



K&L GATES

2016 INVESTMENT MANAGEMENT CONFERENCE

Investment Objectives and Policies

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INVESTMENT OBJECTIVES

- An investment objective is a short statement that describes what the fund seeks to achieve for its shareholders.
- A fund may (but is not required to) designate its investment objective as a fundamental policy (i.e., changeable only with shareholder approval).
- If the investment objective is not fundamental, the fund must disclose this fact in its prospectus.



FUNDAMENTAL POLICIES

- Section 8(b) of the 1940 Act requires a registered fund to recite in its registration statement its policies with respect to certain types of investments and investment practices.
- Section 13 makes it unlawful for a registered fund to deviate from any policies set forth in response to Section 8(b) without a vote of a “majority of the outstanding voting securities” of the fund.



FUNDAMENTAL POLICIES

- Concentration
- Senior Securities
- Borrowing Money
- Underwriting
- Commodities
- Loans
- Real Estate

FUNDAMENTAL POLICIES – CONCENTRATION

- Section 8(b)(1)(E) requires a registered fund to disclose in its registration statement its policy with respect to concentrating its investments in a particular industry or group of industries.
- The SEC staff takes the position that investment (including holdings of debt securities) of more than 25% of the value of a fund's assets in any one industry represents concentration.



FUNDAMENTAL POLICIES – CONCENTRATION

(CONTINUED)

- If the fund intends to concentrate its investments in an industry or group of industries, the fund is required to disclose in its prospectus the industry or group of industries in which it will concentrate.
- If the fund does not intend to concentrate its investments, it may not invest in any given industry, if upon making the investment, more than 25% of the value of the fund's assets would be invested in such industry.
- If securities of a given industry come to constitute more than 25% of the value of the fund's assets due to market movements (as opposed to portfolio transactions), the fund generally is not required to sell the excess and it is not treated as a violation of its policy on concentrating investments.



FUNDAMENTAL POLICIES – SENIOR SECURITIES AND BORROWING MONEY

- Sections 8(b)(1)(B) and (C) require a registered fund to disclose in its registration statement its policy with respect to the issuance of senior securities and borrowing money.
- Section 18(f) prohibits a registered open-end fund from issuing any senior security.
- Section 18(g) defines a senior security as “any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness, and any stock of a class having priority over any other class as to distribution of assets or payment of dividends”



FUNDAMENTAL POLICIES – SENIOR SECURITIES AND BORROWING MONEY

(CONTINUED)

- Exceptions for borrowing money:
 - Section 18(g) states that a senior security does not include a borrowing from a bank which is “for temporary purposes only” and does not exceed 5% of the fund’s assets at the time the loan was made.
 - Section 18(f) provides that a registered open-end fund may borrow money, provided that (1) the borrowing is from a bank and (2) the fund has “asset coverage” (as defined in Section 18(h)) at least equal to 300% of such borrowings.



FUNDAMENTAL POLICIES – SENIOR SECURITIES AND BORROWING MONEY

(CONTINUED)

- The definition of “senior security” has been construed broadly by the SEC and its staff to apply to a wide variety of portfolio transactions, including futures contracts and options on futures contracts; forward commitment contracts, future commitments; and when-issued securities.
- The SEC has taken the position that Section 18 restrictions do not apply to the above types of portfolio transactions if a fund “covers” such transactions (e.g., enters into an offsetting portfolio transaction) or if it “segregates” assets (e.g., places liquid assets in a separate account, or marks such assets on the fund’s books, at least equal in value to the obligation undertaken by the fund).



FUNDAMENTAL POLICIES – UNDERWRITING

- Section 8(b)(1)(D) requires a registered fund to disclose in its registration statement its policy with respect to underwriting securities of other issuers.
- “Underwriter” is defined in Section 2(a)(40) of the 1940 Act generally to mean “any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking...”
- Funds commonly seek to provide flexibility for circumstances where a fund may be deemed to be an underwriter in connection with its regular investment program.



FUNDAMENTAL POLICIES – COMMODITIES

- Section 8(b)(1)(F) requires a registered fund to disclose in its registration statement its policy with respect to purchase or sale of commodities or commodities contracts.
- The Internal Revenue Code generally limits the ability of registered funds to invest directly in commodities.
- Funds commonly seek to preserve the ability to make commodities-related investments to the extent permissible, such as through the acquisition of securities or other instruments backed by commodities or securities of companies engaged in commodities businesses and through the acquisition of commodities due to ownership of securities or other instruments.



