therefore: (1) Is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this proposed rule will not have a significant economic impact on a substantial number of small entities under the critieria of the Regulatory Flexibility Act.

List of Subjects in 14 CFR Part 71

Aviation Safety, Transition areas.

The Proposed Amendment

Accordingly, pursuant to the authority delegated to me, the Federal Aviation Administration proposes to amend part 71 of the Federal Aviation Regulations (14 CFR part 71) as follows:

PART 71—DESIGNATION OF FEDERAL AIRWAYS, AREA LOW ROUTES, CONTROLLED AIRSPACE, AND REPORTING POINTS

1. The authority citation for part 71 continues to read as follows:

Authority 49 U.S.C. 1348(a), 1354(a), 1510; Executive Order 10854; 49 U.S.C. 106(g) (Revised Pub. L. 97-449, January 12, 1983); 14 CFR 11.69.

§71.181 [Amended]

2. Section 71.181 is amended as follows:

Louisa, VA [New]

That airspace extending upward from 700 feet above the surface within a 5-mile radius of the center (lat. 38°00'37" N., long. 77°58'04" W.) of the Louisa County/Freemen Field Airport, Louisa, VA; within 2 miles either side of a 266°(T) 272°(M) bearing extending from 1 mile west of the Louisa, VA, NDB (lat. 38°01'13" N., long. 77°51'34" W.) to the 5-mile radius area.

Issued in Jamaica, New York, on December 5, 1989.

John D. Canoles,

Manager, Air Traffic Division.

[FR Doc. 90-922 Filed 1-12-90; 8:45 am]

BILLING CODE 4510-13-M

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14 CFR Part 75

[Airspace Docket No. 89-AWP-27]

Proposed Establishment of J-236

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: This notice proposes to establish new Jet Route J-236 located between Thermal, CA, and Tuba City, AZ. The establishment of this route is necessary to improve the increasing flow of traffic departing San Diego, CA, and the Los Angeles, CA, basin airports. This new jet route would provide a more precise means of navigation and reduce controller workload.

DATE: Comments must be received on or before February 26, 1990.

ADDRESSES: Send comments on the proposal in triplicate to: Manager, Air Traffic Division, AWP-500, Docket No. 89-AWP-27, Federal Aviation Administration, P.O. Box 92007, Worldway Postal Center, Los Angeles, CA 90009.

The official docket may be examined in the Rules Docket, weekdays, except Federal holidays, between 8:30 a.m. and 5 p.m. The FAA Rules Docket is located in the Office of the Chief Counsel, Room 916, 800 Independence Avenue, SW., Washington, DC.

An informal docket may also be examined during normal business hours at the office of the Regional Air Traffic Division.

FOR FURTHER INFORMATION CONTACT: Alton D. Scott, Airspace Branch (ATO-240), Airspace-Rules and Aeronautical Information Division, Air Traffic Operations Service, Federal Aviation Administration, 800 Independence Avenue, SW., Washington, DC 20591; telephone: (202) 267-9252.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, aeronautical, economic, environmental, and energy aspects of the proposal. Communications should identify the airspace docket and be submitted in triplicate to the address listed above. Commenters wishing the FAA to acknowledge receipt of their comments on this notice must submit with those comments a self-addressed, stamped postcard on which the following statement is made: "Comments to Airspace Docket No. 89-AWP-27." The postcard will be date/time stamped and returned to the commenter. All communications received before the specified closing date for comments will be considered before taking action on the proposed rule. The proposal contained in this notice may be changed in the light of comments received. All comments submitted will be available for examination in the Rules Docket both before and after the closing date for comments. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRM's

Any person may obtain a copy of this Notice of Proposed Rulemaking (NPRM) by submitting a request to the Federal Aviation Administration, Office of Public Affairs, Attention: Public Inquiry Center, APA-230, 800 Independence Avenue, SW., Washington, DC 20591, or by calling (202) 267-3484. Communications must identify the notice number of this NPRM. Persons interested in being placed on a mailing list for future NPRM's should also request a copy of Advisory Circular No. 11-2A which describes the application procedure.

The Proposal

The FAA is considering an amendment to part 75 of the Federal Aviation Regulations (14 CFR part 75) to establish new Jet Route J-236 located between Thermal, CA, and Tuba City, AZ. This route would be established to improve the flow of increasing traffic departing San Diego, CA, and the Los Angeles, CA, basin airports. Aircraft departing these airports routinely file via Thermal, CA, Needles CA, and Tuba City, AZ. Frequent off-course deviations (as much as 10-15 nautical miles) have caused a considerable increase in controller workload and coordination. The adjustment of this route is designed to alleviate off-course deviations and to establish optimum use of the airspace. Section 75.100 of part 75 of the Federal Aviation Regulations was republished in Handbook 7400.6E dated January 3, 1989.

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore (1) is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is

certified that this rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

List of Subjects in 14 CFR Part 75

Aviation safety, Jet routes.

The Proposed Amendment

Accordingly, pursuant to the authority delegated to me, the Federal Aviation Administration proposes to amend part 75 of the Federal Aviation Regulations (14 CFR part 75) as follows:

PART 75—ESTABLISHMENT OF JET ROUTES AND AREA HIGH ROUTES

1. The authority citation for part 75 continues to read as follows:

Authority: 49 U.S.C. 1348(a), 1354(a), 1510; Executive Order 10854; 49 U.S.C. 106(g) (Revised Pub. L. 97-449, January 12, 1983); 14 CFR 11.69.

§ 75.100 [Amended]

2. Section 75.100 is amended as follows:

J-236 [New]

From Thermal, CA; Needles, CA; to Tuba City, AZ.

Issued in Washington, DC, on December 29, 1989.

Harold W. Becker,

Manager, Airspace-Rules and Aeronautical Information Division.

[FR Doc. 90-916 Filed 1-12-90; 8:45 am]

BILLING CODE 4910-13-M

CONSUMER PRODUCT SAFETY COMMISSION

16 CFR Part 1700

Requirements for Child-Resistant Packaging; Proposed Requirements for Household Glue Removers Containing Acetonitrile and Home Cold Wave Permanent Neutralizers Containing Sodium Bromate or Potassium Bromate

AGENCY: Consumer Product Safety Commission.

ACTION: Proposed rules.

SUMMARY: Under the Poison Prevention Packaging Act of 1970, the Commission is proposing to require child-resistant packaging for (1) household glue removers, in liquid form, containing more than 500 mg of acetonitrile in a single container and (2) home permanent neutralizers, in liquid form, containing in a single container (a) more than 600 mg of sodium bromate or (b) more than 50 mg of potassium bromate. These requirements are proposed because the Commission has preliminarily determined that child-resistant packaging is required to protect children under five years of age from serious personal injury and serious illness resulting from ingesting such substances.

DATE: Comments on the proposal should be submitted not later than April 2, 1990.

ADDRESSES: Comments should be mailed to the Office of the Secretary, Consumer Product Safety Commission, Washington, DC 20207, or delivered to the Office of the Secretary, Consumer Product Safety Commission, Room 528, 5401 Westbard Avenue, Bethesda, Maryland, telephone (301) 492-6800.

FOR FURTHER INFORMATION CONTACT: Virginia White, (301) 492-6554.

SUPPLEMENTARY INFORMATION:

A. Background

The Poison Prevention Packaging Act of 1970 (the "PPPA"), 15 U.S.C. 1471-1476, authorizes the Commission to establish standards for the "special packaging" of any household substance if (1) the degree or nature of the hazard to children in the availability of such substance, by reason of its packaging, is such that special packaging is required to protect children from serious personal injury or serious illness resulting from handling, using, or ingesting such substance and (2) the special packaging is technically feasible, practicable, and appropriate for such substance. Special packaging, also referred to as "child-resistant packaging," is defined as packaging that is (1) designed or constructed to be significantly difficult for children under five years of age to open or obtain a toxic or harmful amount of the substance contained therein within a reasonable time and (2) not difficult for normal adults to use properly. (It does not mean, however, packaging which all such children cannot open, or obtain a toxic or harmful amount from, within a reasonable time.) Under the PPPA, effectiveness standards have been established for special packaging (16 CFR 1700.15), as has a procedure for evaluating the effectiveness (§ 1700.20). Regulations have been issued requiring special packaging for a number of household products (§ 1700.14).

By letter dated June 27, 1988, the American Association of Poison Control Centers (AAPCC) petitioned the Commission to require child-resistant packaging for household glue removers containing acetonitrile and home cold wave permanent neutralizers containing sodium bromate or potassium bromate. [1] [1] As justification for establishing special packaging standards for these products, the petitioner cited the high toxicity of acetonitrile and the bromates and cited cases of severe permanent disability and death to young children following accidental ingestion of these products. These requests were docketed as a petition for rulemaking, No. PP 88-2.

On January 25, 1989, the Commission received a similar request from the Cosmetic, Toiletry and Fragrance Association ("CTFA") to require child-resistant packaging for glue removers containing acetonitrile. [3] Since these glue removers were already addressed under petition PP 88-2, CTFA's request was considered a submission in support of that petition.

B. Glue Removers Containing Acetonitrile

1. Toxicity

[2], except where noted otherwise. Acetonitrile is used as a glue remover, often for sculptured nails, and the Commission's Directorate for Health Sciences reports that the acute oral toxicity of acetonitrile has been demonstrated in animals and humans. The mean lethal dose in humans is such that one ounce (24 grams) can be lethal to a 10 kilogram (kg) child. Acetonitrile is also toxic by inhalation and skin absorption. The toxic effects following exposure to the chemical are extremely serious and include respiratory distress, cardiac arrest, convulsions, coma, and possibly death. The toxicity of acetonitrile is most likely related to its metabolism to cyanide.

Medical treatment for acetonitrile poisoning is a lengthy procedure and may be complicated by the delayed onset of toxic effects following exposure. Toxic effects usually do not appear until several hours after exposure; this could cause a delay in seeking medical attention.

The petition contained information on two cases of accidental ingestion by young children of sculptured nail removers containing acetonitrile. The ingested products contained 98 percent acetonitrile. One case was a 16-month-old child weighing 12 kg, who may have ingested up to two tablespoons of the product (approximately 1.9 grams/kg). The child vomited, later experienced respiratory difficulty, was put to bed, and was found dead the next morning. The second case involved a two-year-old child weighing 12.4 kg, who may have ingested as much as one ounce of

[1] Numbers in brackets indicate the number of a relevant document as listed in Appendix 1 to this notice.

the product (approximately 2 grams/kg). This child became seriously ill but recovered after receiving intensive medical treatment.

At least two additional cases of injury to young children following accidental ingestion of acetonitrile glue remover products have been reported to poison centers since the petition was received. In-depth investigations of these cases by the Commission's staff showed that one case was a three-year-old boy who ingested less than a tablespoon of acetonitrile-containing glue remover which the mother had poured into an open dish. [11(d)] This child recovered after being hospitalized under intensive care for five days. The second case involved an 18-month-old boy who ingested approximately one ounce of the product. [11(e)] This child was hospitalized for two days and recovered.

A case reported in the literature of intentional ingestion of 40 grams of acetonitrile (approximately 0.5 gram/kg) by an adult male demonstrates further the severe toxicity of the chemical (at a dose less than that reported for the two cases above involving children). This man experienced severe toxic effects, required extensive medical treatment, and took six months to recover.

The Directorate for Health Sciences concluded that the acute oral toxicity of acetonitrile has been demonstrated in animals and humans and that a one-ounce bottle of acetonitrile can be lethal to a child. Available medical data indicate that treatment of acetonitrile ingestion is complicated by delayed onset of toxicity, the severity of the effects, the complex emergency first aid required, and the protracted, difficult recovery. Thus, it appears that the accidental ingestion of acetonitrile-containing glue remover products by children can cause serious injury, serious illness, and death.

