

Presidential Documents

Title 3—

The President

Presidential Determination No. 93-18 of March 31, 1993

Certification for Major Narcotics Producing and Transit Countries

Memorandum for the Secretary of State

By virtue of the authority vested in me by section 490(b)(1)(B) of the Foreign Assistance Act of 1961, as amended ("the Act"), I hereby determine and certify that the following major narcotics producing and/or major narcotics transit countries/dependent territories have cooperated fully with the United States, or taken adequate steps on their own, to achieve full compliance with the goals and objectives of the 1988 United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances:

The Bahamas, Belize, Bolivia, Brazil, China, Colombia, Ecuador, Guatemala, Hong Kong, India, Jamaica, Laos, Malaysia, Mexico, Morocco, Nigeria, Pakistan, Panama, Paraguay, Peru, Thailand, and Venezuela.

By virtue of the authority vested in me by section 490(b)(1)(B) of the Act, I hereby determine that it is in the vital national interests of the United States to certify the following countries:

Afghanistan and Lebanon.

Information on these countries as required under section 490(b)(3) of the Act is enclosed.

I have determined that the following major producing and/or major transit countries do not meet the standards set forth in section 490(b)(1)(A):

Burma, Iran, and Syria.

In making these determinations, I have considered the factors set forth in section 490 of the Act, based on the information contained in the International Narcotics Control Strategy Report of 1993. Because the performance of these countries varies, I have attached an explanatory statement in each case.

You are hereby authorized and directed to report this determination to the Congress immediately and to publish it in the **Federal Register**.

William Clinton

THE WHITE HOUSE,
Washington, March 31, 1993.

STATEMENTS OF EXPLANATION

The Bahamas

In 1992, the Government of the Commonwealth of The Bahamas (GCOB) made further progress toward achieving the goals of the 1988 UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the "UN Convention") and its bilateral narcotics control agreement with the USG. The GCOB has controls in place to discourage cash money laundering, but newer, more sophisticated money laundering techniques may require additional controls in order to meet fully the goals and objectives of the UN Convention. The GCOB continued its close cooperation with the USG to stop drugs from transiting the 700 islands of the archipelago. Drug enforcement initiatives, through both unilateral and combined programs, have reduced the overall quantities of drugs brought through the Bahamas over the past ten years. The new Ingraham administration, which came into office in August 1992, voiced its early commitment to maintain and enhance the high degree of cooperation in counternarcotics.

The Bahamas, which was the first country to ratify the 1988 UN Convention, has progressively instituted laws and programs to meet its objectives. In past years, the GCOB has created or strengthened laws or agreements relating to sentencing of traffickers, drug asset forfeiture, and mutual legal assistance. In 1992, the GCOB implemented comprehensive regulations to control the import and export of drug precursor and essential chemicals.

In October 1992, USG and GCOB representatives held talks on money laundering. The delegation of U.S. officials agreed with the GCOB conclusion that cash money laundering through banks in The Bahamas had diminished sharply. The majority of banks seemed to be effectively administering a know-your-customer policy which helps deter cash money laundering by non-account holders and/or transients. However, the USG also believes that The Bahamas is vulnerable to exploitation by drug money managers employing more sophisticated techniques involving a variety of monetary instruments passing through layers of shell corporations, which are a major feature of Bahamian banking and commerce. There are indications that money laundering continues via these new techniques.

Belize

The Belizean Government (GOB) has cooperated closely with the U.S. and other countries to combat narcotics trafficking. Cooperation has included interdiction, aerial eradication, sharing of intelligence, training, provision of materiel, and the arrest and return to the U.S. of non-Belizean fugitives from U.S. justice. Cocaine seizures and other drug-related crimes increased dramatically in 1992. Belize, with U.S. support, has successfully reduced marijuana cultivation to negligible levels. There is no indication of transit through Belize of precursor chemicals, or of any significant money laundering in Belize.

In December 1992, the U.S. and Belize signed a comprehensive maritime agreement which should enhance both nations' abilities to interdict illegal narcotics. The GOB has not yet signed the 1988 UN Convention, but many of the provisions of the Convention have already been adopted in Belize's 1990 Misuse of Drugs Act. Belize criminalizes illegal drug cultivation, production and distribution, and has cooperated with the U.S. and Mexico on interdiction of cocaine transshipment—indicators that the country is already in conformity with the intent of the UN Convention. The USG is urging Belize to adhere to the UN Convention and expects it will do so in 1993.

Bolivia

The Government of Bolivia (GOB) continued to cooperate with the USG and its neighbors on counternarcotics objectives in 1992 and has taken adequate steps to further the goals set forth in the 1988 UN Convention.

A major combined police, air force and navy law enforcement operation in the Chapare, the main coca growing region, resulted in significant seizures, including 51 metric tons of coca leaf, over 25 metric tons of cocaine products, nearly 80 metric tons of chemicals, seizure of 10 aircraft, destruction of 427 processing laboratories and 19 airstrips, and arrest or detention of 496 persons suspected of participating in trafficking activities. Building on the success of previous actions, this long-term operation demonstrates the growing capacity of the GOB to implement and sustain successful law enforcement actions throughout the country.

The GOB eradicated 5,149 hectares of coca in 1992. Although short of the GOB 7,000-hectare target, the voluntary eradication program succeeded in duplicating the small net reduction of coca cultivation achieved in 1991. It should be noted that a portion of coca cultivation (traditional chewing and for coca tea) is legal under Bolivian law but that production far exceeds the needs of the domestic market.

GOB counternarcotics results would be improved by strengthened political will against illegal coca cultivation and more vigorous actions against corruption. The GOB needs to implement all provisions of its existing law, including forcible eradication of new coca in the Chapare. Improvements in the justice system would increase GOB ability to prosecute successfully traffickers and keep them in prison.

The GOB extradited one Bolivian drug trafficker to the United States in mid-1992. However, in December 1992, the Bolivian Supreme Court rejected a U.S. request for the extradition of another trafficker on the grounds that the existing extradition treaty did not include narcotics violations, and that the offenses for which the trafficker was charged occurred prior to Bolivia's accession to the 1988 UN Convention. (The UN Convention had been the basis for previous extradition requests.) The Court's decision spurred the GOB to seek a modern extradition treaty with the U.S. which would cover narcotics-related offenses. The GOB is currently reviewing the text of a draft treaty it negotiated with the U.S. in 1990.

Brazil

In 1992, the Government of Brazil (GOB) continued to cooperate with the USG in counternarcotics programs, though results of its efforts have been disappointing. A severe political crisis and chronic economic problems distracted the GOB from effectively addressing its rising drug trafficking and consumption problem.

The GOB has not yet formulated a comprehensive national strategy, nor has it devoted sufficient resources to the problem. The anti-narcotics unit of the Federal Police is severely undermanned and underfunded. Legislation which would substantially improve counternarcotics enforcement continues to languish in congressional committee. Nevertheless, the GOB undertook two notable counternarcotics initiatives in 1992. The President signed a decree increasing the penalty for growing illegal drugs. Under this decree, landowners may be required to forfeit their entire plot of land, not just the small parcel under illicit cultivation. Secondly, the Government imposed regulations for reporting deposits over \$10,000, following a USG-funded money laundering control seminar attended by central bank officials. New President Franco has declared 1993 will be a year of national commitment against drug trafficking. These measures demonstrate progress toward the goals and objectives of the 1988 UN Convention.

China

The People's Republic of China (PRC) has become a significant transit country for heroin produced in the neighboring Golden Triangle region, principally Burma. It also has a growing opium cultivation problem and produces illicit methamphetamine, some of which is exported. The Chinese Government is actively addressing narcotics abuse and has launched a strong internal campaign against illegal drug use, including law enforcement, public education and international cooperation components. The Government treats narcotics-related corruption seriously.

Expansion of PRC cooperation with the USG remains restricted by the still-unresolved case of smuggler Wang Zongxiao, who requested political asylum in the U.S. in 1990 after being sent by PRC authorities at USG request to testify in a narcotics prosecution. The Drug Enforcement Administration has been able to continue a modest liaison relationship with PRC authorities, however, and the Chinese have participated in USG-funded training programs. The PRC itself pursues an active and aggressive counternarcotics effort, which has resulted in numerous arrests and convictions, many resulting in death sentences and substantial seizures.

China's broad-based counternarcotics program, while not in all respects sophisticated by world standards, shows that the PRC has met or is actively seeking to meet the goals and objectives of the 1988 UN Convention.

Colombia

Despite intense pressure by powerful drug trafficking organizations and some setbacks, Colombia continues to be both cooperative and proactive in a broad range of counternarcotics activities. Colombia signed the 1988 UN Convention in 1988. Despite the fact that the Second Senatorial Commission did not ratify it, the Government of Colombia (GOC) has largely met the goals of the Convention and the Gaviria administration still strongly supports its ratification. Pablo Escobar's July escape from prison was a major embarrassment to the GOC, with costly political fallout both domestically and internationally. The GOC responded quickly, by initiating an unprecedented massive manhunt, resulting in thousands of raids. Although Escobar remains at large, many of his key associates have been killed, captured, or have returned to prison voluntarily.

The GOC made a tough political decision in early 1992 to eradicate opium poppy—which only recently appeared in Colombia—with aerial application of herbicide. This decision, coupled with the Colombian National Police's (CNP) aggressive crop spraying campaign, has started to stabilize the opium crop. However, continuing pressure is needed to prevent the spread of opium poppy cultivation.

Led by the CNP's directorate of anti-narcotics (DAN), security services in 1992 seized or destroyed over 33 metric tons of cocaine hydrochloride and base, over 200 cocaine labs, over 6,000 55-gallon drums of ether, acetone and MEK, 110 airstrips, over 30 aircraft, and arrested over 1,700 persons.

The GOC activated its new Prosecutor General's office July 1, setting a standard in Latin America for criminal justice reform and prosecuting narcotics cases. Colombian law enforcement and military components participated fully in both bilateral and multilateral air interdiction and money laundering/asset seizure operations, many targeting the Cali Cartel. The CNP and Venezuelan security forces conducted a successful joint cross-border interdiction operation. Colombia is also conducting its first national-level drug abuse survey. Strong political will exists within the GOC, but the activities of traffickers through bribery, political influence, intimidation, violence and collusion with insurgents make progress difficult.

Ecuador

The Government of Ecuador (GOE) continues to cooperate with the USG to reduce drug trafficking. The GOE has enacted domestic legislation to

implement the provisions of the 1988 United Nations Convention and OAS Model Regulations. The GOE is taking steps to meet the goals and objectives of the 1988 UN Convention. In 1991, Ecuador and the USG signed a chemicals control agreement. In 1992, Ecuador signed an agreement with the USG on money laundering, which entered into force in 1993. Also in 1992, the USG and GOE began work on an asset sharing agreement. The GOE must marshal the various Ecuadorian agencies' efforts to form a viable national counternarcotics strategy.

The GOE's arrest of the leader and most members of the Jorge Reyes Torres Organization (JRTO/the largest narcotics trafficking organization in Ecuador) demonstrated resolve against drug trafficking, although we are waiting for vigorous prosecution of the defendants. The GOE also brought charges against a number of officials in an Ecuadorian military-owned bank for money laundering. In addition, the GOE sentenced a judge to five years in prison for illegally releasing Reyes Torres from jail in 1988. Nevertheless, corruption remains a serious problem.

For the first time, the Ecuadorian military provided air support to the police for counternarcotics operations. In another first, the GOE launched combined police/military operations against suspected drug traffickers in a remote area of the Ecuadorian/Colombian border. Ecuador also participated with the USG and neighbors in multi-national military efforts to curb drug trafficking. Ecuador has continued its participation in a regional air interdiction program.

The GOE eradicated coca in the mid-1980s and continues to conduct reconnaissance to locate and destroy any new cultivation, resources permitting. GOE forces found and destroyed several hectares of opium poppy near the Colombian border in November 1992.

Guatemala

During 1992, the administration of President Serrano cooperated with the U.S. to combat narcotics trafficking. Guatemalan Treasury Police participated with the Drug Enforcement Administration and the State Department Bureau of International Narcotics Matters (INM) in Operation CADENCE, an enhanced cocaine interdiction program combining intelligence sharing, joint counternarcotics missions, and use of USG air assets in Guatemalan territory.

Operation CADENCE and Guatemalan law enforcement authorities' own independent actions resulted in the seizure of 9.5 tons of cocaine in 1992. With USG support, the Guatemalans opened a Joint Intelligence Collection Center and included on the staff an official dedicated to precursor chemical control investigations. The Treasury Police has also undertaken to increase its staff and deploy more heavily throughout the country.

