

## registered fund developments

spring 2009

### SEC Staff Allows Money Market Fund to Use the Amortized Cost Valuation Method Without Maintaining a Fixed Share Price

The staff of the Securities and Exchange Commission (the “Staff”) recently issued a no-action letter to College Retirement Equities Fund (“CREF”)<sup>1</sup> allowing a money market account portfolio (the “Fund”)<sup>2</sup> to use the amortized cost method to value its portfolio securities despite the Fund not maintaining a constant share price.<sup>3</sup> CREF sought the relief because Rule 2a-7 under the Investment Company Act of 1940 (the “1940 Act”) could be read to require maintenance of a fixed share price as a condition to using the amortized cost method. For example, Rule 2a-7(c)(1) conditions a fund’s use of the amortized cost method on a finding by the fund’s board that “it is in the best interests of the fund and its shareholders to maintain a stable net asset value per share or stable price per share.”<sup>4</sup>



CREF maintained that there was no fundamental policy reason that a money market fund should be required to maintain a constant share price in order to take advantage of the amortized cost method. In granting the requested relief, the Staff accorded weight to the following key representations by CREF: (i) the Fund’s board of directors would determine that it is in the best interests of the Fund and its investors to provide additional stability in the Fund’s price per share by using the amortized cost method and complying with the other requirements of Rule 2a-7 (other than maintaining a constant share price); (ii) the Fund’s board of directors would adopt written procedures reasonably designed to maintain stability in the Fund’s price per share;<sup>5</sup> and (iii) the Fund’s prospectus would clearly indicate that the Fund does not maintain a constant value per share and that the Fund’s share value will fluctuate. The Staff suggested that, consistent with the purposes of Rule 2a-7, the foregoing procedures should provide investors with sufficient protection against dilution (despite the lack of a commitment to maintain a constant share price).

The CREF no-action letter is available at <http://www.sec.gov/divisions/investment/noaction/2009/cref041309.htm>. ■

## inside

- 2 | SEC Charges Investment Adviser with Violating Proxy Voting Rule
- 2 | NYSE Amends Its Immediate Release Policy
- 3 | New Rules Require Mutual Funds to Use XBRL
- 4 | SEC Adopts Summary Prospectus Rules
- 5 | ETFs Required to Provide Additional Disclosure Aimed at Retail Investors

- 1 College Retirement Equities Fund (pub. avail. April 13, 2009).
- 2 The Fund is one of the investment portfolios of CREF, an open-end investment company that issues variable annuity certificates. The Fund holds itself out as a money market fund within the definition of Rule 2a-7(b) under the Investment Company Act of 1940.
- 3 CREF represented that it did not distribute dividends due to its “single-tier” structure (*i.e.*, a variable annuity issuer which both issues annuities and holds and manages its investment portfolio) and thus, that maintaining a stable price per share is not feasible.
- 4 Furthermore, Rule 2a-7(c)(7) under the 1940 Act conditions use of the amortized cost method on the board of the fund establishing written procedures reasonably designed to stabilize the money market fund’s net asset value per share at a single value.
- 5 CREF represented that the procedures would include all of those required by Rule 2a-7(c)(7) for funds using the amortized cost method other than procedures designed to enable the Fund to maintain a stable net asset value per share at a single value.

## SEC Charges Investment Adviser with Violating Proxy Voting Rule

The Securities and Exchange Commission (the “Commission”) has charged a registered investment adviser and its former chief operating officer with violating the investment adviser proxy voting rule—Rule 206(4)-6 (the “Proxy Voting Rule”) under the Investment Advisers Act of 1940 (“Advisers Act”). Rule 206(4)-6 generally makes it a fraudulent, deceptive or manipulative practice, within the meaning of Section 206(4) of the Advisers Act, for an investment adviser to exercise voting authority with respect to client securities unless the adviser has policies and procedures that are reasonably designed to ensure that securities are voted in the best interest of clients and addresses material conflicts of interest between the adviser’s interest and those of its clients.<sup>1</sup> In a settled administrative proceeding,<sup>2</sup> the Commission found that INTECH Investment Management LLC (“INTECH”) violated the Proxy Voting Rule because its policies and procedures did not include how the adviser would address material conflicts of interest that may arise between its interests and those of its clients, and did not sufficiently describe its proxy voting policies and procedures to clients.<sup>3</sup>

