International Transcription Services (ITS, Inc.), CY-B400, 445 12th Street, SW., Washington, DC.

Synopsis of the Amendment to Section 51.807

1. The Commission adopted an interim rule in the Local Competition Order establishing a scheme of "final offer" arbitration for section 252(e)(5) proceedings. This rule provides that, in issuing an arbitration award, the arbitrator "shall use final offer arbitration," which may take the form of either entire package final offer arbitration or issue-by issue final offer arbitration." 47 CFR 51.807(d)(1). If the parties' offers do not meet the standards of section 251, the arbitrator may require the parties to submit additional final offers or may adopt a result offered by neither party. 47 CFR 51.807(f)(3) (1999).

2. Experience gained by states in arbitrating numerous interconnection disputes over the past five years suggest that "final offer" arbitration may not always afford the arbitrator sufficient flexibility to resolve complex interconnection issues. Accordingly, the Commission amends § 51.807(f)(3) to