The limited available clinical data for acetonitrile indicate that serious injury or serious illness can occur in young children after ingestion of 0.5 gram/kg. Information is not available on a level of acetonitrile that will not produce serious injury or illness. In lieu of such data, the staff recommended that the known lowest-effect level of acetonitrile in humans be reduced by a factor of 10 (referred to as an "uncertainty factor"). [5] If this is done, glue removers containing more than 500 mg of acetonitrile in a single container should be subject to child-resistant packaging standards. The Commission solicits comments on whether this an appropriate level for regulating glue removers containing acetonitrile.

2. Economic Information

[4] Acetonitrile is used mainly as a solvent and as a chemical intermediate in industrial applications. Its other applications include use as a solvent in artificial fingernail glue removers and removers for cyanoacrylate or "super glues" for household use, and for use by hobbyists in model building. These glue removers are marketed in liquid form. Alternative consumer products are available for these applications.

Artificial fingernail glue removers can be purchased in supermarkets, drug stores, and mass merchandise stores. In addition, products labeled "For Professional Use Only" are readily available for purchase by the general public in retail and "wholesale" beauty supply establishments. Both of the acetonitrile ingestion incidents reported by the petitioner were attributed to artificial fingernail glue removers labeled "For Professional Use Only" that had been purchased by the consumers in beauty supply establishments.

The estimated annual sales of glue removers for cosmetic use is one to two million units, with a market value of approximately $2.5–$5 million. The estimated hobby industry sales of glue removers is one million units annually, with a market value of approximately $3 million.

Although the number of accidental ingestions involving acetonitrile glue removers is low to date, the cost per incident and the potential for death are relatively high. The wide availability of acetonitrile-containing products and their accessibility to young children in the home provide the opportunity for continued accidental ingestions with the potential for serious consequences. At a minimum, all such ingestions require extensive medical treatment, and some may be fatal. The Commission's Directorate for Economic Analysis concludes that, although it is not possible to estimate the future annual costs of acetonitrile ingestions, it seems reasonable that avoiding even a small number of ingestions, and the possibility of death, by requiring child-resistant closures has the potential for large benefits to consumers.

Cost to industry to comply with a special packaging regulation are also difficult to estimate, since the Commission does not have information on the market share of acetonitrile-containing products targeted for cosmetic and hobby use. If manufacturers elect to use substitute chemicals, increased costs are unlikely, since the substitutes may cost even less. The subsequent effect on market share, however, is unknown. Manufacturers who do not reformulate their products may experience increased costs for child-resistant packaging.

3. Technical Feasibility, Practicability, and Appropriateness

In issuing a standard for special packaging under the PPPA, the Commission is required by section 3(a)(2) of the PPPA, 15 U.S.C. 1472(a)(2), to find that the special packaging is "technically feasible, practicable, and appropriate."

a. *Technical feasibility.* [7] Household glue removers containing acetonitrile that are sold for use in removing or debonding glues for artificial, or sculptured, fingernails are marketed in small bottles of a liquid that consists almost entirely of acetonitrile. These bottles are supplied with screw. on caps, and these packages could be made child-resistant by substituting a readily available child-resistant closure for the non-child-resistant closures currently supplied. The glue removers should not be adversely affected by the materials that make up the child-resistant closures, and the glue removers should not affect the materials of the child-resistant closures. Since the closure design does not affect the use or storage of these glue removers, the Commission concludes that there are numerous package designs that meet the requirements of 16 CFR 1700.15(b) that are suitable for use with the form of this product.

b. *Practicability.* Because many existing designs suitable for use with the glue removers that are the subject of the proposed regulation are currently being used in the packaging of other products, special packaging for this product seems practicable in that it is adaptable to modern mass production and assembly line techniques. The Commission anticipates no major supply or procurement problems for the packagers of these glue removers or the manufacturers of child-resistant closure and capping equipment. In addition, there should be no serious problems experienced by manufacturers of the products in incorporating the child-resistant packaging features into their existing packaging lines.

c. *Appropriateness.* As shown by the discussion above, and by the use of many existing suitable designs with other products, special packaging is appropriate since it is available in forms that are not detrimental to the integrity of the substance and that do not interfere with its storage or use.

Accordingly, the Commission preliminarily finds that special

packaging for household glue removers containing acetonitrile is technically feasible, practicable, and appropriate.

C. Permanent Wave Neutralizers Containing Bromates

1. Toxicity

[2], except where noted otherwise. The toxic effects of sodium and potassium bromates are similar; however, sodium bromate has been reported to be less toxic than potassium bromate. Based on cases reported in the literature, the possible lethal oral dose of sodium and potassium bromates ranges from 0.005 gram/kg. to 0.05 gram/kg.

The most devastating non-lethal effects of bromate poisoning are on renal function and hearing. Impaired kidney function can progress to complete renal failure requiring dialysis for the remainder of a person's life. Renal failure in young children is associated with decreased body growth, delayed maturation, bone fracture, learning disabilities, and decreased life expectancy. The alternative to chronic dialysis is kidney transplantation, which may be needed more than once. Hearing loss, which can occur as early as the day of ingestion, is irreversible. When impairment occurs early in childhood, the ability to learn to speak, write, and read are severely affected. In a child so compromised, psychological problems can also be expected. Other toxic effects of bromate ingestion include nausea and vomiting accompanied by abdominal pain and diarrhea, anemia, destruction of red blood cells, decreased blood pressure, convulsions, coma, respiratory depression, and possibly death.

During the 1940s and 1950s, when sodium and potassium bromates were commonly used as neutralizers, nine cases of accidental ingestion of neutralizers by children under age five were reported in the medical literature. Because of the severity of the bromate intoxication in these incidents, manufacturers reformulated their products and replaced the bromates with less toxic substances. However, bromates are again being used in some currently-available liquid home permanent wave neutralizer solutions.

The staff has reviewed 17 cases of accidental ingestion of bromate neutralizer solutions by children under age five. One case, which resulted in permanent hearing loss and kidney damage in a 16-month-old child, was reported by the petitioner. Sixteen cases were reported in the literature. There were no cases of accidental ingestion of bromate neutralizer solutions reported in the CPSC CAP data base. Eight of the 17 cases have been reported since 1984. One case was the death of a 17-month-old child who ingested an unknown amount of a potassium bromate neutralizer solution. These incidents underscore the hazard to young children who may be exposed to these products.

The Commission preliminarily concludes that accidental ingestion of bromate neutralizer solutions presents a risk of serious injury, serious illness, or death to young children. Based on the clinical reports reviewed, the lowest doses of the bromates that caused kidney damage and hearing loss were 0.05 gram/kg for potassium bromate and 0.59 gram/kg for sodium bromate. The levels of potassium and sodium bromates at which no effects can be observed are not known. In lieu of such data, the Directorate for Health Sciences reduced the known lowest effect levels of the bromates in humans by a factor of 10 (referred to as an "uncertainty factor") and judged that permanent wave products containing more than 50 mg of potassium bromate or 600 mg of sodium bromate should be subject to child-resistant packaging standards. [5] The Commission solicits comments on whether these are appropriate levels for regulation of permanent wave products containing these bromates.

2. Economic Information

[4] Sodium bromate is used as a laboratory analytical reagent, a food additive, and a maturing agent in flour, and in several industrial processes. Both sodium and potassium bromate were marketed in permanent wave neutralizers in the 1940s and 1950s. Following reports of bromate poisonings involving these products, manufacturers substituted less toxic neutralizing agents, such as perborate and hydrogen peroxide. Recent ingestion incidents involving bromate-containing neutralizers indicate, however, that new products containing bromates have become available. Five different brands of permanent wave neutralizers are implicated in these recent incidents.

Permanent wave products, including those containing bromates, can be purchased at supermarkets, drug stores, and mass merchandise stores. In addition, some beauty supply outlets sell permanent wave kits, labeled "For Professional Use Only", to the general public. Products designed for professional use tend to be stronger and faster acting than products intended for home use. At least three of the ingestion incidents involved "professional use" products.

The home permanent market has a "general" segment that includes all populations and a "targeted" segment that includes ethnic groups. Sales in the general segment amounted to $107.6 million in 1987. Market information on the targeted segment is not available but is believed to be substantially less than the general market segment.

All ingestions of products containing potassium or sodium bromate will require medical treatment, some of which may be prolonged, and bromate poisoning may have both acute and chronic effects. In addition to the immediate costs of hospitalization, medical costs for a bromate victim may include various combinations of auditory assistance, kidney transplantation, and dialysis treatments. Although it is not possible to estimate cost savings of bromate poisonings averted, the relative severity of each case suggests that the savings would be considerable. The Commission preliminarily concludes that bromate ingestions can result in a reduced quality of life and that even one ingestion can result in large total costs to society. The potential benefit to consumers of avoiding accidental ingestions that have severe and permanent consequences probably outweighs the potential costs.

Effective alternative neutralizers—hydrogen peroxide and sodium perborate—are available for both home and professional permanents. A reformulation of neutralizing solutions to safer ingredients by manufacturers that currently use sodium or potassium bromate will cause virtually no major disruption to the industry and may actually result in a net savings due to the cost differential between hydrogen peroxide and the bromates. Requiring the use of child-resistant closures may lead to the use of safer ingredients (to avoid the need for child-resistant closures) or at most increase manufacturers' costs by $.02 per unit.

3. Technical Feasibility, Practicability, and Appropriateness

In issuing a standard for special packaging under the PPPA, the Commission is required by section 3(a)(2) of the PPPA, 15 U.S.C. 1472(a)(2), to find that the special packaging is "technically feasible, practicable, and appropriate."

a. *Technical feasibility.* [7] Home permanent neutralizers containing sodium bromate or potassium bromate are marketed in liquid form. The containers of this product are intended for "one-time use," so that all of the contents of the package is used at once, and there is no need to store leftover neutralizer. The types of packages in which this product is currently sold

include: (1) A plastic bottle with an applicator that cannot be separated from the container and requires the user to cut off the applicator tip to gain access to the solution, (2) a plastic bottle with a non-child-resistant screw-type closure and a separate applicator tip, and (3) a plastic bottle with a flip-up spout in the cap. Design 1 above is already child-resistant. Designs 2 and 3 are readily adaptable to child resistance, either by replacing the present closure with a child-resistant one or by using an outer child-resistant cap. Neither change would affect the use of the product. Therefore, the Commission concludes preliminarily that there are numerous package designs that meet the requirements of 16 CFR 1700.15(b) that are suitable for use with the form of this product.

b. *Practicability.* Because many existing designs suitable for use with these neutralizers that are the subject of the proposed regulation are currently being used in the packaging of other products, special packaging for this product seems practicable in that it is adaptable to modern mass production and assembly line techniques. The Commission anticipates no major supply or procurement problems for the packagers of these neutralizers or the manufacturers of child-resistant closure and capping equipment. In addition, there should be no serious problems experienced by manufacturers of the products in incorporating the child-resistant packaging features into their existing packaging lines.

c. *Appropriateness.* As shown by the discussion above, and by the use of many existing suitable designs with other products, special packaging is appropriate since it is available in forms that are not detrimental to the integrity of the substance and that do not interfere with its storage or use.

Accordingly, the Commission preliminarily finds that special packaging is technically feasible, practicable, and appropriate.

D. Effective Date

The PPPA provides that, except for good cause, no regulation shall take effect sooner than 180 days or later than one year from the date such regulation is issued. Based on all available information, the Commission believes that six months (approximately 180 days) will provide an adequate period of time for manufacturers to obtain suitable child-resistant packaging and incorporate its use into their packaging lines. [9] Therefore, the special packaging requirement is proposed to become effective 180 days after issuance of a final rule and will apply to all products subject to the rule that are packaged after that date.

E. Regulatory Flexibility Act Certification

When an agency undertakes a rulemaking proceeding, the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 et seq.) generally requires the agency to prepare proposed and final regulatory flexibility analyses describing the impact of the rule on small businesses and other small entities. The purpose of the Regulatory Flexibility Act, as stated in section 2(b) (5 U.S.C. 602 note), is to require agencies, consistent with their objectives, to fit the requirements of regulations to the scale of the businesses, organizations, and governmental jurisdictions subject to the regulations. Section 605 of the Act provides that an agency is not required to prepare a regulatory flexibility analysis if the head of an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

The Commission's Directorate for Economics has prepared an Initial Regulatory Flexibility Act Analysis to examine the effect of the proposed rule on small entities. [9] The findings of that analysis are repeated below.

