IDC Independent Directors Council
Promoting Excellence in Fund Governance

ICI Comments on Securities Offering Reform, January 2005

January 31, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Securities Offering Reform (File No. S7-38-04)

Dear Mr. Katz:

The Investment Company Institute [1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposals to modify the registration, communications, and offering processes under the Securities Act of 1933. [2] The proposals represent a thoughtful and balanced approach to reforming the public company securities offering process.

The Institute's comments reflect the views of our members as both investors and issuers. From an investor perspective, we strongly support the goals of the proposals. An efficient offering process is critical to our members, who, on behalf of millions of individual shareholders, are significant investors in securities. We commend the Commission for its efforts to reform the securities offering process and believe the proposals would bring significant benefits to investors, both institutional and retail. In this regard, we have a few recommendations in order to further the goals of the proposals.

Most of the proposals do not apply to investment companies as issuers because mutual funds are subject to a separate securities offering framework governing registration, prospectuses, and communications. The Commission, however, requests comment on whether the proposals should apply to investment companies and, if so, how they should be modified to reflect their unique offering process.

In view of the differences between the offering processes of mutual funds and other issuers, we do not believe that the Commission should apply the current proposals to mutual funds, including, for example, the proposed interpretive rule relating to liability. Instead, we urge the Commission to evaluate and develop recommendations to improve the mutual fund offering and disclosure regime in the context of a comprehensive proposal focused on funds. The current proposals provide a constructive framework and starting point for considering such reforms. Most significantly, an "access equals delivery" model, similar to that set forth in the proposals, recognizes that the widespread adoption of advancements in technology make alternative forms of prospectus delivery feasible. At the same time, any reforms to the offer and sale of mutual fund shares should consider other Commission initiatives that would affect the sale of fund shares, such as the proposed point-of-sale disclosure document currently being considered by the Commission. [3] We welcome the opportunity to work with the Commission and its staff in developing such reforms.

Our specific comments follow.

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Liability Provisions

The proposals clarify seller liability for purposes of Sections 12(a)(2) and 17(a)(2) of the Securities Act and issuer liability under Section 12(a)(2). This aspect of the proposals would apply to the offer and sale of mutual fund shares.

Unlike other issuers, mutual funds typically offer their shares on a continuous basis. To engage in continuous offerings under the Securities Act, mutual funds must maintain current registration statements. Mutual funds also use alternatives to the statutory prospectus for disseminating information, such as Securities Act Rule 482 advertisements and Rule 498 profiles, that are already subject to Section 12(a)(2) liability and the antifraud provisions of the federal securities laws.

The Institute is concerned that the proposals could lead to an increased scrutiny of communications between a broker and a fund investor that occur at or before the point of sale. As a result, brokers may direct their sales efforts to products not subject to such liability considerations, and which may provide investors with less stringent regulatory protections. Brokers also may be discouraged from effecting a fund sale orally without delivering or making available a statutory prospectus to investors prior to sale. Such a practice could disrupt longstanding sales practices of fund shares and create an unnecessary "speed bump" in the offering process. Indeed, the Commission has previously considered and rejected

requiring an advance prospectus delivery requirement for mutual funds because of the time delays, additional costs, and administrative burdens that would be imposed. [4] For the foregoing reasons, we recommend that the Commission reconsider its proposed interpretive rule and liability proposals as they would apply to mutual funds, and instead consider all related issues in a separate rulemaking initiative specifically tailored to funds.

Prospectus Delivery Reforms

The Institute strongly supports the proposed "access equals delivery" model for satisfying the final prospectus delivery obligations under the Securities Act. This model would allow issuers to capture, process, and disseminate disclosure information to investors in a cost-efficient manner. An "access equals delivery" model also benefits investors by facilitating tailored disclosures to investors depending on their level of investment experience and interest. For example, certain information could be provided to investors at the point of sale and other more detailed information could be made available on a public website. As noted above, such a model should be considered by the Commission in a separate rulemaking initiative for funds.

Communications During the Offering Process

The Institute supports the proposals that would update and liberalize permitted offering activity and communications by substantially revising the long-standing "gun-jumping" restrictions under the Securities Act. We believe the proposals would result in significant benefits to investors by encouraging issuers to provide increased information to investors on a more current and ongoing basis.