INTECH manages portfolios for institutional clients, including both union and non-union-affiliated clients, such as foundations, public funds and corporations. Under its proxy voting procedures, it voted all proxies in accordance with the recommendations of a third-party proxy voting service. Initially, it followed guidelines of a third-party proxy voting service generally consistent with those supported by public company management. However, in response to complaints from some of its union-affiliated clients, INTECH began to vote all proxies in accordance with a different set of guidelines provided by the third-party service, which guidelines were supported by the AFL-CIO union (the “AFL-CIO Guidelines”). INTECH believed that by following the AFL-CIO Guidelines on proxy voting, it would improve its ability to maintain existing, and to attract new, union-affiliated clients. The Commission found that INTECH’s proxy voting policies and procedures did not address the potential conflict caused by implementation of the AFL-CIO Guidelines for all of its clients (*i.e.*, non-union clients) and that INTECH did not disclose to clients that the proxy voting guidelines it was using followed the AFL-CIO Guidelines.

## NYSE Amends Its Immediate Release Policy

The New York Stock Exchange LLC (“NYSE”) Listed Company Manual requires NYSE-listed companies (including closed-end investment companies and business development companies that are NYSE-listed) (“Listed Companies”) to release quickly to the public any news or information which might reasonably be expected to materially affect the market for their securities (“Immediate Release Policy”).<sup>1</sup> Effective May 7, 2009, the NYSE has amended the Listed Company Manual (the “Amendments”) to allow Listed Companies the flexibility to comply with the Immediate Release Policy by choosing



Under the terms of the Commission’s order, INTECH, and its former chief operating officer were required to pay civil money penalties, were censured and were required to cease and desist from committing or causing any violations of the Proxy Voting Rule. The full text of the Release is available at <http://www.sec.gov/litigation/admin/2009/ia-2872.pdf>. ■

- 1 Rule 206(4)-6 also requires an adviser to describe to its clients its proxy voting policies and procedures, and, upon request, to furnish a copy of the policies and procedures to the requesting client.
- 2 In the Matter of INTECH Investment Management LLC and David E. Hurley, Investment Advisers Act Release No. 2872 (May 7, 2009).
- 3 The Commission charged INTECH’s former chief operating officer (“COO”) with violating proxy voting rule requirements since the COO was involved in drafting the firm’s proxy voting policies and procedures, was responsible for evaluating whether certain proxy votes created conflicts between INTECH and its clients interests and knew about the firm’s potential conflict of interest regarding the proxy voting policies and INTECH’s business interests.

any method (or combination of methods) of public disclosure that complies with Regulation Fair Disclosure under the Securities Exchange Act of 1934, as amended (“Regulation FD”). Prior to the Amendments, Listed Companies were required to comply with the Immediate Release Policy by issuing a press release.

Regulation FD allows a public company to disclose material information by any means reasonably designed to effect “broad, non-exclusionary distribution of the information to the public.”<sup>2</sup> Acceptable methods of public disclosure for

*continued on page 3*

## NYSE Amends Its Immediate Release Policy

continued from page 2

purposes of Regulation FD include: furnishing or filing with the Securities and Exchange Commission (the "Commission") a Form 8-K, issuing a press release through a widely circulated news or wire service, making announcements through press conferences, conference calls or webcasts<sup>3</sup> and, in certain circumstances, adding disclosure on the Listed Company's website.<sup>4</sup> The method chosen should take into account the particular circumstances of the Listed Company.