Guatemala's USG-supported aerial eradication program and Guatemala Treasury Police manual eradication missions sharply reduced the cultivation of opium poppy in 1992. The area under cultivation had reached a peak in 1990 at roughly 1,930 hectares, but declined in 1991 to 1,721 hectares, and in 1992 to 1,200 hectares.

Guatemala has signed and ratified the 1988 UN Convention; in 1992, the Guatemalan legislature passed a tough, comprehensive counternarcotics law which, when implemented in 1993, will meet the standards of the 1988 UN Convention. The government's cooperation on extradition and law enforcement with the U.S. as well as its chemical control efforts, drug awareness programs, crop eradication and drug interdiction indicate that the country is already in conformity with the Convention's goals and objectives.

The Serrano administration brought extradition proceedings against former mayor (of Zacapa) Arnoldo Vargas to a successful conclusion in 1992. Vargas and two of his associates now await trial on trafficking charges in the United States.

Hong Kong

Hong Kong is an important center for brokering and transshipping heroin from the Golden Triangle to the United States and other destinations. Drug traffickers also use it to launder their narcotics earnings. Hong Kong's counternarcotics effort represents substantial compliance with the goals and objectives of the 1988 UN Convention, although it is not party to the Convention.

Bilateral cooperation between USG agencies and their HKG counterparts is excellent. About \$25 million in drug-related assets have been confiscated both in Hong Kong and in the U.S. under a U.S.-Hong Kong agreement concerning confiscation and forfeiture of proceeds and instrumentalities of drug trafficking since it came into force in January 1991. The Hong Kong courts ruled in January that U.S. civil court forfeiture orders will be given effect by local courts under the terms of the bilateral agreement. This will give the U.S. the ability to request the freezing of drug assets in Hong Kong by means of either a U.S. civil or criminal forfeiture request. The HKG is positively considering a USG request for the sharing of seized assets. In one setback, a Hong Kong court ruling voided key sections of the financial disclosure laws; the Hong Kong Government is appealing to the Privy Council.

USG-HKG cooperation in extradition matters remains excellent. In 1992, 11 fugitives were extradited from Hong Kong to the U.S. on drug charges. Cooperation between the U.S. Drug Enforcement Administration and Customs and their HKG counterparts continues to be fruitful. Hong Kong is an active participant in the Financial Action Task Force.

India

India's main drug control problems are the transit of illegal drugs across its borders from neighboring producing countries, diversion from its licit opium industry to illicit channels, illegal cultivation and illicit export of chemicals for processing heroin. Despite good cooperation with the United States on individual cases of trafficking and increasing efforts to curtail diversion from licit cultivation, the Government of India (GOI) still needs to raise the priority of anti-drug programs and take stronger measures to control narcotics to the maximum extent possible.

The GOI again in 1992 raised the minimum amount of opium which licit growers must sell the GOI to obtain a new license, tightened terms of the crop-damage clause and paid incentives to growers who sell the GOI more opium than the average yield for the previous growing year. It has also reduced the number of farmers licensed to grow opium and brought the licit opiate stockpile down to a level consistent with market demand. Nevertheless, corruption at various levels and limited resources continue to obstruct effective GOI enforcement to thwart diversion of the licit crop into the hands of traffickers. Significant quantities of opium are still diverted from licit production, although most of what is diverted is probably consumed within the country. GOI-reported seizures of illegal opium fell to 1,585 kg in 1992 versus 2,145 kg in 1991.

On the other hand, GOI-reported heroin seizures rose to 1,034 kg in 1992 versus 622 kg in 1991. GOI regulations controlling the sale and possession of acetic anhydride (AA), used to make heroin, on the Indo-Pakistani and Indo-Burmese border have apparently helped to reduce AA smuggling to neighboring countries. The GOI states that nationwide AA controls are impossible because of its wide licit use, but the government nevertheless has set up an interagency committee to study what further domestic restrictions on AA may be possible.

India is becoming a major repository of Southwest Asian drug money, attracted by weak controls on its financial system, its gold market and its underground banking system. India is also reportedly attracting drug

money from Colombia and other parts of the narcotics world. Several measures of control have been adopted in India, but enforcement is weak.

Existing Indian narcotics-related laws are adequate but rules on asset seizure, conspiracy and money laundering need to be more consistently applied to further advance the goals and objectives of the 1988 UN Convention.

Jamaica

In 1992, the Government of Jamaica (GOJ) took adequate steps toward achieving the goals of both its bilateral narcotics control agreement with the USG and the 1988 UN Convention. Jamaica's new Prime Minister, who entered office in March 1992, reaffirmed his government's commitment to a vigorous counternarcotics program.

The GOJ-USG cooperative interdiction program resulted in increased cocaine seizures during 1992. However, marijuana seizures were down, due at least in part to the vigorous GOJ eradication program to which the USG provided helicopter support. Based on preliminary crop estimates, in 1992 harvestable cultivation of cannabis was reduced to 389 hectares, down from 950 hectares in 1991 and 1,220 hectares in 1990. The Jamaicans hosted a workshop and a ministerial conference on money laundering under the auspices of the Caribbean Financial Action Task Force.

The GOJ is largely effective in controlling public corruption connected with drug trafficking. There have been no known instances of integrity violations in jointly conducted USG-GOJ narcotics investigations. Although no senior GOJ officials are known to be engaged in drug trafficking, an assistant superintendent of police was charged with accepting bribes and providing security for a major marijuana trafficker. A resident magistrate ruled that the GOJ had failed to substantiate the charges, and the assistant superintendent was reinstated to his former position.

The GOJ has not yet ratified the USG-GOJ Mutual Legal Assistance Treaty (MLAT) or the 1988 UN Convention. Draft legislation to ratify the MLAT and a second draft of assets seizure/money laundering legislation were completed in 1992 and are under review by the GOJ. The new U.S.-Jamaican extradition treaty, which entered into force in 1991, provides for the extradition of drug offenders.

The GOJ takes pride in its integrated demand reduction program, which encourages society as a whole to attack drug abuse. The GOJ has not yet developed an information system to monitor the success of the program.

Laos

Laotian counternarcotics efforts expanded in 1992. Estimated opium production declined 13 percent in 1992 from 1991, bringing the total crop reduction since initiation of USG and United Nations Drug Control Program (UNDCP) funded counternarcotics programs in 1989 to 39 percent. Laos is the only major producer in which opium production has decreased for three consecutive years.

Although Lao law enforcement efforts against the drug trade remain largely ineffective, there were several potentially positive developments in the area during the year. The Government of Laos (GOL) has actively publicized narcotics-related arrests and seizures during the past year, in contrast to past practice. An increased number of both highland and lowland Lao have been arrested on charges involving opium, heroin and marijuana. In December, Laos arrested its first foreign heroin trafficker in a case also marked by cooperation with Thai police authorities. The Lao Customs Department has established a separate counter-smuggling unit in Vientiane with counternarcotics responsibilities. In August, the GOL Council of Ministers approved establishment of a counternarcotics police unit, and in September Laos and the USG signed a letter of agreement to provide support and training for this unit. Progress in actual formation of that unit has been

slow, but existing police counternarcotics efforts continue to improve. Laos' counternarcotics efforts remain weak, and its slowness to establish the new police unit and accept USG assistance are disappointing; but these aspects must be seen in the context of a poor country with a poorly developed administrative system.

Laos is not a party to the 1988 UN Convention. It has made only limited formal progress toward meeting its goals and objectives, but is translating materials on the legal requirements of the Convention into Lao for legislative attention, and officials have stated their intent to meet the Convention's standards.

Narcotics corruption among civilian and military personnel continues to be a major problem in Laos. There is no evidence that the Lao Government itself encourages or facilitates narcotics activity. Although senior Lao officials have repeatedly insisted that anyone involved in the narcotics trade will be arrested and prosecuted, there is little evidence of aggressive action in this regard.

Malaysia

Malaysia is an important consumer and transit point for Golden Triangle heroin, some of which is also processed in the country from imported opium or derivatives. The Malaysian Government recognizes the seriousness of the narcotics threat both domestically and internationally, and has strong laws, active law enforcement, public education, and treatment programs. It cooperates well with the United States. During 1992, Malaysia arrested at USG request a major Southeast Asian heroin trafficker and pursued extradition proceedings against him. Although the extradition request was denied, the trafficker was expelled from Malaysia and is now under arrest in the U.S.

While low-level corruption facilitates persistent drug trafficking and abuse, Malaysia pursues aggressive law enforcement efforts under one of the most severe drug laws in the world. Malaysian narcotics policy is generally serious, well funded and well organized. Malaysia is actively moving to meet the goals and objectives of the 1988 UN Convention, which it has signed but not yet ratified.

Mexico

The United States Government and the Government of Mexico (GOM) maintained close, effective counternarcotics cooperation in 1992, despite GOM indignation over what it viewed as violations of Mexican sovereignty and international law in the *Alvarez Machain* case.

Mexico nevertheless continued its vigorous and comprehensive national campaign against production, trafficking and abuse of illegal drugs, meeting the goals and objectives of the 1988 UN Convention. The GOM still needs to enact money laundering legislation, which we expect to be submitted to the Mexican Congress in April 1993. The GOM seized nearly 40 MT of cocaine and 83 kilograms of heroin in 1992, and the USG estimates that Mexico effectively eradicated 6,860 hectares of opium poppy and 12,100 hectares of marijuana. President Salinas called on all of Mexico's governors to develop state programs to complement the national drug plan which addresses both the effects and the roots of the problem—a balanced approach of supply and demand reduction, alternative economic development, etc. In June 1992, the GOM established the National Center for the Planning for the Control of Drugs (CENDRO) as the focal point for strategic planning, threat analysis and operational coordination. The Attorney General continued to press for legal reforms to further combat trafficking and to protect civil rights.

Mexico is working with the U.S. to build a coordinated hemispheric response to the drug threat. President Salinas participated in the San Antonio Summit. The GOM urges its neighbors to take greater responsibility for combatting trafficking in their territories. In July 1992, Mexico announced

that it would complete the process of assuming the costs of counternarcotics programs previously supported by U.S. international narcotics control funds. Future USG support will concentrate on specialized training and technical support.

Despite successes, Mexico faces daunting obstacles. Illicit drug crop cultivation has spread to new and more remote areas. South American cocaine traffickers have taken evasive measures to avoid detection. Mexico's revitalized economy and unregulated money exchange houses make it an attractive venue for money laundering. Also, its extensive chemical industry makes control of precursor chemicals very difficult. Official corruption is a deep-rooted and persistent problem, but it is one which President Salinas is addressing as a high priority.

Morocco

Morocco is one of the world's largest producers of cannabis, much of which is exported as hashish resin or oil to Europe and other countries in North Africa. Increasing quantities of cocaine and, to a lesser extent, heroin are transiting from the Americas and Asia through Morocco en route to Europe. An estimated 15 to 40 percent of Morocco's cannabis crop is consumed domestically. Abuse of prescription drugs is a secondary concern, and authorities report rising use of cocaine and heroin in major cities.

During the latter months of 1992, Morocco began showing signs of new political will to address its drug trafficking and consumption problems. King Hassan II issued a directive in October ordering various ministries to increase their anti-drug efforts. In October, the Moroccan Government also publicly acknowledged the existence of drug-related official corruption and took action against many suspected of involvement in the drug trade. Although official corruption continues to be a serious problem, the government struck from electoral rolls the names of nearly 400 candidates suspected of narcotics-related corruption. Morocco ratified the 1988 UN Convention in November and began drafting modifications to its laws to bring them into conformity. These revisions are expected to be enacted early in 1993.

Following the King's directive, Morocco also initiated a two-phase counternarcotics campaign in the cannabis-producing Rif Mountain region. The first phase involved increased law enforcement activities, although it is not clear how effective these activities have been at reducing cannabis cultivation. For the second phase, King Hassan has requested over \$700 million in financing from the European Community for crop substitution and economic development in the Rif region.

Nigeria

Nigerian drug trafficking organizations are responsible for bringing in much of the Asian heroin that enters the United States. These networks, sophisticated in their practices and ubiquitous in their geographical reach, recruit carriers from throughout Africa, as well as from Europe, Asia, and the United States. Nigerians also are increasingly involved in trafficking cocaine from Latin America into Europe and the United States.