Safe Harbors for Ongoing Communications During an Offering

The Institute supports the proposed safe harbors for regularly released ongoing business communications. Our members report that the current practice often causes issuers to curtail, if not suspend, their ordinary ongoing communications during a registered offering, which has been detrimental to the transparency and availability of information to investors. The proposed safe harbors would provide investors and others with timely, ongoing, and complete disclosure of important information about an issuer with very little risk that such information would be used to condition the market for a securities offering. [5] Providing this information through a safe harbor also would provide issuers with greater certainty that the release of information would not be considered to be an impermissible offer under the Securities Act.

The Institute is concerned, however, that certain conditions imposed on the safe harbors may limit their usefulness. For example, it is unclear what constitutes "regularly" released information because the proposals do not establish any minimum time period to satisfy this condition. In addition, the safe

harbors do not appear to allow for innovative advances in the methods of communication by issuers because of the condition that the timing, manner and form of the information be materially consistent with prior practice. Accordingly, we recommend that the Commission reconsider and clarify these conditions.

Permitted Communications Prior to Filing a Registration Statement

The Institute supports the proposals that would, under certain conditions, provide a bright-line safe harbor for communications made by or on behalf of any issuer during the time period ending 30 days prior to the filing of a registration statement. The proposed safe harbor would be limited to issuers and would not permit information about a securities offering.

To maximize the safe harbor's flexibility, we believe it should be extended to any communications that occur during a specified period before the issuer files a registration statement. We believe the antifraud liability under the federal securities laws would sufficiently deter false or misleading statements during this period. The Institute also believes that the 30-day "quiet period" during which communications are restricted for issuers (other than those defined as "well known seasoned issuers") and their representatives provides sufficient investor protection. We therefore recommend that the Commission eliminate the communication limitation regarding offering related information from the proposed safe harbor.

Permitted Communications After Filing a Registration Statement

The Institute supports the proposals that would permit all issuers and other offering participants, under specified conditions, to use a new type of written communication called a "free writing prospectus" after the filing of the registration statement. We believe that free writing prospectuses will further facilitate the availability of increased information about the terms of securities offerings prior to investors' commitment to purchase, while providing investors with protections against materially false or misleading statements. In addition, conditioning the use of a free writing prospectus for a non-reporting or unseasoned issuer on the prior or contemporaneous delivery of a statutory prospectus would ensure that investors have balanced information about an issuer that has limited or no reporting history.

The Institute is concerned regarding the potential cross-liability of offering participants for the free writing prospectuses of other participants. For example, the proposals do not address whether the mere filing of a free writing prospectus by one party would subject other participants in the offering to potential liability to all purchasers. The proposals also do not address whether purchasers who access free writing prospectuses on file with the Commission may seek to bring Section 12(a)(2) claims against the offering participant that prepared the material even though they ultimately did not purchase

securities from that person. Thus, in order to encourage issuers and other offering participants to use free writing prospectuses as a way to increase the information provided to investors, we recommend the Commission clarify the circumstances under which participants in an offering could be liable for the free writing prospectuses of other participants.

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The Institute appreciates the opportunity to comment on these significant proposals. If you have any questions or need additional information, please contact me at (202) 326-5824, Ari Burstein at (202) 371-5408, or Jane G. Heinrichs at (202) 371-5410.

Sincerely yours,

Amy B.R. Lancellotta
Senior Counsel

cc: The Honorable William H. Donaldson, Chairman
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Harvey J. Goldschmid, Commissioner
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner

Alan L. Beller
Director, Division of Corporation Finance

Paul F. Roye
Director, Division of Investment Management

Securities and Exchange Commission

ENDNOTES

[1] The Investment Company Institute is the national association of the American investment company industry. Information about the Institute's membership is included in an addendum to this letter.

[2] SEC Release Nos. 33-8501, 34-50624, and IC-26649 (Nov. 3, 2004), 69 Fed. Reg. 67392 (Nov. 17, 2004) ("Proposing Release").

[3] See SEC Release Nos. 33-8358, 34-49148, and IC-26341 (Jan. 29, 2004).

[4] See SEC Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation 369 (May 1992).

[5] The proposals also would expand the information that must be filed on Form 10-K by requiring disclosure of the most significant risks associated with an investment in a company's securities. The Institute supports this proposal. As the Proposing Release notes, such risk factor disclosure in filings under the Securities Exchange Act of 1934 would further enhance the contents of Exchange Act reports and their value in informing investors about an issuer.