The Amendments also clarify that if an announcement of news of a material event or a statement dealing with a rumor calls for immediate release before the opening of the market or during market hours (9:30 A.M. to 5:00 P.M., New York time), prior notification to the NYSE is *required*. Previously, the NYSE recommended, but did not require Listed Companies to provide such advance notice. The prior notification must be made by telephone to the Listed Company's NYSE representative, at least ten minutes prior to public disclosure, indicating the substance of

the announcement, the method of dissemination and the information necessary to locate the news upon publication. If the announcement is in written form, Listed Companies must also provide the text of such announcement to the NYSE by email at least ten minutes prior to public disclosure. The newly mandated procedure is intended to better enable the NYSE to consider whether trading in the relevant security should be temporarily halted. The Commission's release relating to the Amendments is available at <http://www.sec.gov/rules/sro/nyse/2009/34-59823.pdf>. ■

1 Section 202.05 of the NYSE's Listed Company Manual.

2 Rule 101 (e)(2) of Regulation FD.

3 See *Selective Disclosure and Insider Trading*, Release No. 34-43154, Section II.B.4 (August 15, 2000).

4 See *Commission Guidance on the Use of Company Web Sites*, Release No. 34-58288, Section II.A.2 (August 7, 2008).

## New Rules Require Mutual Funds to Use XBRL

In an effort to facilitate "comparison shopping" by mutual fund investors, the Securities and Exchange Commission (the "Commission") has adopted rule amendments requiring mutual funds to file risk/return summary information with the Commission using an interactive data format.<sup>1</sup> With interactive data as a resource, the Commission believes investors will be able to compare and contrast funds efficiently and select a mutual fund that best matches their appetite for risk. The amendments call for mutual funds to file with the Commission risk/return summary information in XBRL (Extensible Business Reporting Language), an electronic format that enables web browsers and software applications to recognize and process "tagged" information.<sup>2</sup> This information would be filed only as an exhibit to registration statements and thus would not impact the disclosure or format standards required for mutual fund prospectuses. (Fund prospectuses are already required to include a risk/return summary containing key information about the fund's investment objectives and strategies, costs, risks and past performance.) Funds will also be required to post on their websites the interactive risk/return summary data in XBRL format.<sup>3</sup>

The Commission anticipates investors using the XBRL data in different ways, such as for downloading cost and performance information directly into spreadsheets or incorporating the data into commercial software.<sup>4</sup> This XBRL initiative follows other programs established by the Commission to transform and modernize information access for investors. For instance, on August 19, 2008, the Commission unveiled the Interactive Data Electronics Applications database ("IDEA"), an advanced information portal that allows investors to perform customized searches of fund information, and which supplements, and eventually will replace, the EDGAR system for electronic filing.<sup>5</sup>

It is important to note that, for the time being, the interactive data file generally will not be subject to liability under anti-fraud provisions of the federal securities laws, provided the fund makes a good faith attempt to comply with the

data submission requirements (*i.e.*, tagging and formatting the data as required by the rule).<sup>6</sup> However, after October 31, 2014, this liability exception would cease to apply and the interactive data file will be subject to the same liability provisions as the underlying filing.<sup>7</sup>

The first required submissions of XBRL data are in connection with registration statements that become effective after January 1, 2011.<sup>8</sup> The full text of the Adopting Release is available at <http://www.sec.gov/rules/final/2009/33-9006.pdf>. ■

1 See Interactive Data for Mutual Fund Risk/Return Summary, Investment Company Act Release No. 28617 (Feb. 11, 2009) ("Adopting Release") and see Investment Company Act Release No. 28617A (May 1, 2009) making technical corrections. See also Interactive Data for Mutual Fund Risk/Return Summary, Investment Company Act Release No. 28298 (June 10, 2008) ("Proposing Release").

