

**SEC ADOPTS FINAL RULES ON DISCLOSURE REGARDING PORTFOLIO MANAGERS OF INVESTMENT COMPANIES**

The Securities and Exchange Commission (the “SEC”), as part of its ongoing effort to improve the disclosure that funds provide to investors and to increase transparency regarding fund management and expenses, recently adopted final rules<sup>1</sup> requiring that:

- a fund identify in its prospectus each member of a committee, team or other group of persons that is jointly and primarily responsible for the day-to-day management of the fund’s portfolio (or, in the case of a team with more than five such members, the five members with the most significant responsibility for the day-to-day management of the fund’s portfolio);
- a fund provide information in its statement of additional information (“SAI”) regarding other accounts managed by any of its portfolio managers, including a description of material conflicts of interest that may arise in connection with simultaneously managing the fund and the other accounts;
- a fund disclose in its SAI the structure of, and the method used to determine, the compensation of each portfolio manager;
- a fund disclose in its SAI each portfolio manager’s ownership of securities in the fund; and
- a closed-end fund provide disclosure regarding its portfolio managers in its reports on Form N-CSR.

The final rules will become effective on October 1, 2004. All registration statements on Forms N-1A, N-2 and N-3, including post-effective amendments, filed on or after February 28, 2005 must include the disclosure required by the amendments. Closed-end funds must include the disclosure required by the amendments in all annual reports filed on Form N-CSR for fiscal years ending on or after December 31, 2005 and in all semi-annual reports filed on Form N-CSR after the first such annual report is filed.

**Identification of Portfolio Management Team Members**

The amendments to Forms N-1A, N-2 and N-3 require a fund to disclose in its prospectus the name, title, length of service and business experience of each member of a committee, team or other group of persons associated with the fund or its investment adviser that is jointly and primarily responsible for the day-to-day management of the fund’s portfolio. A fund is not required to provide such information for any individual who is part of a fund’s portfolio management team but is not “jointly and primarily responsible” for the day-to-day management

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<sup>1</sup> SEC Release No. IC-26533 (August 23, 2004) (the “Adopting Release”).

of the fund's portfolio. If more than five persons are "jointly and primarily responsible," the fund need only provide the required information for the five persons with the most significant responsibility.

The SEC stated that the determination of the members of a portfolio management team who are "jointly and primarily responsible" will depend on the facts and circumstances of a particular fund. Although the SEC has not provided definitive guidance on when a portfolio management team member is deemed to be "jointly and primarily responsible," it suggested in the Adopting Release that whether a member of a portfolio management team is "jointly and primarily responsible" depends on the member's authority to make or influence investment decisions for the fund. The SEC stated that an analyst who makes securities recommendations for a fund but does not have decision-making authority could be deemed to be "jointly and primarily responsible" if, for example, the individual who has decision-making authority routinely adopts the analyst's recommendations. Furthermore, the SEC stated that when a single "lead member" is responsible for implementing and monitoring the overall management of a fund's portfolio, it may be appropriate to identify this single "lead member" as the fund's portfolio manager. Similarly, in the case of a research-driven fund, where portfolio management functions are allocated among as many as 50 members, it may be appropriate for the fund to identify the coordinator as its portfolio manager or provide the required disclosure for the five persons with the most significant responsibility for the day-to-day management of the fund's portfolio.

The rule and form amendments also require a fund to provide a brief summary of each portfolio management team member's role, including any limitations on the person's role and the relationship between the person's role and the roles of other persons who have responsibility for the day-to-day management of the fund's portfolio. This requirement is intended to clarify each portfolio management team member's daily responsibilities and assist investors in understanding how a portfolio management team member's responsibilities differ from those of other members, including those who may not be identified in the prospectus as portfolio managers.

The amendments remove the current provision in Form N-1A that excludes index funds from the requirement to identify and provide information about portfolio managers in their prospectuses. Index funds will now be subject to the same portfolio manager disclosure requirements as actively managed funds. The SEC indicated that such disclosure will shed light on the alignment of index fund portfolio managers' interests with shareholders' interests and on their potential conflicts of interest, such as conflicts in determining trading execution priorities.

The amendments require a fund to provide, adjacent to the disclosure identifying its portfolio managers, disclosure that the SAI includes additional information regarding portfolio managers' compensation, other accounts managed by the portfolio managers and the portfolio managers' ownership of securities in the fund. In addition, the amendments require that the back cover page of a fund's prospectus state whether the fund makes available its SAI and annual and semi-annual reports, free of charge, on or through its Web site at a specified Internet address. If a fund does not make its SAI and shareholder reports available in this manner, the fund is required to disclose the reasons for not doing so, including why the fund does not have a Web site. The

amendments require similar disclosure for the front cover page of the prospectuses of closed-end funds and insurance company separate accounts that issue variable annuity contracts. The front cover page of the prospectuses of these entities will be required to include a statement explaining how to obtain a shareholder report and a toll-free (or collect) telephone number for investors to call to request the SAI, annual and semi-annual reports and other information, and to make shareholder inquiries.