The requirements of the proposed rule have been explained previously. There appear to be no reasonable alternatives to the proposal to require PPPA reqirements for glue removers containing acetonitrile and home permanent wave neutralizers containing sodium or potassium bromates that would adequately reduce the risk of serious personal illness or serious illness to children.

Costs to manufacturers of glue removers containing acetonitrile who do not reformulate their products to use substitute chemicals may increase by two to seven cents per child-resistant closure. On an annual basis, this may amount to $15,000 for glue removers used for cosmetic purposes and $35,000 for glue removers used by hobbyists. Some informed sources believe that substitute chemicals may cost even less than acetonitrile. During the last few months, at least one manufacturer of a glue remover for cosmetic purposes has voluntarily reformulated from acetonitrile to a safer substitute chemical with no increase in retail price.

According to available information, about 93% of the marketers of home permanent wave neutralizers targeted to the general population do not use bromates. Definitive market information on products targeted to ethnic markets was unavailable, but a brief market survey revealed that products with and without bromates are available for sale. Costs to manufacturers of home permanent wave neutralizers who continue to use either sodium or potassium bromate may increase by two cents per child-resistant closure.

In addition, based on previous experience with products requiring child-resistant packaging, the Commission believes an effective date of 18 days from the date the regulation is issued will provide an adequate period of time for manufacturers who do not choose to reformulate their products to obtain suitable child-resistant packaging and incorporate its use into their packaging lines.

For the reasons mentioned above, the Consumer Product Safety Commission concludes that the proposal to require special packaging for household glue removers containing acetonitrile and for home permanent neutralizers containing sodium bromate or potassium bromate, if issued, will not have any significant economic effect on a substantial number of small entities.

F. Environmental Considerations

Pursuant to the National Environmental Policy Act, and in accordance with the Council on Environmental Quality regulations and CPSC procedures for environmental review, the Commision has assessed the possible environmental effects associated with Poison Prevention Packaging Act (PPPA) packaging requirements for glue removers containing acetonitrile and permanent wave neutralizers containing bromates.

The Commission's regulations, at 16 CFR 1021.5(c)(3) state that rules requiring special packaging for consumer products normally have little or no potential for affecting the human environment. Analysis of the impact of this proposed rule indicates that child-resistant packaging requirements for these consumer products containing acetonitrile or either sodium or potassium bromates will have no significant effects on the environment. This is because manufacturers of affected products either will replace present closures with a child-resistant closure or will use substitute chemicals. If child-resistant packaging is used, non-child-resistant closure inventories will be depleted by the time the rule becomes effective and will not need to be disposed of in bulk. The rule will not significantly increase the number of child-resistant closures in use, and, in any event, the manufacture, use, and disposal of the child-resistant closures present the same potential

environmental effects as do the currently used non-child-resistant closures. If products are reformulated, the market for the bromates and acetonitrile will not be materially affected because there is a ready market for these chemicals that would be unaffected by the rule proposed below. Moreover, the available chemical substitutes have no known adverse effects on the environment. Therefore, because this proposed rule has no adverse effect on the environment, neither an environmental assessment nor an environmental impact statement is required.

List of Subjects in 16 CFR Part 1700

Consumer protection, Drug, Infants and children, Packaging and containers, Poison prevention, Toxic substances.

G. Conclusion

For the reasons given above, the Commission proposes to amend 16 CFR part 1700 as follows:

PART 1700—[AMENDED]

1. The authority citation for part 1700 continues to read as follows:

Authority: Pub. L. 91–601, secs. 1–9, 84 Stat. 1670–74, 15 U.S.C. 1471–76. Secs 1700.1 and 1700.14 also issued under Pub. L. 92–573, sect. 30(a), 88 Stat. 1231.15 U.S.C. 2079(a).

2. Section 1700.14 is amended by adding new paragraphs (a)(18) and (a)(19), reading as follows (although unchanged, the introductory text of paragraph (a) is included below for context):

§ 1700.14 Substances requiring special packaging.

(a) *Substances.* The Commission has determined that the degree or nature of the hazard to children in the availability of the following substances, by reason of their packaging, is such that special packaging is required to protect children from serious personal injury or serious illness resulting from handling, using, or ingesting such substances, and the special packaging herein required is technically feasible, practicable, and appropriate for these substances:

* * * * *

(18) *Glue removers containing acetonitrile.* Household glue removers in a liquid form containing more than 500 mg of acetonitrile in a single container.

(19) *Permanent wave neutralizers containing sodium bromate or potassium bromate.* Home permanent wave neutralizers, in a liquid form, containing in single container more than 600 mg of sodium bromate or more than 50 mg of potassium bromate.

* * * * *

Dated: January 2, 1990.

Sadye E. Dunn,

Secretary, Consumer Product Safety Commission.

Appendix 1—List of References

(This Appendix will not be printed in the Code of Federal Regulations.)

1. Petition (PP 88–2) from American Association of Poison Control Centers, dated June 27, 1988.
2. Memorandum from CPSC's Directorate for Health Sciences, dated December 5, 1988.
3. Letter from the Cosmetic, Toiletry and Fragrance Association, dated January 25, 1989.
4. Memorandum from CPSC's Directorate for Economic Analysis, dated March 24, 1989.
5. Memorandum from CPSC's Directorate for Health Sciences, dated July 24, 1989.
6. Letter from Department of California Health Services, dated August 3, 1989.
7. Memorandum from CPSC's Directorate for Economic Analysis, dated August 23, 1989.
8. Memorandum from CPSC's Directorate for Economic Analysis, dated October 12, 1989.
9. Memorandum from CPSC's Directorate for Economic Analysis, dated October 23, 1989.
10. Memorandum from CPSC's Office of Program Management and Budget, dated December 11, 1989, with attached briefing package.
11. In-Depth Investigations:
    a. 880929HCC2014
    b. 880929HBC3017
    c. 880929HBC3018
    d. 881201HBC3059
    e. 890517HCC1315
12. Memorandum to the Commission from the Office of the General Counsel, with substitute page for **Federal Register** notice, dated December 22, 1989.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 239, 270, 274

[Release No. 33–6850; IC–17294; S7–1–90]

RIN 3235–AD81

Disclosure and Analysis of Mutual Fund Performance Information; Portfolio Manager Disclosure

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule and form amendments.

SUMMARY: The Commission is proposing for comment two alternative amendments to Form N–1A, the registration form used by open-end management investment companies ("mutual funds") under the Investment Company Act of 1940 and the Securities Act of 1933, to provide investors with new easily understandable information about mutual fund performance in prospectuses or annual reports to shareholders. The first proposal would require management to discuss and analyze the mutual fund's performance during its previous fiscal year and the techniques used to achieve that performance in light of the fund's objectives. The second alternative proposal would require a comparison of fund performance over certain time periods to the performance of an appropriate securities index over the same periods. In addition, the Commission is proposing amendments that would (1) revise the condensed financial information contained in the Form N–1A prospectus; (2) require disclosure about portfolio managers by mutual funds; (3) make corresponding amendments to Form N–14 under the Securities Act of 1933; and (4) amend related rules.

DATE: Comments on the proposed rule and form amendments should be received on or before March 12, 1990.

ADDRESSES: Comment letters should refer to File S7–1–90 and be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549. All comments received will be available for public inspection and copying in the Commission's Public Reference Room 450 5th Street, NW., Washington, DC 20549.

FOR FURTHER INFORMATION CONTACT: Larisa Dobriansky, Special Counsel, or Robert E. Plaze, Chief of Office (202) 272–2107, Office of Disclosure and Adviser Regulation, Division of Investment Management, 450 5th Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today is proposing for comment:

(1) Amendments to Form N–1A [17 CFR 274.11A], the registration form used by open-end management investment companies ("funds" or "mutual funds") to register under the Investment Company Act of 1940 [15 U.S.C. 80a *et seq.*] ("1940 Act") and to register their securities under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] ("1933 Act"). Two alternative proposals would require disclosure about fund performance in the prospectus or the annual report to shareholders: (i) Proposed new Item 5A would call for management's discussion and analysis of the fund's performance during the previous year ("Alternative I"); (ii) Proposed new Item 3A would require a

comparison of the fund's performance over specified periods to that of an appropriate securities index over the same periods, along with a more limited narrative disclosure requirement ("Alternative II"). Other proposed amendments would (A) revise substantially the condensed financial information contained in the prospectus; (B) require disclosure about all persons who significantly contribute to the investment advice relied on by the fund (*e.g.*, portfolio managers), and (C) permit automatic incorporation by reference into the registration statement of information contained in annual reports to shareholders.

(2) Amendment of rule 485(b) [17 CFR 230.485(b)] of Regulation C under the 1933 Act [17 CFR 230.400 *et seq.*] to include among the class of post-effective amendments eligible to become effective immediately upon filing, those filed for the purposes of including or updating the specified information about investment performance required by the proposed alternative amendments.

(3) Amendment of rule 34b–1 under the 1940 Act [17 CFR 270.34b–1] to include performance information (such as that which would be required by proposed Alternative II) in periodic reports to shareholders from the rule's updating requirements.

(4) Amendment of rules 31a–1 and 31a–2 under the 1940 Act [17 CFR 270.31a–1, 31A–2] to require funds to retain specified records relating to the index comparison that would be required by proposed Alternative II.

(5) Conforming amendments to Form N–14 [17 CFR 239.23] to reflect the proposed new disclosure items in Form N–1A.

I. Background and Summary of Proposed Amendments

The Commission is proposing to amend the disclosure requirements for mutual funds. The proposals include (i) alternative amendments for providing investors information about the investment results achieved by funds; (ii) required disclosure about persons who significantly contribute to the investment advice relied on by funds; and (iii) revisions to shorten and simplify the per share table contained in the prospectus. The revised disclosure requirements are intended to provide investors with more information about the performance of the fund and individuals who may be primarily responsible for that performance.

The proposed amendments are a continuation of the Commission's efforts to provide mutual fund investors with material information about funds in a format that is comprehensive and which permits comparisons to be made among funds. In 1989 the Commission amended Form N–1A to require a fee table in the front part of mutual fund prospectuses.[1] The table consolidates, in a single location in the prospectus, fund expense information and require the fund to provide an example of the cumulative amount of these expenses over different investment periods to facilitate a comparison of expenses among funds.[2] Also in 1988, the Commission adopted rules and rule amendments to require uniformly-computed performance information in mutual fund advertisements and sales literature containing performance information.[3] The advertising rules were designed to prevent misleading performance claims by funds and to permit investors to make meaningful comparisons among fund performance claims. These rules did not, however, require the inclusion of any performance information in advertisements or sales literature, nor did they require that performance information be in mutual fund prospectuses. Under current prospectus disclosure requirements, performance data must be derived from the financial information set forth in the per share table.

The proposed alternative amendments to Form N–1A address the Commission's concern that current disclosure requirements may not provide investors with sufficient information to evaluate easily investment results achieved by mutual funds, or to relate those results to the fund's investment objective.[4] However, the two proposals represent different approaches to providing this information. Alternative I would require management to discuss and analyze the fund's fiscal year performance in relation to its investment objectives. Management would be required to evaluate the strategies and techniques used to pursue these objectives and their effects on investment results. At present, while prospectuses state fund objectives and generally specify strategies and techniques that fund advisers may employ, there is no requirement for funds to analyze the extent to which they achieved their objectives or to describe the results of investment strategies actually used.

Alternative II would rely primarily on an objective presentation of performance information. A fund would be required to compare its total returns over one, five, and ten year periods to the performance of an appropriate securities index over the same periods. This approach would provide investors with information on the fund's historic performance compared to that of "the market."

The disclosure requirements under each proposal could be satisfied by including the information either in the prospectus or annual report to shareholders. Both proposals would require narrative disclosure about the impact on a fund and its shareholders of policies and practices that funds may use to maintain a certain level of distributions.