The Federal Military Government (FMG) of Nigeria took some steps to improve its counternarcotics performance in 1992, although much remains to be done. In April 1992, the USG requested the extradition of four Nigerian citizens to face heroin trafficking charges in the United States; one of the four was extradited in October. As Nigeria's importance as a drug transit country has grown, there has been a corresponding growth in drug abuse within Nigeria. The FMG in 1992 made genuine efforts to attack the problem by expanding public awareness, developing anti-drug curricula for public schools, and opening two drug treatment centers.

The FMG does not, as a matter of policy, facilitate the production or trafficking of drugs or the laundering of drug money, but corruption continues to be an endemic problem severely limiting the effectiveness of Nigeria's counternarcotics efforts. Nigeria took some steps in 1992 to recognize its

corruption problems. The Attorney General's office amended Nigeria's drug decree to impose stiffer penalties on corrupt officials. Several drug law enforcement officers were arrested and charged with corruption, including an intelligence officer who received a 30-year prison sentence.

The National Drug Law Enforcement Agency (NDLEA), created in 1989, continued to expand its staffing and budget, but its effectiveness was hampered by corruption and weak leadership. After a period of strained relations that forestalled operations of the joint NDLEA-DEA task force, the joint task force resumed its activities late in 1992 and is discussing a reorganization for 1993.

In many respects, Nigeria's counternarcotics efforts advanced the goals and objectives of the 1988 UN Convention, but the FMG needs to do more in several areas including extraditing the remaining three Nigerian citizens under indictment in U.S. Federal court, targeting major drug organizations and kingpins, and preventing and punishing official corruption.

Pakistan

Pakistan remains a major producer and an important transit country for heroin destined for international markets. The Drug Enforcement Administration estimates that 20 percent of the heroin consumed in the U.S. originates in Southwest Asia where Pakistan is a primary producer.

The Government of Pakistan (GOP) continued anti-narcotics initiatives in 1992. Cooperation with USG agencies on investigations, enforcement and extraditions remained good; however, the GOP initiated only two prosecutions of major traffickers during the year; one was convicted but successfully appealed. The USG expects that Pakistan will do better on arrests and prosecutions when the Narcotics Ministry's Anti-Narcotics Task Forces (ANTF), established in 1992, become fully operational. The GOP states that it is committed to expanding and enforcing the opium poppy ban in the Northwest Frontier Province, but potential opium production decreased only slightly to 175 mt in 1992 as compared to 180 mt in 1991. While 12 heroin labs in the Northwest Frontier Province (NWFP) were reportedly closed, no prosecutions resulted and government action has apparently not deterred the opening of new heroin laboratories. Most of these laboratories are located in areas of the northwest bordering Afghanistan and have never been within the span of central Pakistani government control.

Draft legislation to bring Pakistani laws into compliance with the 1988 UN Convention still awaits passage by the Parliament. If the Parliament adopts recommendations on drug control written by a special committee for the country's next five-year plan, it will represent a commitment to enhancing GOP anti-drug efforts. Pakistan is increasingly of concern as a money laundering site.

Pakistan is taking adequate steps to meet the goals and objectives of the 1988 UN Convention, but the GOP must follow through—financially and politically—to implement more effective narcotics control initiatives if they are to contribute meaningfully to reducing the country's drug problems.

Panama

Panama remains a major narcotics money laundering and illicit drug-transshipment nation. Despite continued policy and budgetary support for counternarcotics measures by the Endara administration, Panama's drug trafficking problem remains severe and the Panamanian Government (GOP) needs to make a stronger, more effective effort against the drug trade.

Cocaine seizures in 1992 increased to 10 tons, exceeding the record 9.3 tons seized in 1991. Most of the large seizures (including a record 5.3 tons on July 15) occurred in the Colon Free Zone, highlighting the importance of that facility to traffickers. The GOP redrafted its national narcotics control legislation (Law 23 of 1986). Panamanian law already meets the goals and

objectives of the 1988 UN Convention: it criminalizes a broad range of narcotics trafficking and money laundering activities and provides for assets seizure. Still, Panama is a "venue of choice" to money launderers, and is one of the four major money laundering countries in this hemisphere. The GOP signed and ratified a Mutual Legal Assistance Treaty with the U.S. in 1991, but the document still awaits the U.S. Senate's ratification. Panama signed the 1988 UN Convention in 1991, but has not yet ratified it.

Execution of drug laws has been inconsistent, in part because Law 23 is more effective for seizure than for forfeiture of illegally obtained assets. Panamanian authorities continued in 1992 to freeze bank accounts of suspected money launderers; however, claiming he was bound by Law 23, the Attorney General released millions of dollars of previously frozen accounts allegedly traceable to drug cartel kingpins. These unwarranted actions prompted the Panamanian Solicitor General to suspend both the Attorney General and Drug Secretary, pending further investigation. The suspensions, upheld by the Supreme Court, revealed much GOP interagency suspicion and weakened Panama's overall counternarcotics effort.

Notwithstanding the need for Panama to prosecute money laundering cases more vigorously, Panama cooperated with the U.S. in 1992, inaugurating a Joint Intelligence Collection Center; opening a new Judicial Technical Police (PTJ) academy, and increasing PTJ staff by about 50 percent. Panamanian Customs cooperated with a U.S. Customs Service survey of Panamanian gateways, and Panamanian law enforcement agencies participated in a joint maritime exercise.

The U.S. and Panama have bilateral agreements on ship boarding, maritime operations and essential chemicals. The PTJ has cooperated fully in providing data on transportation of precursor chemicals transiting Panama for illicit purposes. The GOP extradited three Colombian nationals to the U.S. in accordance with the 1904 bilateral extradition treaty and the 1961 Single Convention, as amended by the 1972 Protocol.

Paraguay

During 1992, the Government of Paraguay's (GOP) efforts to improve its counternarcotics capabilities focused on strengthening enforcement agencies and broadening the legal framework for anti-drug activities. In these efforts, the GOP cooperated with the United States Government.

A notable GOP policy initiative was the inclusion in the new constitution of Article 71, which requires the government to suppress the production and trafficking of narcotics, to fight money laundering, and to establish programs in drug education, prevention, and rehabilitation. The GOP, through its Anti-Drug Secretariat (SENAD), mounted some 30 major operations to disrupt marijuana cultivation and trafficking (most of Paraguay's marijuana harvests are exported and used in Brazil). Finally, the USG and the GOP initialled a financial information exchange agreement aimed at combatting money laundering. These measures demonstrate the GOP's intention to cooperate with the USG and that it is meeting the goals and objectives of the 1988 UN Convention.

There are, however, persistent reports of military corruption and allegations of government officials engaging in money laundering activities.

Peru

While the Government of Peru (GOP) has not made substantial inroads into the flow of cocaine base northward, it has brought to bear significant resources and political will in an effort to disrupt narcotics trafficking in the Huallaga Valley. In 1992, at President Fujimori's direction, the Peruvian armed forces took a more active role in counternarcotics enforcement, although counterterrorism continued to be their priority mission.

The April 5 suspension of constitutional democracy by President Fujimori hindered USG efforts to support Peruvian narcotics-related law enforcement and alternative development efforts in 1992. The strafing of a U.S. C-130 by Peruvian fighters (and death of one U.S. crewman) while on a Peruvian-authorized narcotics mission also complicated bilateral relations. Narcotics corruption remained a significant impediment to GOP counternarcotics efforts in the field.

Despite the suspension of USG military and economic assistance, the GOP significantly increased the number of army engineering battalions assigned to counternarcotics alternative development missions in the Huallaga region and made substantial budgetary contributions to narcotics-related alternative development, including \$8.75 million for road rehabilitation, community development and civic action. The Peruvian National Police narcotics unit increased its seizure rate by 50% over last year and improved the quality of its intelligence. The Peruvian Air Force (FAP) established an air defense zone command at Santa Lucia, assigned counternarcotics interceptors to the base, and deployed 50-man security units to seven key municipal airstrips to prohibit their use by narcotrafficking aircraft. By late December, it had resumed participation in a major air interdiction program.

Consistent with the 1988 UN Convention, the GOP issued new legislation to make money laundering a crime and expand controls on essential chemicals. The GOP is taking steps to address the goals and objectives of the 1988 UN Convention on other fronts as well.

Peru must surmount major obstacles such as human rights abuse, terrorism, a depressed economy and corruption in order to implement an effective long-term counternarcotics policy. Against this backdrop, the Fujimori government displayed a greater willingness to use the limited resources at its disposal for counternarcotics activities. Results, however, were limited, particularly in relation to the size of the problem.

Thailand

While no longer a major source country for opiates (its production potential was estimated as 24 mt of opium in 1992), Thailand remains the primary conduit for heroin from the Golden Triangle sold in the United States. Thailand began to address some of its problems with the August 1991 passage of narcotics conspiracy and forfeiture laws; in 1992, the first arrests were made under these statutes, but the cases have not yet come to trial. In 1992, the Police Narcotics Suppression Bureau was made a separate organization within the National Police and grew to over 500 officers, and Thai authorities arrested 52 major traffickers, compared to 32 in 1991. A new extradition treaty with the United States came into effect in May 1991, and the exchange of instruments of ratification of a Mutual Legal Assistance Treaty is expected early in 1993. Widespread police corruption, expanding cross-border trade with Burma, and the involvement of influential Thai and Sino-Thai tycoons in the narcotics trade with the connivance of some Thai officials are serious impediments to more effective counternarcotics action. Thailand is also of concern as a potential money-laundering center.

While there are serious flaws in Thailand's counternarcotics effort, Thailand is devoting increased resources of its own to narcotics interdiction, public education, and drug treatment. It has sought to encourage regional cooperation with Laos and Burma, works well with Malaysia, and continues to cooperate actively with U.S. law enforcement agencies.

Thailand has in place nearly all the laws and regulations needed for it to accede to the 1988 UN Convention. RTG policy initiatives plus accession to the Convention will mean that Thailand has moved significantly toward meeting the goals and objectives of the Convention.

Venezuela

Venezuela is a significant transit country for cocaine, chemicals and, on a smaller scale, heroin. Although domestic GOV seizures in calendar year

1992 totalled slightly more than 3 mt, seizures outside Venezuela of drugs transshipped from Venezuela totalled more than 30 mt. Venezuelan law enforcement agencies provided information leading to many of the seizures. Venezuela is a Colombian drug trafficker hub.

Pervasive corruption and money laundering remain acknowledged problems in Venezuela and are serious impediments to effective law enforcement activities against narcotics trafficking. While the GOV is making an effort to deal with these problems, much remains to be done.

The Government of Venezuela (GOV) supported stronger bilateral counterdrug cooperation with the USG during 1992. Cooperation with the Judicial Technical Police and the Directorate of Intelligence and Prevention Services led to significant seizures of drugs and documents inside and outside Venezuela. The GOV evidenced its commitment to rid Venezuela of traffickers when it expelled to Italy the Cuntreras brothers, three suspected members of an international cocaine trafficking ring.

The GOV, which participated in the 1992 San Antonio Summit, is a signatory to the 1988 UN Convention. The GOV has performed effectively in complying with the interdiction goals of the Convention; however, it has fallen short on money laundering and chemical controls because it lacks legislation criminalizing money laundering or regulating commerce in precursor and essential chemicals. The GOV does, however, require Venezuelan banks dealing in foreign exchange to maintain cash transaction reports, and it is working towards fulfilling UN Convention requirements to control specific chemicals. The GOV has signed, but not fully implemented, agreements with the USG on case-specific asset sharing, drug awareness, and maritime cooperation. In 1992, Venezuela worked with Colombia to combat drug trafficking along their common border.

Anti-narcotics initiatives announced by President Carlos Andres Perez in mid-1991 were not fully carried out, largely because of two coup attempts, February 4 and November 27, 1992. The GOV's concern with public order overrode the implementation of the proposed national strategy and creation of the operational unified drug command. Problems with a key GOV counterpart (the National Guard) caused the USG to shift assistance programs to new entities.

JUSTIFICATIONS FOR A NATIONAL INTEREST WAIVER

Afghanistan

The USG estimates that opium poppy cultivation in Afghanistan, the second largest producer in the world, increased 12 percent in 1992, from 17,190 hectares in 1991 to 19,470 hectares in 1992, potentially producing 640 metric tons of opium. Increases in opium production in 1992 may be attributed primarily to deteriorating economic conditions which pressure farmers—and returning refugees—to produce more opium for a cash crop. Afghan opium is principally refined into heroin in illegal labs operating in Pakistan's Northwest Frontier Province. About 20 percent of the heroin consumed in the U.S. comes from Southwest Asia, particularly Afghanistan and Pakistan, while most of the heroin exported from the region is destined for European markets.