### **Disclosure Regarding Other Accounts Managed and Potential Conflicts of Interest**

The amendments require a fund to provide information in its SAI regarding any other accounts<sup>2</sup> for which the fund's portfolio manager is jointly and primarily responsible for day-to-day portfolio management.<sup>3</sup> For each portfolio manager who is required to be identified in a fund's prospectus,<sup>4</sup> the fund is required to disclose in its SAI the total number of other accounts managed by the portfolio manager, the total assets in the accounts and the number of accounts and total assets for which the adviser receives a performance-based fee. The amendments also require a fund to describe any material conflicts of interest that may arise in connection with the portfolio manager's simultaneous management of the fund and other accounts. The SEC stated in the Adopting Release that this description would include, for example, material conflicts between the investment strategies of the fund and those of the other accounts and material conflicts in allocation of investment opportunities between the fund and such other accounts. The SEC limited the disclosure requirement to "material"<sup>5</sup> conflicts to avoid inundating investors with lengthy descriptions of potential conflicts.

The SEC was persuaded by commenters not to adopt a proposal requiring funds to describe the policies and procedures used to address conflicts of interest. The SEC indicated that it believed such a requirement would result in lengthy disclosure that would be of little use to investors, but emphasized that its decision to omit such a requirement from the final rule does not diminish a fund's board of directors' and investment adviser's responsibility to address conflicts of interest that may arise from a portfolio manager's management of multiple accounts. The SEC also indicated that it would not prohibit portfolio managers of registered funds from managing certain types of accounts, such as hedge funds. The SEC determined that such a prohibition could deprive investors of access to talented portfolio managers and could disadvantage smaller investment management firms that may not have sufficient resources to maintain separate staffs for different types of accounts.

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<sup>2</sup> "Accounts" include registered investment companies, other pooled investment vehicles and other accounts.

<sup>3</sup> The information regarding other accounts managed by a portfolio manager, compensation structure and ownership of fund securities must be provided as of the end of the fund's most recently completed fiscal year. However, in the case of an initial registration statement or an update to a fund's registration statement that discloses a new portfolio manager, this information must be provided as of the most recent practicable date.

<sup>4</sup> If a fund identifies more than five persons as portfolio managers in its prospectus, it need only provide the required disclosure regarding other accounts managed, compensation and securities ownership for the five persons with the most significant responsibility for the day-to-day management of the fund's portfolio.

<sup>5</sup> A conflict would be material if there is a substantial likelihood that the conflict would be viewed by a reasonable investor as significantly altering the "total mix" of information available about the fund.

### **Disclosure of Portfolio Manager Compensation Structure**

The amendments require a fund to include in its SAI a description of the structure of, and the method used to determine, the compensation received by its portfolio manager with respect to the fund and other accounts managed by the portfolio manager. “Compensation” includes, without limitation, salary, bonus, deferred compensation and pension and retirement plans and arrangements, whether compensation is cash or non-cash. The SEC modified the proposal to permit funds to omit disclosure regarding group life, health, hospitalization, medical reimbursement, relocation and pension and retirement plans and arrangements, provided they do not discriminate in scope, terms or operation in favor of the portfolio manager or a group of employees that includes the portfolio manager and are available generally to all salaried employees. The description of a portfolio manager’s compensation would be required to specify the criteria upon which the compensation is based and any differences in the compensation received for managing the fund versus other accounts, including, for example, whether the manager receives a portion of a performance-based fee on some accounts other than the fund.

### **Disclosure of Securities Ownership of Portfolio Managers**

In order to provide a basis for investors to assess whether a fund’s portfolio manager’s interests are aligned with their own, the amendments require a fund to disclose in its SAI the dollar range of fund securities owned beneficially by each portfolio manager who is required to be identified in the prospectus. The SEC did not adopt its proposal to require funds to disclose a portfolio manager’s ownership not only of securities of the fund, but also of securities of other accounts managed by the portfolio manager or the fund’s investment adviser because it determined that such a requirement would result in overly detailed, complex disclosure that would not help investors determine the extent to which a portfolio manager’s interests are aligned with theirs.

### **Amendment of Form N-CSR**

Because closed-end funds do not offer their shares continuously and therefore are not required to maintain an updated SAI to meet their obligations under the Securities Act of 1933, closed-end funds will be required to include the disclosure regarding their portfolio managers in their annual reports on Form N-CSR.

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If you have any questions concerning this memorandum, please contact Burton M. Leibert (212-728-8238, bleibert@willkie.com), Rose F. DiMartino (212-728-8215, rdimartino@willkie.com), Daniel Schloendorn (212-728-8265, dschloendorn@willkie.com), or Brooke A. Brown (212-728-8533, bbrown@willkie.com).

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is 212-728-8000 and our facsimile number is 212-728-8111. Our Web site is located at [www.willkie.com](http://www.willkie.com).

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