The Commission, in addition, is proposing two revisions to Form N–1A that were recently proposed for closed-end management investment companies ("closed-end funds").[5] One change would provide for a shortened and simplified per share table which would include a new line item setting forth the fund's total return for each of the last ten fiscal years of the fund. The other change would require that mutual fund prospectuses contain certain disclosures about persons who make significant contributions to the investment advice relied on by the fund. This requirement would provide investors with information about any individual who is responsible for fund performance reported in the per share table and evaluated in the text of the prospectus.

II. Discussion of the Proposed Amendments

A. Condensed Financial Information

The Commission proposes to revise the per share table contained in mutual fund prospectuses. The revisions, which are substantially the same as those recently proposed for closed-end fund prospectuses, would shorten and simplify the table.[6] The per share table

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[1] Investment Company Act Rel. No. 16244 (Feb. 1, 1988) [53 FR 3192 (Feb. 4, 1988)].

[2] *Id.*

[3] Investment Company Act Rel. No. 16245 (Feb. 2, 1988) [53 FR 3868 (Feb. 10, 1988)]. Among other things, the amendments permitted fund advertisements to quote a uniformly calculated yield, tax equivalent yield, and total return, as well as to quote performance by non-standardized total return quotations provided that any yield or non-standardized total return quotation is accompanied by uniformly calculated one year, five year, and ten year average total return quotations.

[4] At lease one member of the mutual fund industry has called upon the Commission to mandate disclosure concerning fund performance. *See* Bogle, "Performance-Reporting Challenge for Mutual Funds," remarks before a conference sponsored by the Financial Analysts Federation and the Institute of Chartered Financial Analysts (Jan. 24, Feb. 28, 1989).

[5] Investment Company Act Rel. No. 17091 (July 28, 1989) (File No. S7–21–89) [54 FR 32993 (Aug. 11, 1989)] ("Release 17091").

[6] *Id.* The proposed revisions, if adopted, would provide for a per share table identical to the one proposed for closed-end funds in all respects except

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would be reduced from thirteen to nine items of information.[7] Some items would be deleted, others added, and the captions of some rephrased for greater clarity.[8]

Among the items proposed to be added would be the fund's total return, which would be presented, like the other information in the table, for each of the last ten fiscal years of the fund. Currently, investors must analyze changes in net asset value and distributions to estimate total return of a fund. The new Item would provide investors with material information about past performance to consider before investing in a fund.[9]

B. Proposed Disclosure Requirements Concerning Investment Performance

1. Alternative I

As Alternative I, the Commission is proposing a new Item 5A of Form N–1A to require that prospectuses include a separate discussion and analysis by management of the mutual fund's investment performance ("management's discussion and analysis" or "MD&A"). Proposed Alternative I is grounded conceptually on the disclosure requirement for operating companies subject to the registration or periodic reporting requirements of the federal securities laws.[10]

The MD&A disclosure requirement for operating companies is set out in Item 303 of Regulation S–K [17 CFR 229.303]. Item 303 requires a discussion of an operating company's liquidity, capital resources, results of operations, and other information necessary to an understanding of a company's financial condition, changes in financial condition and results of operations. The item requires the management of an operating company to "identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual." [11] The MD&A provides a narrative discussion of the financial statements of the company and affords security holders an opportunity to look at a company "through the eyes of management." [12]

The shareholders of most mutual funds have not had the benefit of a narrative discussion of fund investment results. Fund prospectuses provide statements of investment objectives, often described in aspirational terms, such as "highest yield possible consistent with capital preservation," or "maximum total return through investment in medium to small companies judged by the adviser to be excellent prospects." They are not required by Form N–1A to include a discussion of the extent to which the fund has achieved those objectives over a specified period or to describe or anaylze the strategies and policies employed during that period in pursuit of those objectives, although some funds voluntarily provide this disclosure in their annual reports. To determine the past performance of the fund, an investor must analyze the fund's per share table or financial statements. However, this is not an adequate substitute for an analysis by fund management designed to help investors understand the investment results of the fund or the extent to which the fund, during a given period, achieved its investment objectives. This is because the per share table only explains "what happened" and not "why it happened."

The MD&A requirement of proposed Item 5A is specifically tailored to mutual funds and differs in two significant respects from Item 303. First, Item 303 calls for a discussion of known trends, demands, commitments, events or uncertainties that are reasonably likely to have a material impact on future operations. The Item encourages the disclosure of other forward-looking information. Proposed Item 5A is designed to assist investors in evaluating the past performance of the fund, thereby providing a basis for assessing the quality of the fund's portfolio management.[13] The Item also is designed to help investors understand the nature of the investment strategies being used. Second, the analysis called for is not of the financial statements but of the performance of the fund, which could be measured in terms such as total return and yield of the fund. These are concepts most often used to evaluate funds and are more commonly understood by investors.

As with Item 303, the disclosure requirements of proposed Item 5A under Alternative I are intentionally general, and reflect the Commission's view that a flexibile approach will elicit more meaningful disclosure and avoid "boilerplate" discussions. Proposed Item 5A would consist of two separate but interrelated disclosure requirements. Funds would be expected to respond to the Item in a separate section of the prospect (or annual report to shareholders), but would not ordinarily be expected to respond to the sub-items separately.

Proposed Item 5A is fashioned as a "management's" discussion and analysis of investment performance. The board of directors is usually not involved in the day-to-day management of fund operations. Unlike operating companies, most funds are externally managed by investment advisers who are delegated responsibility for drafting the fund's disclosure documents. Nonetheless, the board of directors of the fund would bear the ultimate responsibility for the MD&A, like all other parts of the prospectus. The MD&A required by Item 5A would not have to be specifically mentioned in the scope paragraph of the audit report, although the auditors of the fund would have the same responsibility for it as they do for all other financial information in the prospectus.

(a) *Item 5A(a).* Paragraph (a) would require a discussion of the fund's performance during its most recently completed fiscal year in relation to its investment objectives. This paragraph would require a fund to (i) identify those factors that materially affected performance (*e.g.*, interest rates, exchange rates, general market trends); (ii) identify and evaluate the effectiveness of the strategies and techniques used by the fund's investment adviser in pursuing the investment objectives (*e.g.*, extending average maturities, taking a defensive position); and (iii) describe any material effects that those techniques and strategies had on the total return of the fund during the period.

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one, the calculation of total return. As explained in Release 17091 at note 44, closed-end fund total return would take into consideration the market price of fund shares which typically differs from the per share net asset value of fund shares. As proposed, mutual fund total return would be based on per share net asset values.

[7] The Commission also is proposing to delete Instruction number 8 to Item 3(a) of Form N–1A so that capital gains distributions are treated in the same manner for purposes of the per share table as they are for purposes of fund financial statements.

[8] The details of these revisions are explained in Release 17091 *supra* note 5 at section III.B.

[9] Several commenters on the advertising rules suggested including total return in fund prospectuses, in lieu of adopting the advertising rules. *See Summary of Comments on Mutual Fund Advertising Proposal* (March 31, 1987) in File No. S7–23–86.

[10] *See* sections 5 and 7 of the 1933 Act [15 U.S.C. 77e, 77g] and sections 13(a) and 15(d) of the Securities Exchange Act of 1934 ("1934 Act") [15 U.S.C. 78m(a), 78o(d)].

[11] Securities Act Rel. No. 6835 (May 18, 1989) [54 FR 22427 (May 24, 1989)] (citing Securities Act Rel. No. 6349 (Sept. 28, 1981), 23 SEC Docket 964 [not published in the **Federal Register**]).

[12] Securities Act Rel. No. 6711 (Apr. 17, 1987) [52 FR 13717 (Apr. 24, 1987)].

[13] Forward-looking information of mutual funds is not covered by rule 175 [17 CFR 230.175], the safe harbor for projections, because forecasts of the securities markets may pose a significant risk of misleading investors and can quickly become stale.

Instructions 1 and 2 to proposed Item 5A are designed to provide a fund with guidance in responding to this Item. Instruction 1 requires the fund to use an approach that will enable investors to understand how the fund has achieved the investment results of the recent period. Proposed Instruction 2 suggests the types of factors, strategies, and techniques that might be discussed in response to the Item.[14] In evaluating the success of the fund in achieving its investment objectives, the fund is not limited in the types of performance measurements it may use. Thus a fund whose investment objective is obtaining income could discuss performance in terms of yield.

Paragraph (a) also would require an evaluation of the fund's strategies in terms of their impact on its total return. Like the per share table, this Item would require total return to be considered even if the fund does not have total return as an investment objective. If the fund sacrificed total return in order to achieve its investment objective of current income, it would explain the sacrifice in response to this Item. The proposed Item would require an analysis of only the most recent fiscal year. However, investors could consult the per share table for information about longer term performance. Comment is requested as to whether a longer period should be required or, alternatively, whether year-to-year comparisons, such as those required to be made in response to Item 303 of Regulation S–K, would be useful.[15]

(b) *Item 5A(b).* Paragraph (b) of proposed Item 5A would require a fund that has a formal or informal policy of maintaining a specified level of distributions to its shareholders to disclose, in addition to the information called for by paragraph (a), what impact that policy has had on the fund's investment strategies and per share net asset values during the last fiscal year. These policies often result in the realization of capital gains and losses, the return of principal to the investor, and short-term investing at the expense of longer term investment goals.

For example, many of the so-called "government plus" funds invest in government securities and write call options on those securities in order to fund distributions in excess of the portfolio's yield. The dividend income from the government securities together with the option premiums are distributed to shareholders at a level that is in excess of that which could be maintained based on the income from the government securities.[16] While this strategy provides current revenues, it precludes the fund from obtaining the benefit of the appreciation of the securities on which options are written and can result in the fund having a lower return. Although this strategy and the risks inherent in it must be described in the prospectus, investors may not appreciate the extent to which the strategies used to maintain a level of distributions affect the value of their investments. This is particularly true where a fund, to maintain a certain level of distributions, chooses to return capital to its shareholders.

To the extent that these strategies have resulted in lower total return, losses to the fund, or a return of capital, a discussion of the effects would be required in response to paragraph (a) of the proposed Item. Paragraph (b) of proposed Item 5A would require these funds to focus on the impact the distribution policy has had during the last fiscal year on the investment strategies in which the fund engaged and on the per share net asset value of the fund. The Commission believes that this disclosure may make the current risk disclosure in the prospects more meaningful to investors by relating it to the experience of the fund during the past fiscal year, thereby allowing investors to know, before investing, how the fund is maintaining its distribution rate.[17]

2. Alternative II

As Alternative II, the Commission is proposing a new Item 3A of Form N–1A to require a fund to compare in the prospectus, or alternatively in the annual report to shareholders, its total returns over one, five, and ten year periods to the performance of an appropriate securities index over the same periods. The purpose of this requirement is to provide investors with an objective standard against which they can compare the performance of the fund. In addition, it would give investors the opportunity to consider the fund's historic performance compared to that of "the market." As in the case of the proposed MD&A item, the disclosure required by this alternative would not have to be specifically referenced in the scope paragraph of the audit report, although the auditors of the fund would have the same responsibility for it as they do for all other financial information in the prospectus.

Comparison with the performance of a securities index is a widely used method of analyzing the performance of a mutual fund. Some advisers compensate their portfolio managers, in part, based on the extent to which the fund's performance exceeds that of an index. Many prospectuses, annual reports to shareholders, pieces of sales literature, and some advertisements use tables and graphs comparing the performance of the fund with that of a securities index.

Proposed Item 3A reflects the common disclosure practice of comparing fund performance to an index, but would require this disclosure by all funds over uniform and therefore comparable time periods. These time periods, the most recent one, five, and ten year periods, correspond to those time periods for which funds advertising performance are required to show their average annual total returns,[18] and are intended to present past performance over a short, intermediate, and long period. Funds would be required to present the specified total returns in a manner that could be readily understood by investors (*i.e.*, a graph, chart or appropriate tabular format).[19] Unlike the advertising rules, proposed Item 3A would permit use of either an average annual or an aggregate total return figure.[20] Comment is requested as to whether one method of calculating total return should be specified to allow for greater comparability. Comment also is requested on whether different time periods should be required.