In official contacts, the Government of Afghanistan (GOA) has assured the USG that it will undertake a strong anti-narcotics policy, recognizing that it is in the nation's own interest. In October 1992, the GOA published a decree establishing an Inter-Ministerial Counternarcotics Commission with an initial mandate of formulating a national counternarcotics strategy. Representatives from Afghanistan participated in two UN counterdrug conferences in 1992. There are indications that regional commanders in Afghanistan are taking nascent steps to combat drug production, trafficking and abuse. While the signs are good, the USG does not have a diplomatic

presence in Afghanistan and therefore cannot accurately evaluate Afghanistan's practical progress in implementing the 1988 UN Convention, which the country ratified in 1992. However, it appears that progress is too limited to warrant certification.

Despite signs of interest in drug control, the Afghanistan Government's professed good intentions are hampered by political instability, competing priorities, insufficient resources and, most importantly, lack of authority in the hinterland much beyond Kabul. However, U.S. policy objectives for the region, including Afghan narcotics control and national stability, justify a national interest waiver certification for Afghanistan. If allowed to flourish, the drug trade in Afghanistan will threaten the country's move towards democracy, undermine the security of surrounding countries, and increase the potential supply of drugs reaching the U.S. market. A national interest waiver paves the way for enhanced U.S. assistance to Afghanistan, when the timing is right, aid which could help reestablish national stability. U.S. vital national interests in Afghanistan outweigh the USG's interest in insisting upon full counternarcotics cooperation with the GOA under current circumstances.

In September 1992, the USG concluded an agreement for a small cross-border narcotics control project with a non-governmental organization in Kandahar province. The U.S. hopes to conclude additional arrangements for the provision of financial assistance to combat illegal drugs with the central government and/or regional leaders and organizations when they are fully able to participate.

Lebanon

Lebanon is a major drug producing and trafficking country. In addition to traditional hashish production, opium is cultivated and processed into heroin in Lebanon, and Lebanese traffickers have become increasingly involved in the cocaine trade.

Since 1976, Syrian troops have occupied Lebanon's Bika' Valley, and they constitute the only formal security authority in this area. Following a harsh winter that destroyed large areas of the opium and cannabis crops in the Bika' Valley, there were signs of greater cooperation between Syria and Lebanon to control drug production and trafficking in the region. Syrian forces worked with Lebanese authorities to eradicate remaining opium and cannabis cultivation, and to enforce the Lebanese Government's ban on further cultivation of illicit crops. However, the area continued to be a major center for processing heroin.

The political situation in Lebanon continues to impede effective counternarcotics efforts by the Lebanese Government, and to hamper its capacity to cooperate fully with the USG on narcotics control matters. It is not possible for the Lebanese Government to advance significantly the goals and objectives of the 1988 UN Convention in any meaningful way because it lacks control in the Bika' Valley.

Nonetheless, vital U.S. national interests—in maintaining peace and stability in the region and preserving the territorial integrity of Lebanon—would be damaged by a weakening or collapse of the Lebanese Government. These vital national interests would be placed at risk by a cessation of U.S. assistance, and this risk outweighs the USG's interest in insisting upon full counternarcotics cooperation from the Government of Lebanon under current circumstances. The United States seeks to retain the flexibility to respond to Lebanon's legitimate needs for economic and developmental assistance.

STATEMENTS IN SUPPORT OF DENIAL OF CERTIFICATION

Burma

Despite frequent public statements and some law enforcement actions, the Government of Burma has not undertaken serious or sustained counternarcotics efforts since 1988. While estimated opium production dropped slightly, the drop was accounted for entirely by a decline in an area controlled by an ethnic insurgency group in active conflict with Rangoon. Production elsewhere in the country increased marginally.

The Government's political and military accommodations with some of the insurgent/trafficking groups continued, with no indication of the reduced opium reduction which the government claims is the goal of these arrangements. Indeed, these relationships appear to continue to facilitate the drug operations of the armed traffickers. Burma did enter into separate tripartite agreements with the United Nations Drug Control Program (UNDCP) and Thailand, China and Laos for long-term narcotics control projects. However, the projects have yet to make meaningful progress and are on such small scale that in themselves they can only hope to serve as models. Burma has permitted a small-scale opium yield survey by U.S. researchers, but refused to fulfill a commitment to conduct a baseline aerial survey of the UNDCP project areas.

The GOB is a party to the 1988 UN Convention, but made reservations on extradition and the submission of disputes to the World Court. The GOB in January, 1993, promulgated a new narcotics law designed to move Burma towards conformity with the 1988 UN Convention. The new law appears to meet several of the goals and objectives of the Convention, but it is too soon to know how the military government will interpret and enforce the new legislation, which will be more significant than the text itself.

Iran

The Government of Iran (GOI) did not cooperate in illegal drug control with the United States in 1992. However, the GOI did engage in some counternarcotics arrangements with the UN and cooperated in some law enforcement areas with certain neighboring countries. While the Iranian authorities made certain claims of counternarcotics activity, the USG's information to confirm this activity is not such that the USG is able to certify Iran under current U.S. law. Nor can the USG evaluate the extent to which the GOI has advanced the goals and objectives of the 1988 UN Convention which it ratified in 1992, but we believe the extent is minimal.

Iran is historically a transshipment point for opium and heroin from Pakistan and Afghanistan destined principally for Europe. Although the GOI maintains that opium poppy cultivation has been eradicated, the USG estimates that cultivation continued at a level of 350 hectares in 1992 with a potential opium yield between 30 and 70 metric tons.

Syria

Syria is a transit country for illicit hashish and heroin and a suspected site for refining of small amounts of opium into heroin. Following a harsh winter that destroyed large areas of the opium and cannabis crops in the Bika' Valley, there were signs of greater cooperation between Syria and Lebanon to control drug production and trafficking in the region. Syrian forces worked with Lebanese authorities to eradicate remaining opium and cannabis cultivation and to enforce the Lebanese Government's ban on further cultivation of illicit crops. However, the area continued to be a major center for processing heroin.

There were continuing credible reports of involvement by Syrian military officials in the drug trade. Syria has not taken effective measures to prevent and punish the corruption of senior government officials that facilitates production, processing, or trafficking of narcotics.

The Syrian Government did little to meet U.S. concerns about the involvement of its officials in facilitating the Lebanese drug trade, nor did it take adequate steps to justify counternarcotics certification.

[FR Doc. 93-8535

Filed 4-8-93; 10:21 am]

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Rules and Regulations

Federal Register

Vol. 58, No. 68

Monday, April 12, 1993

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

The Code of Federal Regulations is sold by the Superintendent of Documents. Prices of new books are listed in the first FEDERAL REGISTER issue of each week.

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 92-NM-81-AD; Amendment 39-8532; AD 93-06-07]

Airworthiness Directives; de Havilland, Inc., Model DHC-7, DHC-8-100, and DHC-8-300 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule.

SUMMARY: This amendment adopts a new airworthiness directive (AD), applicable to certain Model DHC-7, DHC-8-100, and DHC-8-300 series airplanes, that requires modification or replacement of both quantity limiting valves (QLV) in the inboard nacelles. This amendment is prompted by a report of corrosion found on the QLV valve assembly, which prevented the piston from stopping a discharge of hydraulic fluid. The actions specified by this AD are intended to prevent the loss of both hydraulic systems due to depletion of hydraulic fluid.

DATES: Effective May 12, 1993.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of May 12, 1993.

ADDRESSES: The service information referenced in this AD may be obtained from de Havilland, Inc., Garratt Boulevard, Downsview, Ontario M3K 1Y5, Canada. This information may be examined at the Federal Aviation Administration (FAA), Transport Airplane Directorate, Rules Docket, 1601 Lind Avenue, SW., Renton, Washington; or at the FAA, Engine and Propeller Directorate, New York Aircraft Certification Office, 181 South Franklin Avenue, Room 202, Valley Stream, New York; or at the Office of the Federal

Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Mr. Danko Kramar, Aerospace Engineer, New York Aircraft Certification Office, Systems and Equipment Branch, ANE-173, FAA, Engine and Propeller Directorate, 181 South Franklin Avenue, Room 202, Valley Stream, New York 11581; telephone (516) 791-6427; fax (516) 791-9024.

SUPPLEMENTARY INFORMATION: A proposal to amend part 39 of the Federal Aviation Regulations to include an airworthiness directive (AD) that is applicable to certain Model DHC-7, DHC-8-100, and DHC-8-300 series airplanes was published in the Federal Register on July 6, 1992 (57 FR 29684). That action proposed to require modification or replacement of both quantity limiting valves (QLV) in the inboard nacelles.

Interested persons have been afforded an opportunity to participate in the making of this amendment. Due consideration has been given to the comments received.

One commenter supports the rule as proposed.

One commenter requests that the compliance time for the proposed modification of certain Model DHC-8-100 and DHC-8-300 series airplanes be extended from the proposed 1,000 hours time-in-service to 3,000 hours time-in-service. The commenter has been advised by the manufacturer of the QLV modification kits that there may be a modification kit availability problem. In the interim, the commenter suggests that the rule require a QLV operational check within 1,000 hours time-in-service after the effective date of this AD, and thereafter at intervals not to exceed 1,000 hours time-in-service. The commenter believes that these repetitive operational checks will provide an acceptable level of safety until the QLV's are replaced. The FAA does not concur with the commenter's request to extend the compliance time. In developing an appropriate compliance time for this action, the FAA considered not only the degree of urgency associated with addressing the subject unsafe condition, but the availability of required parts and the practical aspect of installing the required modification within a maximum interval of time allowable for all affected airplanes to continue to operate without

compromising safety. The FAA has determined that an ample number of required parts will be available for modification of the U.S. fleet within the proposed compliance period. The FAA considers that the repetitive operational checks suggested by the commenter may not be suitable for all other operators. However, under the provisions of paragraph (d) of the final rule, the FAA may approve requests for adjustments to the compliance time if data is submitted that substantiates that such an adjustment would provide an acceptable level of safety.

One commenter requests that the phrase "Prior to the accumulation of 1,000 hours time-in-service after the effective date of this AD," as related to the compliance time specified in paragraph (a) of the proposal, be revised to "Within 1,000 hours time-in-service after the effective date of this AD." The commenter contends that the proposed phrase is not incorrect; however, such language is usually reserved for describing a threshold period. The FAA concurs that the commenter's suggestion would clarify the intended compliance time. This language in both paragraph (a) and paragraph (b) of the final rule has been revised accordingly.

After careful review of the available data, including the comments noted above, the FAA has determined that air safety and the public interest require the adoption of the rule with the change previously described. The FAA has determined that this change will neither increase the economic burden on any operator nor increase the scope of the AD.

The FAA estimates that 131 airplanes of U.S. registry will be affected by this AD, that it will take approximately 5 work hours per airplane to accomplish the required actions, and that the average labor rate is \$55 per work hour. Required parts will cost approximately \$57 per airplane. Based on these figures, the total cost impact of the AD on U.S. operators is estimated to be \$43,492, or \$332 per airplane. This total cost figure assumes that no operator has yet accomplished the requirements of this AD.

The regulations adopted herein will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various

levels of government. Therefore, in accordance with Executive Order 12612, it is determined that this final rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

For the reasons discussed above, I certify that this action (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) will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act. A final evaluation has been prepared for this action and it is contained in the Rules Docket. A copy of it may be obtained from the Rules Docket at the location provided under the caption ADDRESSES.

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by adding the following new airworthiness directive:

93-06-07 DE HAVILLAND, INC.:

Amendment 39-8532. Docket 92-NM-81-AD.

Applicability: Model DHC-7 series airplanes, serial numbers 003 through 113, inclusive; Model DHC-8-102 and -103 series airplanes, serial numbers 003 through 321, inclusive; and Model DHC-8-301 and -311 series airplanes, serial numbers 100 through 320, inclusive; certificated in any category.

Compliance: Required as indicated, unless accomplished previously.

To prevent the loss of both hydraulic systems due to depletion of hydraulic fluid, accomplish the following:

(a) For Model DHC-7 series airplanes: Within 1,000 hours time-in-service after the effective date of this AD, or within 6 months after the effective date of this AD, whichever occurs first, remove the existing Quantity Limiting Valves (QLV), from the left- and right-hand inboard nacelles; and modify or replace them with new QLV, Modification 7/

2610; in accordance with de Havilland Service Bulletin S.B. 7-29-20, dated March 20, 1992.