FUNDAMENTAL POLICIES – MAKING LOANS

- Section 8(b)(1)(G) requires a registered fund to disclose in its registration statement its policy with respect to making loans.
- The SEC staff has taken the position that the making of a loan does not include the purchase of a portion of an issue of debt securities, whether or not the purchase was made upon the original issuance of the securities.
- Funds commonly seek to (1) provide flexibility to invest in a wide range of debt instruments and (2) reserve the right to make loans of portfolio securities in connection with securities lending programs.



FUNDAMENTAL POLICIES – REAL ESTATE

- Section 8(b)(1)(F) requires a registered fund to disclose in its registration statement its policy with respect to the purchase or sale of real estate and real estate mortgage loans.
- The SEC staff generally takes the position that an interest in real estate includes securities of companies whose assets consist substantially of real property and interests therein, but does not include securities of companies whose investments in real estate are incidental to another business which is primary (e.g., banks).
- The Internal Revenue Code generally limits the ability of registered funds to invest directly in real estate.
- Funds commonly seek to preserve the ability to make real estate-related investments, such as through the acquisition of securities or other instruments backed by real estate or securities of companies engaged in real estate businesses and through the acquisition of real estate due to ownership of securities or other instruments.



FUND DIVERSIFICATION

- Section 5(b) of the 1940 Act classifies management companies as “diversified” or “non-diversified” investment companies. A “diversified” investment company must satisfy certain requirements.
 - At least 75% of the fund’s total assets must be represented by (i) cash and cash items (including receivables), (ii) Government securities (as defined in the 1940 Act), (iii) securities of other investment companies, and (iv) securities of other issuers, provided that the investment represented by securities of other issuers does not exceed 5% of the total assets of a fund or 10% of the voting stock of the issuer.
- If an investment company does not satisfy these requirements, it is a “non-diversified” company and must describe itself as such. Its disclosures, if it is offering its securities to the public, must note that status and the risks thereof.
- There are separate diversification standards for registered investment companies under the Internal Revenue Code.



FUND NAMES

- Section 35(d)
 - Prohibits a fund from using as its name any words which the SEC finds by rule or order to be “materially deceptive or misleading.”
- Rule 35d-1
 - Defines certain “materially deceptive or misleading” names for purposes of Section 35(d).



RULE 35D-1: SCOPE

- Rule 35d-1 addresses four categories of fund names:
 - Names suggesting guarantee or approval by the U.S. government;
 - Names suggesting investment in certain investments or industries;
 - Names suggesting investment in certain countries or geographic regions; and
 - Names suggesting that a fund's distributions will be exempt from federal and/or state income tax.



RULE 35D-1: U.S. GOVERNMENT

- Rule 35d-1 prohibits the use of any name suggesting that the fund or its shares are “guaranteed” or “approved” by the U.S. Government.
- This prohibition includes use of any name that uses the terms “guaranteed” or “insured” or similar terms in connection with “U.S. Government.”



RULE 35D-1: INVESTMENTS/INDUSTRIES

- Rule 35d-1 prohibits the use of any name suggesting that the fund focuses its investments in a particular type of investment, or in investments in a particular industry, unless:
 - The fund has a policy of investing at least 80% of the value of its assets in the particular type of investment, or in investments in the particular industry, suggested by its name; and
 - This policy is either fundamental or changeable only with at least 60 days prior notice to shareholders.



RULE 35D-1: COUNTRIES/REGIONS

- Rule 35d-1 prohibits the use of any name suggesting that the fund focuses its investments in a particular country or geographic region, unless:
 - The fund has a policy to invest at least 80% of the value of its assets in investments that are tied economically to the particular country or region suggested by its name;
 - The fund discloses in its prospectus the criteria used to select these investments; and
 - This policy is either fundamental or changeable only with at least 60 days prior notice to shareholders.



RULE 35D-1: TAX-EXEMPT FUNDS

- Rule 35d-1 prohibits the use of any name suggesting that the fund's distributions are exempt from federal and/or state income tax, unless the fund has adopted a fundamental policy:
 - To invest at least 80% of the value of its assets in investments the income from which is exempt from federal and/or state income tax (as applicable); or
 - To invest its assets so that at least 80% of the income that it distributes is exempt from federal and/or state income tax (as applicable).



RULE 35D-1: COMPLIANCE CONSIDERATIONS

- The 80% tests apply at the time of investment.
- The 80% tests apply “under normal circumstances.”
- “Assets” is defined in the rule to mean “net assets, plus the amount of any borrowings for investment purposes.”
- Strict prior notice requirements apply to changes to the 80% investment policies.



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