As an alternative, the Commission requests comment on whether the index comparison should be made by adding a line to the per share table showing the return on the index during each of the

[14] The factors, techniques and strategies listed in the instruction include: developments in the markets in which the portfolio securities traded, composition of the fund's portfolio (*e.g.*, types of issuers, types of securities, quality of portfolio securities, etc.), net asset value of the fund, expense ratio, portfolio turnover, sales and redemption trends, currency fluctuations, hedging transactions, and whether the fund assumed a temporary defensive position.

[15] *See* Instruction 1 to Item 303(a) [17 CFR 229.303(a)].

[16] Prior to the adoption of the mutual fund advertising rules in 1988, these funds commonly advertised a "distribution rate." The rates these funds advertised were substantially higher than prevailing yields on government securities because they included capital gains. Because of investor confusion regarding the components of a distribution rate, the Commission precluded funds from advertising distribution rates, and permitted them to be included in sales literature only when accompanied by a uniformly-computed yield and total return and sufficient disclosure to inform investors of the difference between a yield and a distribution rate. *See* Release 16245 at section II.5., *supra* note 3.

[17] Section 19(a) of the 1940 Act [15 U.S.C. 80a-19(a)] requires a written statement describing the source of a distribution to accompany any payment in the nature of a dividend if the source is other than net income.

[18] Rule 482(e) [17 CFR 230.482(e)(3)].

[19] Instruction 1 to proposed Item 3A.

[20] Instruction 3 to proposed Item 3A.

past ten fiscal years.[21] This approach would have the advantage of placing all of the performance information in one place in the prospectus, the per share table, but would be less convenient for the fund to explain, if it wished, the basis for its performance vis-a-vis the index. Moreover, funds would not be able to respond to this requirement by presenting the types of charts and graphs that many funds currently use to illustrate their performance. Finally, because sales loads and account fees are not reflected in the total return figures that would be included in the per share table, they would not be reflected in the comparison.

Under Alternative II, a fund would be required to compare its performance to an "appropriate securities index." The concept of an "appropriate securities index" is taken from section 205(b)(2) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–205(b)(2)], which limits a performance-based fee paid to an adviser of a fund to one based on the performance of a fund relative to an "appropriate securities index." This would give a fund a considerable degree of flexibility to select an index that it believes best reflects the markets in which the fund invests. In some cases, of course, there will not be an index available that encompasses the types of securities in which the fund invests. Nonetheless, a broad market index could always be used to serve as a benchmark for how an alternative, unmanaged investment in the securities market performed during the period.[22] Comment is requested as to whether the Commission should provide further guidance on what would constitute an "appropriate securities index" or, conversely, an inappropriate securities index for purposes of the proposed new item, and if so, what the standards should be.

Instruction 2 to proposed Item 3A limits the use of an "appropriate securities index" to one that is created and administered by an organization that is not an affiliated person of the fund, its adviser, or principal underwriter to avoid the conflict of interest that would occur if a fund were to create and administer an index against which to measure its own performance.[23] An exception is provided for those indexes that are widely recognized and used, since the potential for conflict is mitigated by the fact that the index is used for multiple purposes and not only to compare performance of the fund.

Funds would be able to change indexes from time to time, but would be required by Item 3A to explain the reasons for the change and to include the previously used index comparison for a period of one year. This is designed to give funds some flexibility to change indexes as new indexes are developed or the nature of the fund's investment objectives or policies change, but to minimize the possibility that a fund will change indexes solely because the fund begins to perform poorly compared to one index and favorably when compared to another.

The securities index used must reflect the reinvestment of dividends, but must not be adjusted for any fund expenses.[24] Costs associated with an investment in a fund, such as advisory fees, sales loads, and brokerage, are costs of investing in a professionally managed portfolio.[25] Therefore, they must be overcome before a fund can be said to have "beaten" the market.[26] To the extent that fund performance is reduced by these expenses, a fund would have the opportunity to explain this to investors.

The proposed item would only permit money market funds to use an index consisting of the securities of other mutual funds, *i.e.*, a peer group of mutual funds.[27] Use of a peer group index by other types of funds would not necessarily show how a fund's performance compared to the market if the peer group as a whole performs poorly. Comment is requested as to whether such a peer group index should be permitted to satisfy the requirements of proposed Item 3A for non-money market funds, or whether such an index should be used by these funds only in addition to a more traditional securities market index. Funds would be limited by Item 3A to using a securities index. Comment is requested as to whether the Item should permit the use of indexes not tied to the securities markets, such as a consumer price index.

Studies have asserted that funds with more volatile, riskier portfolios obtain, on average, higher returns than those with less risky portfolios because higher risk securities tend to have higher returns to compensate investors for assuming greater risk.[28] Thus a favorable comparison between a fund and an index may simply reflect the riskier portfolio rather than superior portfolio management. Several scholars have asserted that fund management is most appropriately evaluated by measuring return in light of the risks assumed to obtain the return.[29] Comment is requested on whether funds should be required to adjust their performance to reflect the riskiness (*i.e.*, "beta") of their portfolios.[30]

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[21] As proposed to be revised, the per share table would include a line item that would indicate the fund's total return for each of the last ten fiscal years. *See* section II.A. *supra*.

[22] Money market funds eligible to quote a seven-day yield under Item 22 of Form N–1A would be required to compare their yield(s) to an appropriate index of yields.

[23] The term "affiliated person" is defined in section 2(a)(3) of the 1940 Act [15 U.S.C. 80a–2(a)(3)].

[24] Instruction 2 to proposed Item 3A.

[25] A comparison of both the performance of the fund and the index assumes portfolios that have been assembled before beginning the measuring periods, and thus need not take into account acquisition costs. In the case of the index, the portfolio is not managed and there are no subsequent transaction costs. However, an actively managed portfolio will have transaction and other costs, including advisory fees, which must be appropriately reflected in performance.

[26] An index adjusted for such fees and expenses would not be an objectively maintained benchmark and would penalize low cost funds vis-a-vis high cost funds.

[27] *See supra* note 22.

[28] Sharpe, *Risk Aversion in the Stock Market: Some Empirical Evidence*, 20 Journal of Finance 416 (Sept. 1965); Sharpe, *Mutual Fund Performance*, 39 Journal of Business 119 (Jan. 1966); McDonald, *Objectives and Performance of Mutual Funds* (1960–1969), 9 Journal of Financial and Quantitative Analysis 311 (June 1974); Modigliani and Pogue, *An Introduction to Risk and Return*, 30 Financial Analysts Journal 68 (March/April), 69 (May/June 1974); R. Brealey, *An Introduction to Risk and Return From Common Stocks*, Chapt. 4 (1969). These findings have been reexamined recently using the methodology developed to evaluate a manager's ability to time the market and select individual securities. Henriksson and Merton, *On Market Timing and Investment Performance. II. Statistical Procedures for Evaluating Forecasting Skills*, 54 Journal of Business 513 (Oct. 1981). The recent studies found no significant differences with the general findings of the earlier studies. Chang and Lewellen, *Market Timing and Mutual Fund Investment Performance*, 57 Journal of Business 57 (Jan. 1984); Henriksson, *Market Timing and Mutual Fund Performance: An Empirical Investigation*, 57 Journal of Business 73 (Jan. 1984); Jagannathan and Korajczyk, *Assessing the Market Timing Performance of Managed Portfolios*, 59 Journal of Business 217 (April 1986).

[29] Treynor, *How to Rate Management of Investment Funds*, 43 Harv. Bus. Rev. 63 (Jan.–Feb. 1965); Jensen, *Risk, the Pricing of Capital Assets, and the Evaluation of Investment Portfolios*, 42 Journal of Business 167 (April 1969); Mains, *Risk, the Pricing of Capital Assets, and the Evaluation of Investment Portfolios: Comment*, 50 Journal of Business 371 (July 1977). *See also* Bank Administration Institute, *Measuring the Investment Performance of Pension Funds For the Purpose of Inter-Fund Comparisons* 6 (1968): "A superior fund manager is one who obtains on the average a high rate of return relative to the degree of risk he has assumed, or is permitted by policy to assume, in his investments."

[30] Comment on similar issues was requested by the Commission in connection with the proposal of the mutual fund advertising rules. *See* Investment Company Act Rel. No. 15315 (Sept. 17, 1986) [51 FR 34390 (Sept. 26, 1986)] at Section III.

In addition to requiring an index comparison, proposed Item 3A would call for the same information required by proposed Item 5A(b). Therefore, a fund with a formal or informal policy of maintaining a specified level of distributions to its shareholders would have to discuss the effect that policy has had on the fund's investment strategies and per share net asset values during its last fiscal year.

3. Procedural Requirements

(a) *Annual Report to Shareholders.* As noted earlier, the disclosure requirements under either of the alternative proposals could be satisfied by including the specified information in the annual report to shareholders instead of in the prospectus. Those funds that currently prepare an analysis of fund performance usually include it in their annual reports. The Commission's proposed alternative amendments would accommodate this practice; as a result, some funds may only have to make minor revisions to their annual reports to comply with the respective proposed form amendments, if adopted.

To place the specified information in the annual report instead of the prospectus, a fund would have to meet three conditions under either proposal.[31] First, a copy of the annual report must either precede or accompany delivery of the prospectus. Second, the required disclosures must be incorporated by reference into the prospectus so that prospectus liability attaches to that information regardless of the document in which it is delivered. Third, the specified performance information must be filed with the Commission as an exhibit to the registration statement to facilitate examination of the disclosures by the Commission staff reviewing the prospectus.

The Commission also requests comment on alternative means of using annual reports to satisfy these disclosure requirements. Under this alternative, funds would be required to include the new disclosure in their prospectuses unless it appears in their annual reports. However, funds including this information in their annual reports would not be required to incorporate the material by reference into the prospectuses or deliver the annual report to prospective investors. Rather, the prospectus would be required to include a statement that the annual report contains an explanation of the fund's performance during its most recent fiscal year, and that it is available upon request.

(b) *New Funds.* Respective instructions to the proposed alternative amendments specify certain requirements for new funds.[32] A new fund would have to include the disclosures required under the alternative proposals in the first form of prospectus used after the end of its first fiscal year, if that prospectus (or the related Statement of Additional Information) contains audited financial information for a period of at least six months. If that prospectus does not contain financial statements for at least a six month period, the specified information would not be required to be included until the first form of prospectus used after the end of the fund's second fiscal year. Thus, the proposed disclosures would only be required in a prospectus after a sufficient period of operations has occurred to permit a meaningful discussion and analysis (or index comparison). Secondly, the instructions would facilitate the use of annual reports as the means of presenting the required information. A new fund that wished to include the specified performance information in its annual report would not have to first include the information in its prospectus and then wait until its next annual report to move it to the annual report. Comment is requested on whether a new fund that would be required to include the information into its prospectus only after the end of its second fiscal year should be required to do so earlier.

(c) *Proposed Amendments to Rule 485.* Mutual funds update their prospectuses annually by means of post effective-amendments to their registration statements. Under rule 485(b) [17 CFR 230.485(b)] post-effective amendments that contain only routine updating changes become effective automatically and without staff review. Under rule 485(a) [17 CFR 230.485(a)] all other post-effective amendments become effective sixty days after filing or, at the option of the fund, up to eighty days after filing. During this period the Commission staff has an opportunity to review and comment on the filings.

Under either alternative, the Commission would amend rule 485 so that post-effective amendments that are currently eligible to be filed under paragraph (b) will continue to be so eligible notwithstanding the inclusion of information concerning investment performance required by the alternative proposals. The Commission contemplates that the staff will review those disclosures on a spot-check basis in order to assess the development and adequacy of disclosure practices. However, post-effective amendments containing disclosures required by the alternative proposals that are filed under paragraph (a) for purposes other than those specified in paragraph (b) would continue to be reviewed as part of the normal review of post-effective amendments.