(b) For Model DHC-8-102 and -103 series airplanes and Model DHC-8-301 and -311 series airplanes that have accumulated 6,700 total hours time-in-service or more as of the effective date of this AD, or if 50 months or more have passed since the airplane was manufactured as of the effective date of this AD: Within 1,000 hours time-in-service after the effective date of this AD, or within 6 months after the effective date of this AD, whichever occurs first, remove the existing QLV from the left- and right-hand inboard nacelles; and modify or replace them with new QLV, Modification 8/1803; in accordance with de Havilland Service Bulletin S.B. 8-29-21, dated March 20, 1992.

(c) For Model DHC-8-102 and -103 series airplanes and Model DHC-8-301 and -311 series airplanes that have accumulated less than 6,700 total hours time-in-service as of the effective date of this AD and if less than 50 months have passed since the airplane was manufactured as of the effective date of this AD: Prior to the accumulation of 7,700 hours time-in-service since the airplane was manufactured, or within 12 months after the effective date of this AD, whichever occurs first, remove the existing QLV from the left- and right-hand inboard nacelles; and modify or replace them with new QLV, Modification 8/1803; in accordance with de Havilland Service Bulletin S.B. 8-29-21, dated March 20, 1992.

(d) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, New York Aircraft Certification Office (ACO), FAA, Engine and Propeller Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, New York ACO.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the New York ACO.

(e) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(f) The removal, modification, and replacement shall be done in accordance with de Havilland Service Bulletin S.B. 7-29-20, dated March 20, 1992 (for Model DHC-7 series airplanes); or de Havilland Service Bulletin S.B. 8-29-21, dated March 20, 1992 (for Model DHC-8-102 and -103 series airplanes and Model DHC-8-301 and -311 series airplanes); as applicable. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from de Havilland, Inc., Garratt Boulevard, Downsview, Ontario M3K 1Y5, Canada. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the FAA, Engine and Propeller Directorate, New York Aircraft Certification Office, 181 South Franklin Avenue, room 202, Valley Stream,

New York; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(g) This amendment becomes effective on May 12, 1993.

Issued in Renton, Washington, on April 1, 1993.

Darrell M. Pederson,
Acting Manager, Transport Airplane
Directorate, Aircraft Certification Service.
[FR Doc. 93-8062 Filed 4-9-93; 8:45 am]
BILLING CODE 4910-13-P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 270 and 274

[Release Nos. 33-6988; IC-19382; S7-1-90]

RIN 3235-AD81

Disclosure of Mutual Fund Performance and Portfolio Managers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule and form amendments.

SUMMARY: The Commission is adopting rule and form amendments under the Securities Act of 1933 and the Investment Company Act of 1940 to improve disclosure of the performance of open-end management investment companies ("mutual funds") in their prospectuses and annual reports to shareholders. Under the amendments, a mutual fund is required to include in its prospectus or, alternatively, in its annual report to shareholders a discussion of those factors, strategies, and techniques that materially affected its performance during its most recently completed fiscal year; and a line graph comparing its performance to that of an appropriate broad-based securities market index. In addition, the amendments revise the content and format of the condensed financial information contained in the prospectus and require disclosure about portfolio managers. The rule and form amendments will provide investors with additional information concerning mutual fund performance and the individuals responsible for that performance.

EFFECTIVE DATE: July 1, 1993. This is the effective date for most but not all mutual funds. For the specific applicability of the effective date to individual funds, see Section I.E. of this Release.

FOR FURTHER INFORMATION CONTACT: With respect to the amendments generally, Martha H. Platt, Senior Attorney, or Robert E. Plaze, Assistant

Director, (202) 272-2107, Office of Disclosure and Adviser Regulation; with respect to the revisions to the condensed financial information, Lawrence A. Friend, Chief Accountant, (202) 272-2106, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") today is adopting amendments to:

(1) Form N-1A (17 CFR 239.15A, 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-1 *et seq.*) ("1940 Act") and to register securities under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) ("1933 Act"), that: (a) Revise substantially the condensed financial information contained in the prospectus; (b) require disclosure about the person(s) primarily responsible for the day-to-day management of the fund's portfolio; and (c) require a fund to provide in its prospectus or, alternatively, its annual report to shareholders: (i) A discussion of those factors, strategies, and techniques that materially affected its performance during the period of the report; (ii) a line graph comparison of its performance to that of an appropriate broad-based securities market index over the last ten years; and (iii) related information about the impact of maintaining guaranteed distributions;

(2) Form N-14 (17 CFR 239.23) to reflect the new disclosure item in Form N-1A; and

(3) Rule 34b-1 under the 1940 Act (17 CFR 270.34b-1) to exclude performance information included in periodic reports to shareholders from certain of the rule's requirements.

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I. Discussion

On January 8, 1990, the Commission issued a release proposing amendments to Form N-1A ("Proposing Release").¹ The proposals were designed to improve disclosure made to mutual fund investors in three areas by: (i) Revising and simplifying the per share table; (ii) requiring disclosure about persons who contribute significantly to the investment advice relied on by the fund (the "portfolio manager"); and (iii) providing investors with a "management's discussion and analysis" of investment performance that would give fund management an opportunity to explain the fund's investment results ("Management's Discussion of Fund Performance" or "Management's Discussion"). In response to the proposed amendments, the Commission received 669 comment letters, 617 of which were from individual investors.

The Commission has decided to adopt the proposed amendments and related rule changes, modified to reflect many of the comments received. These revised disclosure requirements will give investors more information upon which to evaluate the performance of mutual funds and the individuals responsible for that performance.

A. Financial Highlights

The Commission proposed substantial revisions to the condensed financial information ("per share table") contained in mutual fund prospectuses to shorten and simplify the table. In addition, the Commission proposed adding to the table a line showing the fund's total return during each of the reported periods. Most commenters who addressed this proposal endorsed these changes. One commenter proposed organizing the data in a manner that will permit investors to trace more easily the operating performance of the fund on a per share basis from the fund's beginning net asset value to its ending net asset value so that they may understand the sources of changes.² The revised format in which these proposals are being adopted is based on the recommendations of that commenter.³

¹ Investment Company Act Rel. No. 17294 (Jan. 8, 1990) [53 FR 1460 (Jan. 16, 1990)] (File No. S7-1-90). The comment letters, as well as two comment summaries prepared by the Commission staff, are available for public inspection and copying at the Commission's Public Reference Room.

² See Letter from T. Rowe Price Associates to Jonathan G. Katz (Mar. 14, 1990), File No. S7-1-90.

³ In addition, the Commission is adding an instruction to the table exempting money market

The table is substantially the same as one contained in recent amendments to Form N-2, the registration form for closed-end investment companies, and is called "Financial Highlights."⁴

B. Portfolio Managers

The proposed amendments to Form N-1A would have added a new Item 5(c) to require prospectus disclosure about all persons who significantly contribute to the investment advice relied on to manage the fund's portfolio. The Commission received 667 comment letters, most of which were from individual investors supporting the proposed disclosure requirement. Industry commenters argued that the scope of any new disclosure requirement should be more circumscribed than the Commission's proposal.

After considering the comments received, the Commission has determined to modify the proposed item to identify more clearly the individuals that must be named in response to the item and to narrow its scope somewhat. As adopted, Item 5(c) requires a fund to disclose the name and title of the person or persons employed by or associated with the fund or its adviser "who are primarily responsible for the day-to-day management of the fund's portfolio."

The item is substantially the same as Item 9.1.c. of Form N-2, as recently amended.⁵ As in the case of Item 9.1.c., if all investment decisions for a fund are made by a committee and no person(s) is primarily responsible for making recommendations to that committee, no

funds from the requirement to state their portfolio turnover rates. See Instruction 13 to Item 3. Although not previously exempted, money market funds, in effect, had not been required to respond to this item because it instructed funds to omit from the calculation any security that matured within one year. Until 1991, substantially all securities held by money market funds matured within one year. In 1991, the Commission amended rule 2a-7 to lengthen the permitted maximum maturity of securities held by money market funds to 397 days (13 months) and, in certain cases, 762 days (25 months) if the security is a Government security. See Rule 2a-7(c)(2) (17 CFR 270.2a-7(c)(2)) and Investment Company Act Rel. No. 18005 (Feb. 20, 1991) [56 FR 8113 (Feb. 27, 1991)]. Money market funds could therefore have been required to respond to this item. This instruction, which codifies a no-action position taken by the Division of Investment Management in Investment Company Institute (pub. avail. Aug. 6, 1991), makes clear that these funds are exempt.

⁴ Investment Company Act Rel. No. 19115 (Nov. 20, 1992) [57 FR 56826 (Dec. 1, 1992)] ("Release 19115"). The differences in the financial highlights tables in Forms N-1A and N-2 result from functional differences between these types of funds (e.g., closed-end funds issue senior securities). In addition, the Commission has revised the captions in the table slightly from those adopted in Form N-2. Closed-end funds may use the modified captions in their prospectuses.

⁵ Id.

individuals need be identified by the fund.⁶ However, Item 5(c) contains an additional instruction, which states that its requirements do not apply to money market funds and index funds.⁷ Money market funds have been excluded because they must meet the risk-limiting conditions of rule 2a-7 under the 1940 Act (17 CFR 270.2a-7), which constrains the role of the portfolio manager.⁸ Index funds, which have as their investment objective replicating the performance of a specified securities index, have been excluded because the portfolio management of such funds is largely mechanical. However, an "index plus" fund, which has as its objective out-performing the performance of a specified fund index, would be required to respond to the item since its portfolio manager would have to make investment decisions that go beyond replicating the performance of the index.

Funds are required to update their prospectuses to disclose material changes subsequent to the effective date of the registration statement or any post-effective amendment. This updated disclosure usually would be set forth in a prospectus supplement or "sticker" that is filed with the Commission and delivered to investors.⁹ Several commenters expressed concern that the new portfolio manager disclosure requirement would impose burdensome updating requirements when the portfolio manager changed. Several of these commenters appeared to interpret the proposal to require disclosure about a potentially large group of advisory personnel. As discussed above, the new item, as adopted, addresses this concern.

⁶ See Item 5(c), Instruction 2. This exception is very narrowly drawn and is not applicable to a committee that merely ratifies the decisions of a portfolio manager or establishes broad strategies followed by a portfolio manager. This provision was also included in the recent amendments to Form N-2. See Investment Company Act Rel. No. 19115 at Sec. II.3., Item 9.

⁷ Instruction 3.

⁸ Rule 2a-7 is the exemptive rule used by most money market funds to maintain a stable net asset value. All money market funds are subject to certain risk-limiting conditions, e.g., they may only invest in short-term, dollar-denominated debt securities having minimal credit risks, and their average portfolio maturity may not exceed 90 days. See Investment Company Act Rel. No. 18005, *supra* note 3.

⁹ The "sticker" would be filed in accordance with rule 497 under the 1933 Act (17 CFR 270.497). In addition to updating by a sticker, fund prospectuses may be updated by a post-effective amendment to a fund's registration statement. Under rule 485(b), post-effective amendments that currently are eligible to be filed under paragraph (b) will continue to be so eligible, notwithstanding the addition of, or changes to, information provided in response to Item 5(c).

In addition, several commenters believed that the portfolio manager disclosure would obligate funds to make additional mass mailings of stickers to fund shareholders. Consistent with current requirements, the fund prospectus, stickered to reflect a change in the portfolio manager, would be delivered to new investors in a fund. New investors would include any current fund shareholder who is acquiring new fund shares through additional cash purchases (other than through a dividend reinvestment plan but including shares purchased through an automatic cash investment plan).¹⁰ So long as the current fund shareholder previously received the fund's prospectus, only the sticker need be delivered.¹¹ Current shareholders who are not new fund investors could receive the sticker in the fund's next regular mailing. Of course, a fund is free to send the sticker to all fund shareholders in an additional mailing.

C. Management's Discussion of Fund Performance

In the Proposing Release, the Commission requested comment on two alternative approaches to a Management's Discussion requirement. Alternative I would have required a fund to discuss and analyze its previous fiscal year's performance and the techniques used to achieve that performance in light of the fund's investment objectives. Alternative II would have required a fund to compare its total return to that of an appropriate securities index over specified time periods. Either alternative would have required a fund that has a formal or informal policy of maintaining a specified level of distributions to discuss the effects that the policy has had on the fund's investment strategies and per share net asset value during the previous fiscal year. In addition, the Commission requested comment on whether the Management's Discussion should combine elements of both alternatives.