2 Under the new rules, a mutual fund would "tag" its risk/return summary information using a list of tags initially developed by the Investment Company Institute. Adopting Release at n.46. The list of tags contains descriptive labels, authoritative references to Commission regulations where applicable and other elements designed to provide the contextual information necessary for interactive data to be recognized and processed by software. Adopting Release at 14.

3 The website-posting requirement applies only to those mutual funds that already maintain a website. Adopting Release at 32.

4 Proposing Release at 7.

5 See "SEC Announces Successor to EDGAR Database," Securities and Exchange Commission Press Release, Aug. 19, 2008, available at <http://www.sec.gov/news/press/2008/2008-179.htm>.

6 Adopting Release at 46-47.

7 *Id.* at 47.

8 *Id.* at 57. Mutual funds will not be required to comply with the provision to submit a tagged risk/return summary exhibit with any form of prospectus filed pursuant to Rule 497(c) or (e) under the Securities Act of 1933, as amended, until that fund has first submitted an exhibit with a registration statement that has become effective after January 1, 2011.

# SEC Adopts Summary Prospectus Rules

On January 13, 2009, the Securities and Exchange Commission (the “Commission”) published amendments to the registration statement form used by mutual funds to require the inclusion of a summary section at the front of every prospectus that contains key information about the fund, including investment objectives and strategies, risks, costs and performance information.<sup>1</sup> The Commission also issued rule amendments allowing funds the option of delivering to investors only the summary section of the prospectus (provided the full statutory prospectus is made available to investors on a fund’s website and delivered to investors upon request). The changes are intended to focus investors on “key information that is important to an informed investment decision.”<sup>2</sup>

The summary section must include the following elements (in the following order):

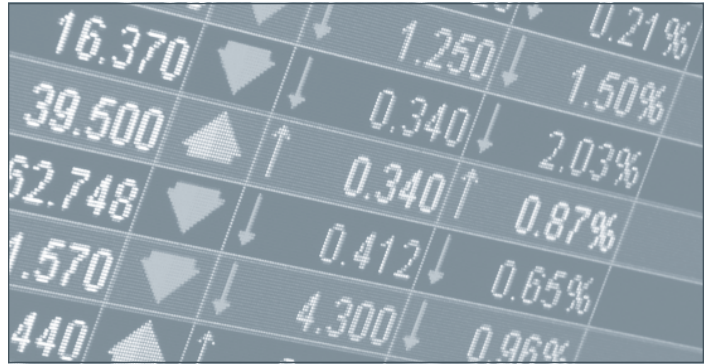
- (1) Description of investment objectives and goals;
- (2) Fee table (including annual expenses and any sales charges) and an example of costs;
- (3) Description of principal investment risks and prior performance;
- (4) Identification of fund management (*i.e.*, investment advisers and portfolio managers);
- (5) Terms for purchase and sale of fund shares;
- (6) Certain tax information; and
- (7) Disclosure of financial intermediary compensation.

The summary section is prohibited from including any additional information. The only items that can precede the summary are the prospectus cover page and table of contents. The Commission expects that the summary section will be concise (approximately three or four pages in length), although there is no mandated maximum number of pages.<sup>3</sup>

Information about multiple classes of shares of any one fund may be combined in the summary section for that fund. However, a prospectus for multiple funds must present a separate summary section for each fund and may not combine the information for more than one fund (except for the information required by Items 5 through 7 above, provided these items are identical for all funds covered in the prospectus).

## The “Summary Prospectus” Delivery Option

Under amended Rule 498, the obligation to deliver a mutual fund prospectus under the Securities Act of 1933, as amended, may be satisfied by delivering a stand-alone “summary prospectus.” This summary prospectus is required to contain the information that must be included in the summary section of the statutory prospectus. It may also incorporate by reference information contained in the remainder of a fund’s statutory prospectus and statement of additional information (“SAI”). A stand-alone summary prospectus must include on its cover the fund’s name (and



covered share classes), the fund’s exchange ticker symbol, the date of the summary, a statement identifying the document as a “Summary Prospectus” and the following legend:

Before you invest, you may want to review the Fund’s prospectus, which contains more information about the Fund and its risks. You can find the Fund’s prospectus and other information online at [\_\_\_\_\_]. You can also get this information at no cost by calling [\_\_\_\_\_] or by sending an e-mail request to [\_\_\_\_\_].