(d) *Sales Literature.* Rule 34b–1 under the 1940 Act requires that sales literature containing performance information include the same uniformly-computed performance information that rule 482 under the 1933 Act [17 CFR 230.482] requires to be disclosed in mutual fund advertisements.[33] Rule 34b–1 contains an exception for reports to shareholders, including annual reports, that contain performance data covering only the period of the report. Responses to proposed Item 3A (Alternative II) would, of course, involve performance data covering periods in excess of the period covered in the annual report. Under the current rule, if a fund were to include performance information, such as the data required by Alternative II, in its annual report to shareholders, it would be required: (i) Either to make the index comparison called for by proposed Item 3A by using average annual total return figures or by using aggregate total return figures accompanied by average annual total return figures; (ii) to include the legend required by paragraph (a)(6) of rule 482; [34] and (iii) to update the information quarterly.[35]

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[31] *See* proposed amendment to General Instruction E of Form N–1A in Section II.B.3.(g). *infra.*

[32] Instruction 5 to proposed Item 3A; Instruction 3 to proposed Item 5A.

[33] Rule 34b–1 provides that sales literature containing any performance information (except that of a money market fund) must contain uniformly-computed average annual total return for one, five, and ten year periods; sales literature containing yield (or some other quotation of income or distributions) must contain a uniformly-computed yield figure; and sales literature containing a tax equivalent yield (or some other quotation of tax equivalent income or distributions) must contain a uniformly-computed tax equivalent yield figure.

[34] Paragraph (a)(6) of rule 482 requires a fund to disclose that the performance data quoted represents past performance and that the investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Money market funds may omit information about principal fluctuation.

[35] Rule 34b–1(a) requires that the uniformly-computed total return information required to be included in sales literature be the total return information specified in paragraph (e)(3) of rule 482. Subparagraph (e)(3)(ii) of rule 482 requires that the total return be current as to the most recent calendar quarter prior to submission for publication. The note to rule 34b–1 provides that the currentness provisions of rule 482, paragraph (f), also apply to

Continued

The Commission is proposing to amend rule 34b–1 to exempt from the updating requirements performance information (such as that required by Alternative II) contained in any periodic report to shareholders. This revision would avoid application of a different updating requirement to performance information included in annual reports from the one applied to such information in prospectuses. In addition, this exception from the updating requirement may be warranted because investors are likely to understand that the performance information in a periodic report is only as current as the report.[36]

(e) *Recordkeeping.* In connection with Alternative II, the Commission is proposing an amendment to rules 31a–1 and 31a–2 under the 1940 Act [17 CFR 240.31a–1 and 31a–2], the investment company recordkeeping rules, to require that funds preserve for Commission inspection worksheets used to compile the data necessary to compare fund total return to a securities index in response to proposed Item 3A. This would facilitate Commission staff review of the integrity of the data in the prospectus in the course of a fund inspection.

(f) *Amendment to Form N–14.* Form N–14 is the registration form used by investment companies to register under the 1933 Act securities to be issued in mergers and other forms of business combinations and reorganizations. The Commission is proposing to amend Item 5(a) of Form N–14 to require that shareholders be furnished with the information required by the proposed alternatives. In the case of transactions involving mutual funds, that Item currently requires funds using Form N–14 to provide specified material information about the parties to the transaction that also is required by Form N–1A.[37] The performance information that would be called for under either alternative would be equally material to an investment decision relating to the issuance of securities in business combinations involving mutual funds because investors would be interested in obtaining information about a fund's performance before making their investment decisions. The alternative of including the new disclosure in the annual report also would be available to funds in connection with these transactions. In the event that the annual report is made available to investors upon request, then appropriate changes would be made to Form N–14 to assure timely delivery of the required information.[38]

(g) *Incorporation by Reference of Subsequently Filed Information.* As discussed above, a fund could respond to either of the alternative proposals by incorporating by reference into the prospectus information contained in annual reports to shareholders, if investors receive the annual report along with the prospectus or, as is often the case with respect to existing shareholders of a fund, the annual report is delivered before the prospectus.[39] Form N–1A now permits a fund to satisfy its financial information requirements by incorporating by reference into the Statement of Additional Information ("SAI") or prospectus financial information contained in the annual report to shareholders.

General Instruction E of Form N–1A permits a fund to incorporate by reference into the SAI in response to Item 23 of the Form financial statements contained in an annual report meeting the requirements of section 30(d) of the 1940 Act [40] that has been filed by the fund with the Commission, provided that the report is delivered to new shareholders along with the SAI.[41] As a result, the financial statements contained in each new annual report have to be incorporated by reference separately into the SAI when the fund annually updates its registration statement. If a new annual report is issued before the registration statement is updated to incorporate by reference the financial information from the new report, the fund must continue to deliver the old annual report along with the SAI. Alternatively, the fund could file a post-effective amendment incorporating by reference the new annual report when it is issued.

The Commission is proposing to amend General Instruction E to provide for the automatic incorporation by reference into the registration statement of information required by the alternative proposals and Item 23 of Form N–1A and contained in annual reports that are filed subsequently [42] by a fund with the Commission.[43] In either case, if a fund chooses to incorporate by reference into the prospectus or SAI, as appropriate, disclosure in response to the alternative proposals or financial statements in response to Item 23 or both, the fund would be required to state in the prospectus or SAI that the designated information would be deemed to be incorporated by reference into the registration statement and to be a part thereof from the date the reports are filed with the Commission.[44] Therefore, funds could deliver their current annual reports along with their prospectuses or SAIs as soon as the annual reports are filed with the Commission. The accountant's written consent that is required with respect to financial statements incorporated by reference in a previously filed registration statement would be required to be filed with the Commission as an attachment to the annual report. Comment is requested on whether the proposed amendment to General Instruction E should be extended to permit funds to incorporate by reference into the prospectus information contained in a subsequently filed annual report in response to any item of Form N–1A.

The proposed amendment also would require a fund to file as an exhibit to its registration statement those parts of the annual report incorporated by reference. As proposed, this exhibit would not

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sales literature. Thus all performance information in sales literature must be as current as practicable considering the type of investment company and the media through which the advertising will be conveyed, but total return is updated only quarterly The staff has interpreted these provisions to require quarterly updating of any performance information in sales literature.

[36] The Commission is also revising rule 34b–1 to clarify that the currentness provisions apply as of the date of usage of sales literature, and not the date of submission for publication.

[37] General Instruction G to Form N–14 permits this information to be incorporated by reference from the party's prospectus and corresponding Statement of Additional Information if certain conditions are met.

[38] *See* section II.B.3.(a) *supra.*

[39] *Id.*

[40] 15 U.S.C. 80a–29(d).

[41] A copy of the annual report must be furnished, without charge, upon the request of an existing shareholder who already has received the material incorporated by reference. General Instruction E also permits funds to incorporate by reference into the prospectus in response to Item 3(a) of Form N–1A information contained in reports to shareholders that meet the requirements of section 30(d) and are filed with the Commission.

[42] The proposed revision in based on the provisions of Form S–3 [17 CFR 239.13] which require the incorporation by reference into a registration statement on that form of documents filed subsequently by the registrant with the Commission pursuant to 1934 Act section 13(a) or 15(d).

[43] Rule 30b2–1 [17 CFR 270.30b2–1] requires funds to file with the Commission copies of every periodic or interim report containing financial statements and transmitted to a fund's shareholders. The proposed change would apply equally to the incorporation by reference into the prospectus in response to Item 3(a) of Form N–1A of information contained in subsequently filed annual reports.

[44] Rule 412 of Regulation C under the 1933 Act [17 CFR 230.412] provides that any statement contained in any subsequently filed document which is deemed to be incorporated by reference into the registration statement shall be deemed to modify or supersede any previous statement therein to the extent that the statement modifies or replaces that earlier statement.

have to be updated until the fund files its next post-effective amendment.

C. *Portfolio Managers.* The Commission is proposing to add a new Item 5(c) to Form N–1A to require disclosure about all persons who significantly contribute to the investment advice relied on to manage the fund's portfolio. In most cases, this will be the fund's portfolio manager. The proposed amendment is substantially the same as an amendment recently proposed to Form N–2, the registration form used by closed-end funds.[45]

Item 5(c) would require disclosure of the name, title, business experience during the past five years, and period of employment with the adviser of each individual employed by the fund's investment adviser whose participation in providing investment advice may be important to fund investors. The disclosure of this information is intended to make investors aware of the individuals who may not be named as the investment adviser of the fund, but who nonetheless may have a significant impact on the fund's investment success. This disclosure would permit investors to assess the background and experience of such a person and evaluate the extent of the person's responsibility for the previous investment success (or lack thereof) of the fund before making an investment decision.[46] Comment is requested as to whether the requirement that previous business experience be disclosed be limited to securities-related business experience.

If the persons significantly contributing to the investment advice relied on by the fund changed, the prospectus would have to be revised by means of a post-effective amendment or a "sticker" in accordance with rule 497 under the 1933 Act [17 CFR 230.497] because the information contained therein would be materially incorrect. This would inform investors about changes to the fund that may affect the nature of their investment.

The proposed amendment would limit required disclosure to only those persons who, under the organizational arrangements of the investment adviser, make a significant contribution to the investment advice used by the fund. The proposed amendment is based upon Item 401(c) of Regulation S–K [17 CFR 229.401(c)], which requires similar disclosure regarding employees who make, or who are expected to make, significant contributions to the registrant's business, although they are not executive officers. Like those registrants subject to the Item 401(c) disclosure requirement, the success of the fund may be, "to a large extent, contingent upon retaining such persons."[47]

In response to the proposed amendment to Form N–2 to require disclosure concerning fund portfolio managers, the Investment Company Institute (a trade association representing the mutual fund industry, hereinafter "ICI") stated that a fund only should be required to disclose a portfolio manager's identity under the following circumstances: (1) Where "the manager's identity is of such critical importance to the advisory organization that if the person were to leave, the organization would no longer exist or operate in the same manner as it did under the direction of that person;"[48] and (2) whenever the fund promotes that manager to the press or the public as being critical to the investment decisions of the fund.[49] Comment is requested on whether the ICI's recommended formulation would omit material information that investors would want to know before investing. For instance, there may be circumstances where the portfolio manager's background and experience are such that an investor would not invest if he or she knew this information, although the portfolio manager was not critical to the advisory organization's existence and the fund did not promote the portfolio manager as being critical to the investment decisions of the fund. Comment also is requested as to how the Commission or a court could determine whether a manager is "of critical importance to the advisory organization" or whether the advisory organization promotes the manager as being "critical to the investment decisions of the fund."

The Commission requests comment on whether the proposed disclosure requirement should be modeled after Item 401(c), the ICI's proposal, or whether a different test with a more objective standard should be formulated for determining when portfolio manager disclosure is required, and if so, what this test should be. The Commission also requests comment as to whether additional disclosure should be required in the Statement of Additional Information discussing specifically the nature of the adviser's (or the fund's) portfolio decision making process, and the role in that process of any person listed in the prospectus in response to the proposed item.

III. General Request for Comments

Any interested persons wishing to submit written comments on the rule and form changes that are the subject of this release, to suggest additional changes, or to submit comments on other matters that might have an impact on the proposals contained herein, are requested to do so. In particular, comment is requested on the merits of the alternative proposed amendments and whether it would be advisable to combine certain elements of each of the proposals.

IV. Cost/Benefit Analysis

The Commission believes that the rule and form changes proposed today would substantially improve the quality of prospectus disclosure without significantly adding to the cost or burden of existing disclosure requirements. The proposed changes would provide investors material information concerning portfolio managers and fund performance, as well as render the per share table a more effective summary of fund financial information. It is believed that compliance with the proposed changes would only require funds to disclose information that is readily available to them.