Individual investor commenters overwhelmingly favored the Management's Discussion proposals, citing the value of the information in understanding fund performance. Many investors wrote that they did not believe mutual funds currently provide sufficient information to permit investors readily to evaluate fund

investment results. Most commenters representing the mutual fund industry objected to elements of both alternatives. They cited the subjective judgments that a fund would have to make in either analyzing its performance or selecting a securities index as their principal objections to the proposal.

One industry commenter, along with a majority of the individual investors, argued that the alternatives should be combined. This commenter believed that implementing both proposals would obligate a fund to discuss its performance record, reference a standard against which its investment results may be evaluated, and provide an explanation if the results diverged from that standard. The Commission agrees, and is adopting an approach that combines features of both alternatives, as explained in greater detail below.

1. Disclosure Document

The proposed amendments to Form N-1A would have required that the Management's Discussion be in either the prospectus or, if the annual report is incorporated by reference into the prospectus, in the annual reports to shareholders.¹² In response to comments, the Commission is retaining the alternatives but is not requiring that an annual report containing the Management's Discussion be incorporated by reference into the prospectus.¹³ So that new or prospective investors may avail themselves of this new disclosure, the Commission is requiring a fund that places the Management's Discussion information in its annual report to disclose in its prospectus that its annual report contains additional performance information that will be made available upon request and without charge.¹⁴

2. Narrative Discussion of Fund Performance

As proposed, Alternative I would have required a separate discussion and

¹² The proposals would have required that a copy of the annual report either precede or accompany delivery of the prospectus.

¹³ The Commission anticipates that, as a result, most funds will place the Management's Discussion in their annual reports. Accordingly, the Commission is not adopting proposed amendments to rule 485(b) under the 1933 Act, which would have permitted post-effective amendments containing the information required by new Item 5A to be eligible for immediate effectiveness under that rule.

¹⁴ A new Part C item also requires a fund that elects to include the Management's Discussion in its annual report instead of its prospectus to undertake in its registration statement to provide the annual report without charge to any recipient of its prospectus who requests the information. See new Item 32(c) of Part C of Form N-1A.

¹⁰ If a sales load is deducted from reinvested dividends, the dividends reinvested are treated the same as additional cash purchases. Investment Company Act Rel. No. 6480 (May 10, 1971) (36 FR 9627 (May 27, 1971)).

¹¹ Securities Act Rel. No. 5985 (Oct. 4, 1978) (43 FR 52022 (Nov. 8, 1978)), at note 8.

analysis by management of the fund's performance during its most recently completed fiscal year in light of its investment objectives. Specifically, Alternative I would have required each fund to: (i) Identify and evaluate those factors that materially affected its performance; (ii) evaluate the effectiveness of significant investment techniques and strategies used to pursue the fund's investment objectives; and (iii) describe any material effects that those techniques and strategies had on the fund's total return for its last fiscal year.

Mutual fund industry commenters objected that the proposal, as drafted, would require a "self-appraisal" by management of its own past performance. They argued that this is unrealistic because fund investment objectives do not specify "performance targets" or "quantifiable goals" against which a fund can measure its performance.

The Investment Company Institute ("ICI") recommended language that would eliminate the self-evaluative aspects of the proposal and would simply call for a discussion of those factors, strategies, and techniques that materially affected the fund's performance during its most recently completed fiscal year.¹⁵ The Commission is adopting the ICI's suggested language substantially as recommended. Item 5A(a) does not obligate funds to evaluate the effectiveness of the strategies and techniques they employed to achieve their performance, nor does it require funds to assess the extent to which they attained their investment objectives. Rather, the item requires funds to explain what happened during the previous fiscal year and why it happened. The narrative must describe what techniques or strategies, within the fund's investment objectives and limitations, management used that, together with market conditions and events, resulted in the performance of the fund.

3. Index Comparison

As proposed, Alternative II would have required a fund to compare its performance to that of an appropriate securities market index. The Commission is adopting an index comparison reporting requirement similar to that proposed, but is requiring that the index comparison be provided in the format of a line graph.¹⁶ This

format is similar to the format recently adopted by the Commission to be included in the disclosure of executive compensation under the 1933 Act and the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).¹⁷ The graph is designed to permit a comparison of the performance of the fund with "the market," and to put the narrative discussion into perspective. A sample graph appears as an appendix to this release.

A number of industry commenters said that comparing an unmanaged, expense-free index to a managed, expense-bearing fund would be inappropriate. The line graph assumes portfolios that have been assembled before beginning the measuring periods and thus need not reflect acquisition costs. As the Commission explained in the proposing release, an actively managed portfolio will have transaction and other costs, including advisory fees, which must be appropriately reflected in performance as the costs of managing a portfolio. 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.¹⁸

Commenters pointed out what they viewed as significant differences between funds and recognized indexes. However, as several commenters acknowledged, it is common practice for funds to include index comparisons in their annual reports and sales literature. To this extent, the adoption of this

Analysis and Retrieval ("EDGAR") System should refer to paragraphs (a) through (c) of rule 304 under Regulation S-T (17 CFR 232.304 (a)(c)) and the EDGAR Filer Manual for the rules and technical requirements related to the filing of graphic material on the EDGAR System. The information contained in the line graph would be described in the electronically submitted document, preferably through the use of a chart that would provide for each of the data points on the graph (i.e., the beginning of each of the ten years), the account value of the investment in the registrant, and the investment in the index. The paper version would, of course, contain the required line graph.

¹⁷ Securities Exchange Act Rel. No. 31327 (Oct. 16, 1992) (57 FR 48125 (Oct. 21, 1992)). Investment companies were excepted from these requirements because their management is usually performed externally. *Id.* at Section I.

¹⁸ Accordingly, Instruction 7 to Item 5A(b) provides that the securities market index may not be adjusted to reflect fund expenses. The line graph for funds that serve as underlying investment vehicles for unit investment trusts offering periodic payment plans and those organized as insurance company separate accounts offering variable insurance contracts will not reflect trust (separate account) expenses. These funds should prominently disclose that the line graph does not reflect trust (separate account) expenses. In contrast, separate accounts may not advertise underlying fund performance unless accompanied by separate account performance which reflects separate account expenses. Investment Company Act Rel. No. 16245 (Feb. 2, 1988) (53 FR 3868 (Feb. 10, 1988)), Sec. II.7.

disclosure requirement is a codification of the disclosure practices of some funds. Moreover, comparisons are widely used by investment professionals in evaluating the performance of mutual funds, and are frequently used in the mutual fund industry as a means of measuring the compensation of portfolio managers and, in some cases, investment advisers to mutual funds. If a fund believes that the comparison is inapposite in ways that are not readily apparent, it should discuss these differences in the narrative portion of the Management's Discussion.

Some fund commenters argued that the diversity of funds and their range of investment strategies make selecting an index difficult. Item 5A(b) gives a fund considerable flexibility in selecting a broad-based index that it believes best reflects the market(s) in which it invests.

Instructions to Item 5A(b) provide funds with guidance in creating the line graph. The instructions for the line measuring fund performance generally follow the instructions in Item 22 of Form N-1A for the calculation of fund total return used in fund advertisements and sales literature.¹⁹ The graph must assume a \$10,000 hypothetical investment and reflect all fund expenses, sales loads, and any account fees.²⁰

Item 5A(b) requires that a broad-based securities market index, such as the S&P 500, the Nikkei Index, or the Lehman Corporate Bond Index be used in the graphic comparison. The Commission has chosen to require funds to use a broad-based index in order to provide investors with a benchmark for evaluating fund performance that

¹⁹ Two instructions address issues regarding the computation of fund performance which have been addressed by the Division of Investment Management in the context of mutual fund advertisements and sales literature. Instruction 5 provides that, if the fund has not been in operation during each of the ten fiscal years, the fund may commence the line graph at either the effective date of its registration statement under the 1933 Act or the date it commenced operations, i.e., began to invest its assets in accordance with its investment objectives, provided that that date is subsequent to the effective date of the registration statement. See *The Fairmont Fund Trust* (pub. avail. Dec. 9, 1988), note 1. Instruction 6 provides that, in certain circumstances, the fund may eliminate performance prior to the date the current investment adviser began to provide advisory services to the fund. See *Investment Trust of Boston Funds* (pub. avail. Apr. 13, 1989) and *Unified Funds* (pub. avail. Apr. 23, 1991).

²⁰ Instruction 4(c) provides guidance as to the appropriate method for allocating flat dollar account fees (e.g., \$100) among series of a series fund, and is taken from Instruction 21(e) to Item 3(a) of Form N-4, the registration form used by insurance company separate accounts offering variable annuity contracts. (17 CFR 274.11c.)

¹⁵ See Letter from the ICI to Jonathan G. Katz (Mar. 12, 1990), File No. S7-1-90.

¹⁶ Registrants filing the Management's Discussion on the Commission's Electronic Data Gathering.

affords a greater basis for comparability than a narrow index would afford.²¹

Several commenters urged the Commission to permit peer group comparisons for all funds. They argued that an investor wants to know how his or her fund performed in comparison with other funds having similar investment objectives. The Commission has not adopted this approach. The index comparison requirement is designed to show how much value the management of the fund added by showing whether the fund "out-performed" or "under-performed" the market, and not so much whether one fund "out-performed" another.²² A fund could underperform a relevant market, while nevertheless comparing favorably with its peers. In addition to the comparison required (with a broad-based index), the Commission is urging funds to compare their performance with other, more narrowly-based indexes. In addition, a registrant may compare its performance to an additional broad-based index or non-securities index, such as the Consumer Price Index, provided that the comparison is not set forth in a misleading manner.²³

Instruction 7 places general limitations on the kind of index that can be used. To prevent a conflict of interest from arising, the index must be created and administered by an organization that is not an affiliated person of the fund, its adviser or principal underwriter, unless the index is widely recognized and used.²⁴ In the latter case, the potential for conflict is diminished because the index is used for purposes other than as a benchmark against which to measure fund performance.

Item 5A(b) permits funds to change indexes, provided certain conditions are met. Instruction 12 requires that funds explain the reasons for any change and include the previously used index comparison in the Management's Discussion in which the new index first appears.²⁵

Item 5A(b) requires that, within or contiguous to the graph, funds include

²¹ A broad-based index is one that provides investors with a performance indicator of the overall applicable stock or bond markets, as appropriate. An index would not be considered to be broad-based if it is composed of securities of firms in a particular industry or group of related industries.

²² The average annual total return figures that are required to be within or contiguous to the line graph will provide a basis for comparing one fund to another. See discussion of Item 5A(b) below.

²³ See Item 5A(b), Instruction 8.

²⁴ The term "affiliated person" is defined in section 2(a)(3) of the 1940 Act (15 U.S.C. 80a-2(a)(3)).

²⁵ Both indexes must cover the entire 10-year period during the transition year.

their average annual total return for the one, five and ten year periods ending on the last day of the most recently completed fiscal year calculated in conformance with Item 22 of Form N-1A. These are the "standardized" total return figures used in advertisements and sales literature.²⁶ This information will assist investors in comparing the performance of different funds. Finally, the line graph must be accompanied by a statement that past performance is not predictive of future performance.

4. Disclosure Regarding Maintenance of Fixed Distribution Levels

As proposed, Item 5A(c) requires each fund that has a policy or practice of maintaining a specified level of distributions to its shareholders to report what impact that policy had on the fund's investment strategies and per share net asset value during its last fiscal year. Commenters generally believed that this information would help investors better appreciate the extent to which the strategies used to maintain a particular distribution level affected the value of their investments.

While the other requirements of new Item 5A concentrate on overall fund performance, this requirement focuses on how the fund sustained its distribution rate and any consequent changes in per share net asset value. From a fund's response to this disclosure requirement, the investor should have a clearer picture of whether the fund had to distribute capital, as well as profits, to maintain its distribution rate.

5. Money Market Funds

Money market funds would be exempt from the Management's Discussion requirement. The problems that the Management's Discussion requirement seeks to address with respect to investor understanding of performance do not appear to exist with respect to money market funds. Of course, money market funds retain the option of providing investors with a discussion of their performance, including illustrative line graphs.