It should, however, be noted that: “provided the content and order requirements of the rule are met, funds have almost complete flexibility with respect to design matters, including layout, graphics and color.”<sup>4</sup> The Commission believes that this new summary prospectus delivery option will enable investors to obtain useful mutual fund information in a format that they are more likely to use and understand.<sup>5</sup> To the extent a fund chooses to avail itself of the summary prospectus option, both its statutory prospectus and SAI must be made available on the fund’s website. Also, the complete statutory prospectus must be furnished upon request.

Mutual funds will be required to comply with the form amendments for registration statement filings made on or after January 1, 2010, although funds may elect to comply prior to that date. The summary prospectus delivery option became effective March 31, 2009. Thus, mutual funds may now avail themselves of this option. The full text of the Adopting Release is available at <http://www.sec.gov/rules/final/2009/33-8998.pdf>. ■

1 See Enhanced Disclosure and New Prospectus Delivery Option For Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) (“Adopting Release”) and see Investment Company Act Release No. 28584A (May 28, 2009), making technical corrections to cross-references and a citation. We note that the Adopting Release also includes enhanced disclosure requirements for open-end exchange-traded funds (“ETFs”). The ETF-related requirements are discussed in a separate Article, “ETFs Required to Provide Additional Disclosure Aimed at Retail Investors.”

2 Adopting Release at 14-15.

3 Adopting Release at 24.

4 Adopting Release at 73.

5 Adopting Release at 61.

# ETFs Required to Provide Additional Disclosure Aimed at Retail Investors

On January 13, 2009, the Securities and Exchange Commission (the “Commission”) adopted several amendments to the registration form for open-end funds that require exchange-traded funds, or ETFs, to disclose additional information in their prospectuses intended for retail investors who purchase ETF shares in secondary market transactions.<sup>1</sup> Although ETFs are classified, as a technical matter, as open-end funds (*i.e.*, they offer daily redemption rights to investors accumulating large blocks of shares known as “creation units”), from a retail investor’s standpoint, they more resemble publicly-traded, closed-end funds since their shares trade throughout the day on an exchange.

Specifically, the amendments require ETF prospectuses to: (1) identify the principal U.S. exchange or exchanges on which the ETF shares trade and the fund’s exchange ticker symbol(s); (2) indicate that investors in ETF shares may pay brokerage commissions not reflected in the fee table; (3) explain that shareholders may pay more than the ETF’s NAV per share when purchasing shares on the market and may receive less than NAV per share when selling shares on the market, (4) disclose the extent to which market prices of ETF shares have tracked the fund’s NAV; and (5) disclose the number of trading days during the most recently completed calendar year (and quarters since that year) on which the market price of the ETF shares traded above and below its NAV (“premium/discount information”).<sup>2</sup> The premium/discount information need not be included if it is provided on the ETF’s website and the prospectus identifies the website address where the information can be located.<sup>3</sup>

The amendments also permit an ETF with a creation unit size of at least 25,000 shares to exclude prospectus disclosure on how to purchase and redeem shares directly

from the ETF<sup>4</sup> (though such information must still be included in the ETF’s statement of additional information). The Commission reasoned that ETF prospectus disclosure should be more suited to retail investors, rather than institutions and firms that purchase large-block “creation units” directly from the ETF.