Many funds currently compare their performance to that of an index in their prospectuses. Some funds also discuss and analyze their performance in periodic reports to shareholders. In addition, the information required by the proposed alternative items is the type that generally is considered by a fund's board of directors in evaluating the performance of the fund's investment adviser in connection with deciding whether or not to renew its investment advisory contract, as required by section 15(a)(2) of the Investment Company Act [15 U.S.C. 80a–15(a)(2)]. Imposing uniform performance reporting obligations on mutual funds would benefit investors by requiring funds to disclose investment results for

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[45] *See* Release 17091 *supra* note 5. The Commission stated in Release 17091 that it expected to consider proposing for comment similar amdnements to Form N–1A. Reference should be made to Release 17091 for a more detailed discussion of the Commission's prior proposals for similar disclosure.

[46] The Commission also is proposing to require that total return data be included in the condensed financial information in the prospectus. *See* discussion, *supra*. The disclosure of changes in the portfolio manager would allow investors to evaluate the historical performance data in light of this information.

[47] Securities Act Rel. No. 5949 (July 28, 1978) [43 FR 34402 (Aug. 3, 1978)] (incorporating Form S–1 [17 CFR 239.11] disclosure items regarding management of publicly held companies into Regulation S–K).

[48] Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated Oct. 20, 1989, from the Investment Company Institute, at p. 11 in File No. S7–21–89.

[49] *Id.* at 12.

comparable time periods on a regular basis and analyze performance. The alternative proposals also would permit funds the flexibility of including the required information in their annual reports to shareholders rather than in their prospectuses.

To minimize burdens associated with the proposed rule and form changes, the Commission proposes to allow a fund to delay amending its registration statement until it files its next post-effective amendment following adoption of any of the proposed amendments.

The Commission invites specific comments on its assessments of the costs and benefits associated with the various proposals contained in this release, including estimates of any costs and benefits perceived by commenters. In particular, comment is requested on the comparative costs and benefits of the proposed alternative amendments to Form N–1A and the various parts of each proposal.

V. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis in accrdance with 5 U.S.C. 603 regarding the proposed amendments. The analysis notes that the rule and form proposals contained in this release are intended to improve the quality of investor disclosure by requiring more information about portfolio managers and the performance of the fund, and simplifying the per share table. Other aggregate cost-benefit information reflected in the "Cost/Benefit Analysis" section of this release also is reflected in the analysis. A copy of the Initial Regulatory Flexibility Analysis may be obtained by contacting Larisa E. Dobriansky, Mail Stop 5–2, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549.

VI. Text of Proposed Rule and Form Amendments

List of Subjects in 17 CFR Parts 230, 239, 270, 274

Investment companies, Reporting and recordkeeping requirements, Securities

The Commission is proposing to amend Chapter II, Title 17 of the Code of Federal Regulations as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Regulation C of part 230 continues to read as follows:

Authority: Sections 230.400 to 230.499 issued under Secs. 6, 8, 10, 19, 48 Stat. 78, 79, 81, 85, as amended (15 U.S.C. 77f, 77h, 77j, 77s); * * *

2. By revising paragraph (b)(1)(iii) of § 230.485 to read as follows:

§ 230.485 Effective date of post-effective amendments filed by certain registered investment companies.

* * * * *

(b) * * *

(1) * * *

(iii) Bringing the financial statements and other information up to date pursuant to section 10(a)(3) of the Act, and in conjunction therewith, making such other non-material changes as the registrant deems appropriate and, in the case of a post-effective amendment to a registration statement filed by a registered open-end management investment company, providing the information required by Item 3A [or Item 5A] of Form N–1A; and

* * * * *

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

3. The authority citation for part 239 continues to read, in part, as follows:

Authority: The Securities Act of 1933, 15 U.S.C. 77a, *et seq.*, unless otherwise noted.

4. By revising paragraph (a) of Item 5 of Form N–14 in § 239.23 to read as follows:

§ 239.23 Form N–14, for the registration of securities issued in business combination transactions by investment companies and business development companies.

* * * * *

Item 5. Information about the Registrant

* * * * *

(a) If the Registrant is an open-end management investment company, furnish the information required by Items 3, 4(a) and (b), 5, 5A [or 3A], 6(a), (c), (d), (e), (f), and (g), and 7 through 9 of Form N–1A under the 1940 Act;

* * * * *

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

5. The authority citation of part 270 continues to read as follows:

Authority: Secs. 38, 40, 54 Stat. 841, 842; 15 U.S.C. 80a–37, 80c–89. The Investment Company Act of 1940, as amended, 15 U.S.C. 80a–1 *et seq.*; unless otherwise noted.

6. In the case of Alternative II, by amending the current text of § 270.31a–1 by redesignating paragraph (b)(12) as paragraph (b)(13) and by adding a new paragraph (b)(12) to read as follows:

§ 270.31a–1 Records to be maintained by registered investment companies, certain majority-owned subsidiaries thereof, and other persons having transactions with registered investment companies.

* * * * *

(b) * * *

(12) All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of any investment company performance or securities index data contained in any prospectus or report to shareholders.

* * * * *

7. In the case of Alternative II, by revising the current text of § 270.31a–2(a)(3) to read as follows:

§ 270.31a–2 Records to be preserved by registered investment companies, certain majority-owned subsidiaries thereof, and other persons having transactions with registered investment companies.

(a) * * *

(3) Preserve for a period not less than 6 years from the end of the fiscal year last used, the first 2 years in an easily accessible place, any advertisement, pamphlet, circular, form letter or other sales literature addressed to or intended for distribution to prospective investors and all accounts, books, and internal working papers required to be maintained by rule 31a–1(b) (12) of the Act [17 CFR 270.31a–1(b)(12)].

* * * * *

8. By revising § 270.34b–1 to read as follows:

§ 270.34b–1 Sales literature deemed to be misleading.

(a) Except as provided in paragraph (b) below, any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Act [15 U.S.C. 80a–24(b)] and that contains any investment company performance data ("sales literature") shall have omitted to state a fact necessary in order to make the statements made therein not materially misleading unless the sales literature also contains performance data specified in subparagraphs (1), (2) and (3) of this section, and the disclosure required by paragraph (a)(6) of rule 482 under the Securities Act of 1933 [17 CFR 230.482(a)(6)], and the performance data contained therein complies with the currentness requirements of paragraph (f) of rule 482 [17 CFR 230.482(f)].

(1) Sales literature containing any investment company performance data (except that of a money market fund) shall also contain the total return information required by paragraph (e)(3) of rule 482 [17 CFR 230.482(e)(3)].

(2) Sales literature containing a quotation of yield or other similar quotation purporting to demonstrate the income earned or distributions made by the company shall contain a quotation of current yield specified by paragraph (e)(1) of rule 482 [17 CFR 230.482(e)(1)], or, in the case of a money market fund, paragraph (d)(1) of rule 482 [17 CFR 230.482(d)(1)].

(3) Sales literature containing a quotation of tax equivalent yield or other similar quotation purporting to demonstrate the tax equivalent of income earned or distributions made by the company shall contain a quotation of tax equivalent yield specified by paragraph (e)(2) and current yield specified by paragraph (e)(1) of rule 482, or, in the case of a money market fund, paragraph (d)(1) of rule 482 [17 CFR 230.482(d)(1)].

Note: Sales literature containing a quotation of yield or tax equivalent yield must also contain the total return information. In the case of sales literature, the currentness provisions apply from the date of distribution and not submission for publication.

(b) The requirements specified in paragraph (a) of this section shall not apply to any quarterly, semi-annual or annual report to shareholders under section 30(d) of the Act [15 U.S.C. 80a-29(d)], containing performance data for a period commencing no earlier than the first day of the period covered by the report; nor shall the requirements of paragraphs (e)(3)(ii) and (f) of rule 482 [17 CFR 230.482(e)(3)(ii), and (f)] apply to any such periodic report containing any other performance data.

PARTS 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

9. The authority citation for part 239 continues to read as follows:

Authority: The Securities Act of 1933, 15 U.S.C. 77a, *et seq.*, unless otherwise noted.

10. The authority citation for part 274 continues to read as follows:

Authority: The Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, unless otherwise noted; * * *

§ 239.15A Form N-1A, registration statement of open-end management investment companies.

§ 274.11A Form N-1A, registration statement of open-end management investment companies.

Note: Form N-1A is not codified in the Code of Federal Regulations.

11. By revising the fourth paragraph of General Instruction E of Form N-1A (17 CFR 239.15A and 274.11A) to read as follows:

* * * * *

General Instructions

* * * * *

E. Incorporation by Reference

* * * * *

Subject to the above rules and the conditions enumerated below, a Registrant may incorporate by reference into the prospectus or the Statement of Additional Information in response to any of the following Items of the Form the information contained in any report to shareholders meeting the requirements of section 30(d) of the 1940 Act [15 U.S.C. 80a-29(d)] and Rule 30d-1 [17 CFR 270.3d-1] thereunder, that has been filed by the Registrant with the Commission: (a) Item 3(a); (b) Item 23; and (c) Item 3A [5A]. In that event, notwithstanding the above rules, the Registrant also will incorporate by reference in response to the same Item(s) the information contained in annual reports to shareholders meeting the same requirements that are filed subsequently by the Registrant with the Commission. The following conditions must be satisfied in connection with incorporating information by reference in accordance with this Instruction:

1. The material that is incorporated by reference is prepared in accordance with this Form;

2. The Registrant includes a statement at the place in the prospectus or the Statement of Additional Information where the information required by the relevant Item(s) specified above would otherwise appear that the information is incorporated by reference from a report to shareholders. The Registrant also will state that the updated information contained in any subsequently filed annual report to shareholders will be deemed to be incorporated by reference in the prospectus or Statement of Additional Information and to be a part thereof from the date of filing such document with the Commission.

* * * * *

4. The Registrant will submit to the Commission, as an attachment to financial statements to be incorporated by reference into the previously filed registration statement, the written consent of the accountant or accountants to the incorporation of that material. That consent will be deemed to be filed with the Commission.

5. The Registrant will file as an exhibit to the registration statement those parts of the annual report to shareholders incorporated by reference therein. That exhibit must be updated at the time the Registrant files its next post-effective amendment.

* * * * *

12. By revising paragraph 4 of General Instruction F of Form N-1A [17 CFR 239.15A and 274.11A] to read as follows:

* * * * *

General Instructions

* * * * *

F. Documents Comprising Registration Statement or Amendment

* * * * *

4. A registration statement or an amendment thereto which is filed under only the 1940 Act shall consist of the facing sheet of the Form, responses to all items of parts A and B except Items 1, 2, 3 and 5A [or 3A] of part A thereof, responses to all items of part C except Items 24(b)(6), 24(b)(10), 24(b)(11), and 24(b)(12), required signatures, and all other documents which are required or which the Registrant may file as part of the registration statement.

* * * * *

13. By revising Item 3 of Form N-1A (17 CFR 239.15A and 274.11A) to read as follows:

* * * * *

Item 3. Condensed Financial Information

(a) Furnish the following information for the Registrant, or for the Registrant and its subsidiaries, consolidated as prescribed in rule 6-03 [17 CFR 210.6-03] of Regulation S-X.

Per Share Income and Capital Changes (for a share outstanding throughout the year)

1. Net Investment Income
2. Net Gains or Losses on Securities (both realized and unrealized)
3. Dividends (from net investment income)
4. Distributions (from capital gains)
5. Net Asset Value (at end of period)

Ratios

6. Expense Ratio (expenses to average net assets)
7. Income Ratio (net investment income to average net assets)
8. Portfolio Turnover Rate
9. Total Return
10. Net Assets at End of Period (000s)

Instructions:

1. Present the information in comparative columnar form for each of the last ten fiscal years of the Registrant (or for the life of the Registrant and its immediate predecessors, if less) but only for periods after the effective date of Registrant's 1933 Act registration statement. In addition, present the information for the period between the end of the latest fiscal year and the date of the latest balance sheet or statement of assets and liabilities furnished. Where the period for which the Registrant provides condensed financial information is less than a full fiscal year, the ratios set forth in the table may be annualized but the fact of this annualization must be disclosed in a note to the table.

2. List per share amounts at least to the nearest cent. If the computation of the offering price is extended to tenths of a cent or more, then state the amounts on the table

in tenths of a cent. Present the information using a consistent number of decimal places.