²⁶ Rule 34b-1 requires that sales literature containing performance information include the same uniformly-computed average annual total return figures required by rule 482 under the 1933 Act to be included in advertisements containing performance information. Rule 34b-1 provides an exception for reports to shareholders, including annual reports, that contain performance data covering only the period of the report. See Proposing Release at Section II.B.3(d). The Commission is amending rule 34b-1. See discussion *infra* at Section D.1 of this Release.

D. Miscellaneous

1. Sales Literature

As proposed, the Commission is adopting technical amendments to rule 34b-1.²⁷ Among other things, the rule requires performance information in sales literature to be reasonably current, and thus periodically updated so that the performance data is not stale.²⁸ The amendments exclude from the updating requirements performance information contained in periodic reports to shareholders.²⁹

2. 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 combination. The Commission is amending Item 5(a) of Form N-14 to require that security holders voting on (or consenting to) a merger or other business combination be furnished with the Management's Discussion information required by Item 5A.³⁰ The

²⁷ Rule 34b-1 excludes annual reports to shareholders under section 30(d) of the 1940 Act that contain only performance data for the period of the report. In Investment Company Act Rel. No. 16254 (Feb. 2, 1988) (53 FR 3868 (Feb. 10, 1988)) at n. 39 the Commission stated that inclusion of financial statements (including the per share table) in an annual report does not trigger the uniform disclosure provisions of rule 34b-1. The addition of total return figures to the per share table (now, financial highlights) in response to amended Item 3(a) will not trigger the provisions of rule 34b-1 provided that the figures are given no special prominence from the other data in the table.

²⁸ A note to rule 34b-1 provides that the currentness provisions of paragraph (f) of rule 482 (17 CFR 230.482(f)) also apply to 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.

²⁹ In addition, and as proposed, the Commission is adding a sentence to the note to rule 34b-1 clarifying that the currentness provisions apply from the date of distribution of sales literature and not from the date of submission for publication. The Commission is also revising rule 34b-1 to correct a drafting error in Release 18005, *supra* note 3, which, among other things, amended rule 34b-1 to require that money market fund sales literature include the legend required by paragraph (a)(7) of rule 482 under the 1933 Act (17 CFR 230.482(a)(7)). Paragraph (a)(7) requires a money market fund to disclose that an investment in the fund is not insured by the U.S. government and that there can be no assurance that the fund will maintain a stable net asset value. Unintentionally, this requirement was limited to money market fund sales literature containing performance information. To correct this, the rule has been redrafted into two sections—paragraph (a), which applies to all money market fund sales literature, and paragraph (b), which only applies to sales literature containing performance information.

³⁰ Item 5 of Form N-14, as amended, requires that the Management's Discussion information must be

Management's Discussion must be included in the prospectus delivered in connection with such a transaction, unless the prospectus is accompanied by an annual report to shareholders containing the Management's Discussion information.³¹

E. Date of Effectiveness

The Commission is staggering the date when the amendments adopted today will become effective to coincide, to the extent possible, with the annual updating of registration statements and the distribution of new annual reports to shareholders.

1. Prospectuses

The amendments to Form N-1A regarding (i) disclosure of portfolio managers, (ii) financial highlights, and (iii) Management's Discussion for those funds that elect to include a Management's Discussion in their prospectuses will become effective in the following manner. For funds whose registration statements become effective on or after July 1, 1993, or a series added by post-effective amendment that becomes effective on or after July 1, 1993, the revisions are effective for prospectuses used on or after that date. For funds with fiscal years ending on February 28, these revisions will become effective on July 1, 1993, as to prospectuses used on or after that date, the date on which their post-effective amendments ordinarily must become effective. For all other funds, today's revisions will become effective upon use of any prospectus contained in any post-effective amendment filed on July 1, 1993 or thereafter.³²

2. Annual Reports

Funds that have included or intend to include a Management's Discussion in their annual reports must do so in any annual report first distributed to shareholders on or after July 1, 1993. Funds must use the new financial highlights in all annual reports distributed on or after July 1, 1993.

Funds should note, however, that, under Instruction 5(b) to new Item 5A,

provided for the acquiring fund and Item 6 (which cross-references Item 5) requires the Management's Discussion to be provided for the acquired fund.

³¹ Although the Commission is not amending Form N-14 in any further respect, because Form N-14 cross-references items of Form N-1A, the adoption of amendments to Form N-1A revising the condensed financial information and requiring disclosure of portfolio managers will require the same additional disclosure in registration statements filed on Form N-14.

³² These are the same effectiveness provisions that were used when Form N-1A was revised to require a fee table in mutual fund prospectuses. See Investment Company Act Rel. No. 16244 (Feb. 1, 1988) (53 FR 3192 (Feb. 4, 1988)).

a newly registered fund (or series) will not have to include a Management's Discussion in the annual report unless the report contains audited financial statements covering a period of at least six months.³³

II. Cost/Benefit Analysis

Several commenters raised concerns that the form and rule amendments as proposed could result in additional costs for funds which may be passed on to investors. The Commission has modified the amendments to reflect many of these concerns. The Commission has narrowed the scope of the item requiring identification of portfolio managers, which will, in turn, reduce the costs of updating; reduced the need to update information in annual reports; and simplified the narrative portion of the Management's Discussion. The Commission also considered the cost of satisfying the Management's Discussion requirements generally and concluded that significant expenses will not be incurred because the information required is readily available to funds and is of a type generally considered by a fund's board in connection with deciding whether to renew the advisory contract. Moreover, the Commission believes that the costs of the amendments adopted today are outweighed by the benefits to investors of receiving the additional disclosure.

III. Regulatory Flexibility Act Analysis

A summary of the Initial Regulatory Flexibility Analysis, which was prepared in accordance with 5 U.S.C. 603, was published in Investment Company Act Release No. 17294. No comments were received on this analysis. The Commission has prepared a Final Regulatory Flexibility Analysis, a copy of which may be obtained by contacting Martha H. Platt, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549.

IV. Text of Final Rule and Form Amendments

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

Investment Companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Commission is amending chapter II, title 17 of the Code of Federal Regulations as follows:

³³ The Commission does not expect the information required by new Item 3(d) of Form N-1A to be included in the prospectus of a fund until the fund's annual report contains the new disclosures.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

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

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78w(a), 78l(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a-8, 80a-29, 80a-30 and 80a-37, unless otherwise noted.

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

Note: Form N-14 will not appear in the Code of Federal Regulations.

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

Form N-14

* * * * *

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, 6 (a), (c), (d), (e), (f), and (g), and 7 through 9 of Form N-1A under the 1940 Act, *provided, however*, that the information required by Item 5A may be omitted if the prospectus is accompanied by an annual report to shareholders containing the information otherwise required by Item 5A;

* * * * *

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

3. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-37, 80a-39, unless otherwise noted;

* * * * *

4. By revising § 270.34b-1 to read as follows:

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

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)] ("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 includes the information specified in paragraphs (a) and (b) of this section.

(a) Sales literature for a money market fund shall contain the information required by paragraph (a)(7) of § 230.482 of this chapter;

(b)(1) Except as provided in paragraph (b)(2) of this section, any sales literature

containing investment company performance data shall also include:

- (i) The disclosure required by paragraph (a)(6) of § 230.482 of this chapter; and
- (ii) The following additional performance data, which shall meet with the currentness requirements of paragraph (f) of § 230.482 of this chapter:

(A) Except in the case of a money market fund, the total return information required by paragraph (e)(3) of § 230.482 of this chapter;

(B) In the case of sales literature containing a quotation of yield or other similar quotation purporting to demonstrate the income earned or distributions made by the company, a quotation of current yield specified by paragraph (e)(1) of § 230.482 of this chapter, or, in the case of a money market fund, paragraph (d)(1) of § 230.482 of this chapter; and

(C) In the case of 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, a quotation of tax equivalent yield specified by paragraph (e)(2) and current yield specified by paragraph (e)(1) of § 230.482 of this chapter, or, in the case of a money market fund, paragraph (d)(1) of § 230.482 of this chapter.

(2) The requirements specified in paragraph (b)(1) of this section shall not apply to any quarterly, semi-annual or annual report to shareholders under section 30 of the Act [15 U.S.C. 80a-29], containing performance data for a period commencing no earlier than the first day of the period covered by the report.

Note: Sales literature (except that of a money market fund) 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 the date of submission for publication.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

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

5. The authority citation for part 274 continues to read, in part, as follows:

Authority: 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 will not appear in the Code of Federal Regulations.

6. By revising paragraph 4 of General Instruction F of Form N-1A (§§ 239.15A and 274.11A) to read as follows:

Form N-1A

* * * * *

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 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.

* * * * *

7. By amending Item 3 of Form N-1A (§§ 239.15A and 274.11A) by revising paragraph (a) and by adding new paragraph (d) to read as follows:

Form N-1A

* * * * *

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.

Financial Highlights

(Introduction)

Net Asset Value, Beginning of Period

Income From Investment Operations

Net Investment Income

Net Gains or Losses on Securities (both

realized and unrealized)

Total From Investment Operations

Less Distributions

Dividends (from net investment income)

Distributions (from capital gains)

Returns of Capital

Total Distributions

Net Asset Value, End of Period

Total Return

Ratios/Supplemental Data

Net Assets, End of Period

Ratio of Expenses to Average Net Assets

Ratio of Net Income to Average Net Assets

Portfolio Turnover Rate

Instructions:

General Instructions

1. Briefly explain the nature of the information contained in the table and its

source. The auditor's report as to the financial highlights need not be included in the prospectus. Note that the auditor's report is contained elsewhere in the registration statement, specify its location, and state that it can be obtained by shareholders.

2. 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 subsequent to 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. Where the period for which the Registrant provides financial highlights 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.

3. List per share amounts at least to the nearest cent. If the offering price is expressed in tenths of a cent or more, then state the amounts in the table in tenths of a cent. Present the information using a consistent number of decimal places.

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

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

6. The financial highlights for at least the latest five fiscal years must be audited and must so state.

Per Share Operating Performance

7. Derive net investment income data by adding (deducting) the increase (decrease) per share in undistributed net investment income for the period to (from) dividends from net investment income per share for the period. The increase (decrease) may be derived by comparing the per share figures obtained by dividing undistributed net investment income at the beginning and end of the period by the number of shares outstanding on those dates. Other methods may be acceptable, but should be explained briefly in a note to the table.

8. The amount shown at the Net Gains or Losses on Securities caption is the balancing figure derived from the other figures in the statement. 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.

9. For any distributions made from sources other than net investment income and capital gains, state the per share amounts thereof separately at the Returns of Capital caption and note the nature of the distributions.

10. In the Net Asset Value, End of Period caption, use the net asset value for the end of each period for which information is being provided.

Total Return

11. When calculating "total return"

(a) assume an initial investment made at the net asset value last calculated on the business day before the first day of each fiscal year;

(b) assume all dividends and distributions by the Registrant are reinvested at the price stated in the prospectus on the reinvestment dates during the year, i.e., total return must reflect any sales load charged upon reinvestment of dividends;

(c) assume a redemption at the price last calculated on the last business day of each fiscal year;

(d) do not reflect sales loads or account fees, but if the Registrant charges sales load or account fees, note that they are not reflected in total return; and

(e) for a period less than a full fiscal year, annualize (but do not compound) the total return and disclose the annualization in a note to the table.

Ratios/Supplemental Data

12. Compute "average net assets" based on the value of the net assets determined no less frequently than the end of each month.

13. A Registrant (or a series of a Registrant) that is a money market fund may omit the portfolio turnover rate.

14. Compute the portfolio turnover rate 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 portfolio securities as of the beginning and end of the first month of the 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 maturities or expiration dates at the time of acquisition were one year or less. Include all long-term securities, including long-term U.S. Government securities. Purchases include any cash paid upon the conversion of one portfolio security into another and the cost of rights or warrants. Sales include net proceeds of the sale of rights or warrants and 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. Appropriately adjust the denominator of the portfolio turnover computation, and disclose the exclusions and adjustments; and

(d) include in purchases and sales any short sales that the Registrant intends to maintain for more than one year and put and call options with expiration dates more than one year from the date of acquisition. Include proceeds from a short sale in the value of the portfolio securities sold during the period; include the cost of covering a short sale in the value of portfolio securities purchased

during the period. Include premiums paid to purchase options in the value of portfolio securities purchased during the reporting period; include premiums received from the sale of options in the value of the portfolio securities sold during the period.

(d) If the information called for by Item 5A is not included in the prospectus, disclose that further information about the performance of the Registrant is contained in the Registrant's annual report to shareholders which may be obtained without charge.