The amendments became effective on March 31, 2009. All Form N-1A registration statements for ETFs filed on or after January 1, 2010, must comply with the new disclosure requirements. The full text of the Adopting Release is available at <http://www.sec.gov/rules/final/2009/33-8998.pdf>. ■

- 1 These amendments were among a series of others included in the Commission’s adopting release that related primarily to the new summary prospectus rules (which are covered in a separate Article, “SEC Adopts Summary Prospectus Rules”). See “Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies,” Investment Company Act Release No. 28584 (Jan. 13, 2009) (“Adopting Release”).
- 2 For purposes of calculating premium/discount information, the Commission also adopted a definition of “market price,” which refers to “the last reported sale price at which ETF shares trade on the principal U.S. market on which the fund’s shares are traded during a regular trading session or, if it more accurately reflects the current market value of the fund’s shares at the time the fund uses to calculate its NAV, a price within the range of the highest bid and lowest offer on the principal U.S. market on which the fund’s shares are traded during a regular trading session.” Adopting Release at n. 192.
- 3 Adopting Release at 56. Currently, ETFs are required to disclose on their websites the prior business day’s last determined NAV, the market closing price of the fund’s shares or the midpoint of the bid-ask spread at the time of the calculation of NAV, and the premium/discount of that price to NAV. Adopting Release at n. 183.
- 4 See Adopting Release at 54.

## Disclaimer

The information in this newsletter has been prepared by Schulte Roth & Zabel LLP (“SRZ”) for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty whatsoever as to the accuracy or completeness of the information or whether it reflects the most current legal developments. Distribution of this information is not intended to create, and its receipt does not constitute, an attorney-client relationship between SRZ and you or anyone else. Electronic mail or other communications to SRZ (or any of its attorneys, staff, employees, agents or representatives) resulting from your receipt of this information cannot be guaranteed to be confidential and will not, and should not be construed to, create an attorney-client relationship between SRZ and you or anyone else. No one should, or is entitled to, rely in any manner on any of this information. Parties seeking advice should consult with legal counsel familiar with their particular circumstances. Under the rules or regulations of some jurisdictions, this material may constitute advertising.

© 2009 Schulte Roth & Zabel LLP. All Rights Reserved.

SchulteRoth&Zabel® is the registered trademark of Schulte Roth & Zabel LLP.

## For more information, contact:



**Kenneth S. Gerstein** is a partner in the investment management group at Schulte Roth & Zabel. He represents investment advisers, broker-dealers and banks in the organization and operation of investment funds and services, including mutual funds, hedge funds, closed-end investment companies, business development companies, bank collective funds, wrap accounts and other investment products. He also advises clients on a broad range of securities regulatory and compliance matters.

+1 212.756.2533 | [kenneth.gerstein@srz.com](mailto:kenneth.gerstein@srz.com)



**George M. Silfen** is a partner in the investment management group at Schulte Roth & Zabel. He represents investment companies and their boards of directors, investment advisers and broker-dealers in connection with the organization and operation of investment products and services, including mutual funds, closed-end investment companies, business development companies, registered hedge funds, wrap accounts, and 401k and IRA products. He also advises on regulatory and compliance matters.

+1 212.756.2131 | [george.silfen@srz.com](mailto:george.silfen@srz.com)



**Philip A. Heimowitz** is special counsel in the investment management group at Schulte Roth & Zabel. He advises on registered and unregistered funds, regulatory and compliance issues, unit investment trusts and swaps and derivatives.

+1 212.756.2583 | [philip.heimowitz@srz.com](mailto:philip.heimowitz@srz.com)

### Schulte Roth & Zabel

#### New York

Schulte Roth & Zabel LLP  
919 Third Avenue  
New York, NY 10022  
+1 212.756.2000  
+1 212.593.5955 fax

[www.srz.com](http://www.srz.com)

#### Washington, DC

Schulte Roth & Zabel LLP  
1152 Fifteenth Street, NW, Suite 850  
Washington, DC 20005  
+1 202.729.7470  
+1 202.730.4520 fax

#### London

Schulte Roth & Zabel International LLP  
Heathcoat House  
20 Savile Row, London W1S 3PR  
+44 (0) 20 7081 8000  
+44 (0) 20 7081 8010 fax