3. Make, and indicate in a note, all appropriate adjustments to reflect any stock split or stock dividend during the period.

4. If the investment adviser has been changed during the period covered by this item, disclose the date(s) of the change(s) in a note.

5. The condensed financial information for not less than the latest five fiscal years must be audited and must so state. The auditor's report as to the condensed financial information need not be included in the prospectus.

6. Derive the amount to be shown at caption 1 by adding (deducting) the increase (decrease) per share in undistributed net investment income for the year to (from) dividends from net investment income per share for the year. Such increase (decrease) may be derived from a comparison of the per share figures obtained by dividing the undistributed net investment income at the beginning and end of the year by the number of shares outstanding on those respective dates. Other methods may be acceptable, but should be explained in a note to the table.

7. The amount to be shown at caption 2, which is derived by adding together the amounts computed for the periods during the year when shares were sold or repurchased (which could be as often as twice daily), is also the balancing figure derived from the other figures in the statement and should be so computed. The amount shown at this caption for a share outstanding throughout the year may not agree with the change in the aggregate gains and losses in the portfolio securities for the year because of the timing of sales and repurchases of Registrant's shares in relation to fluctuating market values for the portfolio.

8. If any distribution were made from capital sources other than net realized profits on securities, state the per share amounts thereof separately immediately below caption 3. In a note indicate the nature of such distributions.

9. In caption 5, the net asset value should be set forth at the end of each period for which the information in the table is being provided.

10. Compute the "average net assets," as used in captions 6 and 7, upon the basis of the value of the net assets determined no less frequently than as of the end of each month.

11. Compute the portfolio turnover rate to be shown at caption 8 as follows:

a. Divide (A) the lesser of purchases or sales of portfolio securities for the particular fiscal year by (B) the monthly average of the value of the portfolio securities owned by the Registrant during the fiscal year. Calculate the monthly average by totalling the values of the portfolio securities as of the beginning and end of the first month of the particular fiscal year and as of the end of each of the succeeding eleven months and dividing the sum by 13.

b. Exclude from both the numerator and the denominator all securities, including options, whose maturity or expiration date at the time of acquisition were one year or less. All long-term securities, including long-term U.S. Government securities, should be included. Purchases shall include any cash paid upon the conversion of one portfolio security into another and the cost of rights or warrants purchased. Sales shall include the net proceeds of the sale of rights or warrants and the net proceeds of portfolio securities that have been called, or for which payment has been made through redemption or maturity.

c. If during the fiscal year the Registrant acquired the assets of another investment company or of a personal holding company in exchange for its own shares, exclude from purchases the value of securities so acquired, and from sales, all sales of such securities made following a purchase-of-assets transaction to realign the Registrant's portfolio. In such event, make appropriate adjustment in the denominator of the portfolio turnover computation and disclose such exclusions and adjustments.

d. Short sales that the Registrant intends to maintain for more than one year and put and call options where the expiration date is more than one year from the date of acquisition are included in purchases and sales for purposes of this item. The proceeds from a short sale should be included in the value of the portfolio securities that the Registrant sold during the period and the cost of covering a short sale should be included in the value of the portfolio securities which the Registrant purchased during the period. The premiums paid to purchase options should be included in the value of the portfolio securities that the Registrant purchased during the reporting period and the premiums received from the sale of options should be included in the value of the portfolio securities that the Registrant sold during the period.

e. If periods prior to 1985 are not calculated on the same basis as that required above, disclose this in a note to the table.

12. When calculating the "total return" to be shown at caption 9:

a. Assume a purchase of common stock at the then-current per share net asset value on the first day and a sale at the then-current per share net asset value on the last day of each period reported in the table;

b. Do not reflect sales load or account fees (Indicate in a footnote, if relevant, that the total return does no reflect sales load or account fees.); and

c. Assume reinvestment of all dividends and distributions at the per share offering price.

* * * * *

14. By redesignating current paragraphs (c), (d), (e), and (f) of Item 5 of Form N–1A (17 CFR 239.15A and 274.11A) as (d), (e), (f), and (g), and adding a new paragraph (c) to read as follows:

* * * * *

Item 5. Management of the Fund

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(c) Disclose the name and title of all persons who make or are expected to make significant contributions to the investment advice provided to the Registrant and describe each person's business experience during the past five years and the length of time he or she has been employed by or associated with the investment adviser (or Registrant);

* * * * *

15. In case of Alternative II, by adding Item 3A to Form N–1A (17 CFR 239.15A and 274.11A) to read as follows:

* * * * *

Item 3A. Disclosure of Investment Performance

(a)(1) Unless the Registrant is a money market fund described in subparagraph (a)(2) of this Item, compare the total returns that the Registrant achieved for each of the last one, five and ten year periods ending on the last day of its most recent fiscal year to those of an appropriate index of securities over the same time periods.

(2) In the case of a money market fund that is eligible to quote a seven day yield under Item 22 of this form, compare the yield(s) that the Registrant achieved during the last fiscal year to an appropriate index of short-term securities or money market securities.

(3) If the Registrant selects a different index from the one it used previously, in each form of prospectus used during the twelve month period following the date of the first prospectus in which the new securities index ws incuded, explain the reason(s) for this change and compare the respective total returns or, in the case of money market funds, yield(s), with those of the index used previously.

(b) Discuss the impact that any formal or informal policy as to the maintenance of a specified level of distributions to shareholders had on investment strategies of the fund and per share net asset value during the Registrant's last fiscal year.

Instructions:

1. The index comparison called for by this Item must be set forth in a manner that can be readily understood by investors (*i.e.*, a graph, chart or appropriate tabular format). Include a statement explaining that past performance is not predictive of future performance.

2. The index that the Registrant uses in response to this Item must be adjusted to reflect the reinvestment of dividends, but not to reflect the Registrant's expenses. For purposes of this Item, an "appropriate securities index" must be one that is created and administrated by an organization that is not an affiliated person of the Registrant, its investment adviser or principal underwriter, unless the index is widely recognized and used.

3. In presenting total return for purposes of this Item, the Registrant may use either the average annual total return computed in the manner set forth in Item 22 of this form or an aggregated total return, provided that the total return reflects sales loads, account fees and all fund expenses.

4. If the Registrant's registration statement under the Securities Act of 1933 has been effective for less than five or ten years, substitute the period of effectiveness for the five and/or ten year period specified in subparagraph (a)(1) of this Item.

5. The Registrant must include the information required by this Item in the first

form of prospectus used after the end of its first fiscal year, if that prospectus or related Statement of Additional Information contains audited financial statements covering a period of at least six months; otherwise, the information required by this Item must be included in the first form of prospectus used after its second fiscal year.

6. If the Registrant is a series company, include the information required by this Item for each series.

* * * * *

16. In the case of Alternative I, by adding Item 5A to Form N–1A (17 CFR 239.15A and 274.11A) to read as follows:

* * * * *

Item 5A. Management's Discussion and Analysis of Investment Performance

(a) Discuss and analyze the Registrant's performance during its last fiscal year in relation to its investment objectives. Indentify and evaluate the factors that materially affected performance. Evaluate the effectiveness of significant investment techniques and strategies used to pursue the investment objectives, and describe any material effects that those techniques and strategies had on total return.

(b) Discuss the impact that any formal or informal policy as to the maintenance of a specified level of distributions to shareholders had on investment strategies of the fund and per share net asset value during the Registrant's last fiscal year.

Instructions:

1. The purpose of the discussion and analysis is to provide investors information relevant to an assessment of the Registrant's performance, given its investment objectives and policies. The Registrant should use an approach that will enable investors to best understand how it has achieved its performance. Include a statement explaining that past performance is not predictive of future performance.

2. The discussion and analysis in response to paragraph (a) of this Item should focus only on factors, techniques, and strategies materially affecting performance during the last fiscal year. These factors, techniques, and strategies may (but are neither limited to nor required to) include the following: developments in the markets in which the portfolio securities traded, composition of the Registrant's portfolio (e.g., types of issuers (capitalization, industry grouping, foreign or domestic), types of securities, quality of portfolio securities, average maturity of portfolio securities, cash equivalent position), net asset value of the fund, expense ratio, portfolio turnover, sales and redemption trends, currency fluctuations, hedging transactions, whether the fund assumed at any time a temporary defensive position.

3. The Registrant must include the information required by this Item in the first form of prospectus used after the end of its first fiscal year, if that prospectus or related Statement of Additional Information contains audited financial statements covering a period of at least six months; otherwise, the information required by this Item must be included in the first form of prospectus used after its second fiscal year.

4. If the Registrant is a series company, include the information required by this Item for each series.

By the Commission.

Dated: January 8, 1990.

Jonathan G. Katz,

Secretary.

[FR Doc. 90–836 Filed 1–12–90; 8:45 am]

BILLING CODE 6010–01–M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 10, 310, 314, and 320

[Docket No. 85N–0214]

RIN 0905–AB63

Abbreviated New Drug Application Regulations; Extension of Comment Period

AGENCY: Food and Drug Administration.

ACTION: Proposed rule; extension of comment period.

SUMMARY: The Food and Drug Administration (FDA) is extending to April 9, 1990, the comment period for the proposed rule to implement Title I of the Drug Price Competition and Patent Term Restoration Act of 1984 (Pub. L. 98–417) (July 10, 1989; 54 FR 28872). The proposal provides for the submission of abbreviated new drug applications (ANDA's) for generic versions of drug products. This document extends for 90 days the time for submission of comments on the proposal.

DATE: Comments by April 9, 1990.

ADDRESSES: Written comments to the Dockets Management Branch (HFA–305), Food and Drug Administration, Rm. 4–62, 5600 Fishers Lane, Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT: Philip L. Chao, or, Wayne H. Mitchell, Center for Drug Evaluation and Research (HFD–362), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301–295–8049.

SUPPLEMENTARY INFORMATION: In the Federal Register of July 10, 1989 (54 FR 28872), FDA issued a proposed rule to implement Title I of the Drug Price Competition and Patent Term Restoration Act of 1984 (Pub. L. 98–417), which amends section 505 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 355). The proposal provides for the submission of ANDA's for generic versions of drug products. These new provisions are intended to benefit consumers by making generic drug products available more quickly. The proposal gave interested persons an opportunity to submit written comments for 90 days (by October 10, 1989).

In the Federal Register of October 11, 1989 (54 FR 41629), FDA extended the comment period to January 9, 1990, in response to requests from several organizations. These organizations requested additional time to respond adequately to the proposal because of complex issues and questions that need careful analysis and evaluation. FDA carefully evaluated the requests and determined that a 90-day extension to the comment period for the preparation and submission of meaningful comments to a detailed and complex proposed rule was in the public interest.

FDA has received another request to extend the comment period for an additional period of time. The request asked that the comment period be extended to permit the generic drug industry to prepare and submit to FDA meaningful comments.

FDA has carefully considered this request and has determined that, because of the complexity of the proposed rule and the interest in the generic drug program, there has been insufficient time for interested persons to evaluate the proposal and to submit meaningful comments to the agency. Accordingly, the comment period for submission of comments by any interested person is extended to April 9, 1990.

Interested persons may, on or before April 9, 1990, submit written comments regarding this proposal to the Dockets Management Branch (address above). Two copies of any comments are to be submitted, except that individuals may submit one copy. Comments are to be identified with the docket number found in brackets in the heading of this document. Received comments may be seen in the Dockets Management Branch between 9 a.m. and 4 p.m., Monday through Friday.

Dated: January 9, 1990.

James S. Benson,

Acting Commissioner of Food and Drugs.

[FR Doc. 90–980 Filed 1–10–90; 2:47 pm]

BILLING CODE 4160–01–M

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21 CFR Parts 310, 343, and 369

[Docket No. 77N–0094]

RIN 0905–AA06

Internal Analgesic, Antipyretic, and Antirheumatic Drug Products for Over-the-Counter Human Use; Tentative Final Monograph; Extension of Reply Comment Period

AGENCY: Food and Drug Administration.