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

Form N-1A

Item 5. Management of the Fund

(c) Disclose the name and title of the person or persons employed by or associated with the Registrant's investment adviser (or the Registrant) who are primarily responsible for the day-to-day management of the fund's portfolio and disclose the length of time that each person has been primarily responsible and each person's business experience during the past five years.

Instructions

1. In responding to this item, it is sufficient to provide information about the person (or persons) who serves as the Registrant's portfolio manager, whether or not subject to the oversight, approval or ratification of a committee.

2. In the event that the organizational arrangements of the investment adviser (or the Registrant, if internally managed) require that all investment decisions be made by a committee, and no person(s) is primarily responsible for making recommendations to that committee, the Registrant may state that fact in lieu of identifying the committee members.

3. Registrants that are money market funds or whose investment objectives involve replicating the performance of an index are not required to respond to this item.

Item 5A. Management's Discussion of Fund Performance

For all registrants other than money market funds, unless the information called for by this item is contained in the annual report of the Registrant:

(a) Briefly discuss those factors, including the relevant market conditions and the investment strategies and techniques pursued by the Registrant's investment adviser, that materially affected the performance of the Registrant during the most recently completed fiscal year.

(b) Provide a line graph comparing the initial account value and subsequent account values at the end of each of the most recently completed ten fiscal years of the Registrant, assuming a \$10,000 investment in the Registrant at the beginning of the first fiscal

year, to the same investment over the same periods in an appropriate broad-based securities market index. In a table placed within or contiguous to the graph, provide the company's average annual total returns for the one, five, and ten year periods ended on the last day of the most recent fiscal year computed in accordance with Item 22(b)(i). Accompany the graph with a statement that past performance is not predictive of future performance.

Instructions

In preparing the line graph comparison:

1. Computation:

(a) Assume that the initial investment was made at the public offering price last calculated on the business day before the first day of the first fiscal year.

(b) Base subsequent account values on the net asset value of the Registrant last calculated on the last business day of the first and each subsequent fiscal year.

(c) Calculate the final account value by assuming the account was closed and redemption was at the price last calculated on the last business day of the most recent fiscal year.

(d) If the Registrant requires a minimum initial investment of more than \$10,000, base the line graph on initial investment of the minimum amount.

2. **Sales Load.** Reflect sales load (or any other fees charged at the time of purchasing shares or opening an account) by beginning the line graph at the amount that actually would be invested, i.e., a dollar amount below \$10,000. Assume that the maximum sales load (and other charges deducted from payments) is deducted from the initial \$10,000 investment. In the case of a Registrant that charges a deferred sales load (or other amounts at redemption or upon closing of an account), assume the deduction of the maximum deferred sales load (or other charges) that would be applicable for a complete redemption that received the price last calculated on the last business day of the most recent fiscal year.

3. **Dividends and Distributions.** Assume all dividends and distributions by the Registrant are reinvested at the price stated in the prospectus on the reinvestment dates during the period, i.e., total return must reflect any sales load charged upon reinvestment of dividends and/or distributions.

4. **Account Fees.** Reflect all recurring fees that are charged to all accounts.

(a) For any account fees that vary with the size of the account, assume a \$10,000 account size.

(b) If recurring fees charged to shareholder accounts are paid other than by redemption of fund shares, they should be appropriately reflected.

(c) In the case of a series company, reflect an annual account fee by allocating the fee among the series in the following manner: Divide the total amount of account fees collected during the year by the total average net assets of the series, multiply the resulting percentage by the average account value for each series and reduce the value of each hypothetical account at the end of each fiscal year during which the account fee was charged.

5. New Registrants.

(a) A new Registrant (or a new series) is not required to include the information specified by this item in its prospectus (or, in the case of a Registrant that opts to include the information in the annual report, its annual report) unless the Statement of Additional Information (or annual report) contains audited financial statements covering a period of at least six months.

(b) If the Registrant's registration statement under the Securities Act of 1933 has not been effective (or, in the case of a series, the Registrant has not offered shares of the series to the public) for all of the ten year periods, begin the line graph either on (a) the date the registration statement became effective (or the Registrant began to offer shares of the series), or (b) the date the Registrant (or series) commenced operations, i.e., began to invest its assets in accordance with its investment objectives, provided such date is subsequent to the date the Registrant's registration statement became effective.

6. *New Advisers.* If the Registrant has not had the same investment adviser during the previous ten fiscal year periods, the Registrant may begin the line graph on the date the current adviser began to provide advisory services to the fund, provided that (a) neither the current adviser nor any affiliate is or has been in "control" of the previous adviser as that term is defined in Section 2(a)(9) of the Investment Company Act (15 U.S.C. 80a-2(a)(9)); (b) the current adviser employs no officer of the previous adviser or employees of the previous adviser who were responsible for providing investment advisory or portfolio management services to the company; and (c) the graph is accompanied by a statement explaining that previous periods during which the fund was

advised by another investment adviser are not shown.

7. *Appropriate Index.* For purposes of this item, an "appropriate broad-based securities market index" must be one that is administered 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. The securities index must be adjusted to reflect reinvestment of dividends on securities in the index, but not the expenses of the Registrant.

8. *Use of Additional Indexes.* In addition to the required comparison to a broad-based index, registrants are urged to compare their performance to other more narrowly-based indexes which reflect the market sectors in which they invest. In addition, a registrant may compare its performance to an additional broad-based index, or to a non-securities index, e.g., the Consumer Price Index, provided that the comparison is not set forth in a misleading manner.

9. *Other Periods.* The line graph may cover earlier fiscal years and may compare the ending values of interim periods, e.g., monthly or quarterly ending values, provided that those periods are subsequent to the effective date of the Registrant's registration statement under the 1933 Act.

10. *Scale.* The axis of the graph measuring dollar amounts may be constructed using either a linear or logarithmic scale.

11. *Series Companies.* Treat each series as a separate Registrant for purpose of this item.

12. *New Indexes.* If the Registrant selects a different index from an index used in the line graph for the immediately preceding fiscal year, explain the reason(s) for the change and also compare the Registrant's annual change in the value of an investment in a

hypothetical shareholder account with that of both the newly selected index and the index used in the line graph for the immediately preceding fiscal year.

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

Instruction

In responding to Item 5A(c), discuss the extent to which its distribution policy resulted in distributions of capital.

9. By amending Item 32 of Form N-1A (§§ 239.15A and 274.11A) by adding paragraph (c) to read as follows:

Form N-1A

* * * * *

Item 32. Undertakings

* * * * *

(c) if the information called for by Item 5A is contained in the latest annual report to shareholders, an undertaking to furnish each person to whom a prospectus is delivered with a copy of the Registrant's latest annual report to shareholders, upon request and without charge.

* * * * *

Dated: April 6, 1993.

By the Commission.

Margaret H. McFarland,
Deputy Secretary.

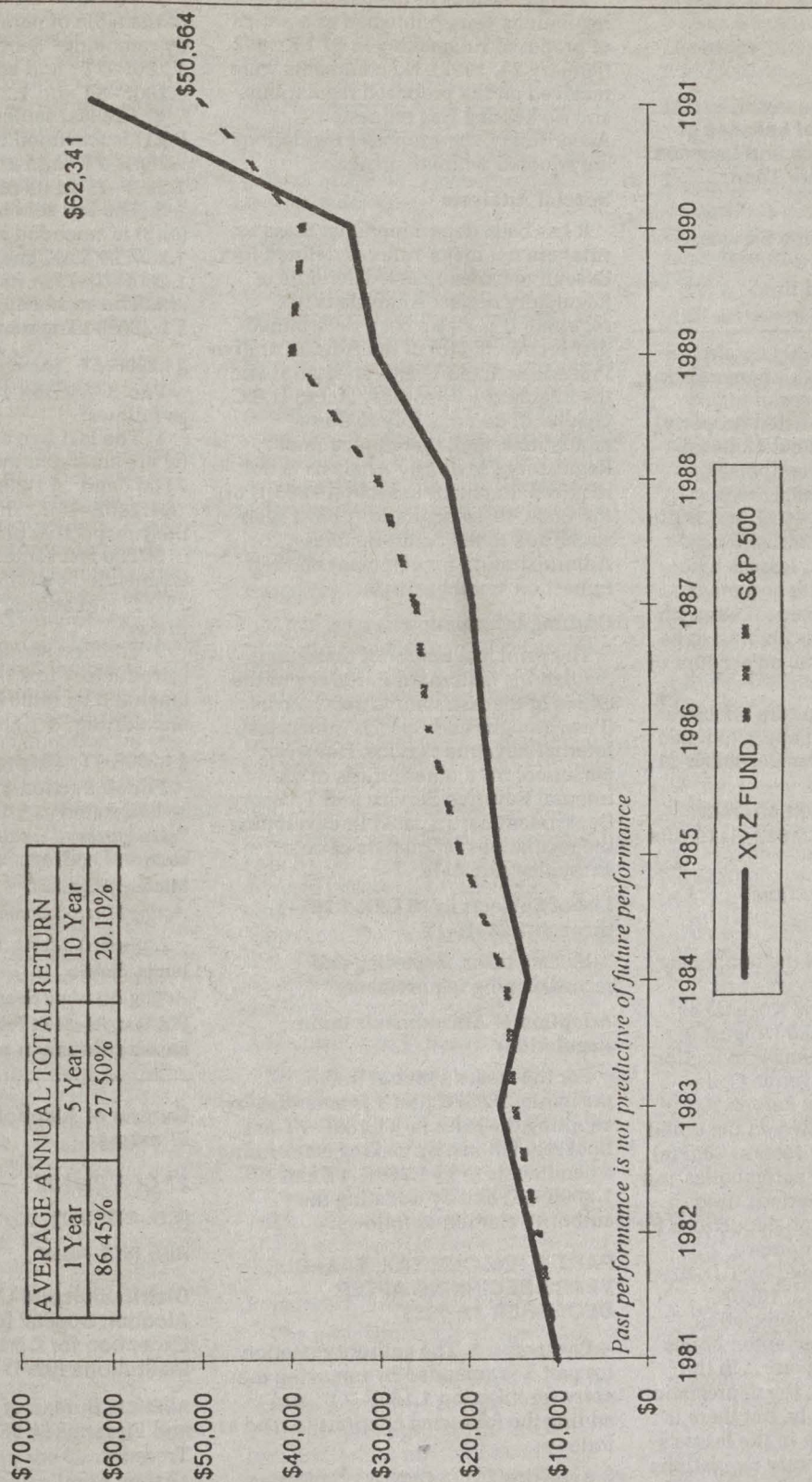
Note: The appendix will not appear in the Code of Federal Regulations.

BILLING CODE 8010-01-P

APPENDIX

COMPARISON OF CHANGE IN VALUE OF \$10,000 INVESTMENT IN
XYZ FUND AND THE S&P 500

AVERAGE ANNUAL TOTAL RETURN			
1 Year	5 Year	10 Year	
86.45%	27.50%	20.10%	



DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[T.D. 8473]

RIN 1545-AO04

Inclusions in Income of Lessees of Passenger Automobiles and Lessees of Listed Property Other Than Automobiles**AGENCY:** Internal Revenue Service, Treasury.**ACTION:** Temporary and final regulations.

SUMMARY: This document contains temporary and final regulations relating to the treatment of lessees of luxury automobiles and other listed property. The rules in the final regulations are currently contained in temporary regulations, parts of which were published on April 12, 1990, and expire within three years of their issuance. These regulations affect lessees who lease luxury automobiles and other listed property and provide them with guidance concerning the amount to be included in gross income on account of the lease.

DATES: These regulations are effective on January 1, 1987, and apply to listed property first leased after December 31, 1986.

FOR FURTHER INFORMATION CONTACT: Bernard P. Harvey, (202) 622-3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:**Background**

Section 1.280F-7T of the temporary Income Tax Regulations was first published in the *Federal Register* as T.D. 8218 in 53 FR 29880 (August 9, 1988) in response to changes to section 280F of the Internal Revenue Code (Code) made by the Tax Reform Act of 1986. These changes lowered the dollar limitations imposed by section 280F(a) on the depreciation for automobiles and changed the recovery periods used in determining depreciation deductions for listed property. The temporary regulations were amended by T.D. 8298 in 55 FR 13808 (April 12, 1990).

Section 280F limits depreciation deductions for passenger automobiles and certain "listed property." In the case of leased property, the depreciation limitation does not apply, but there is an equivalent reduction in the lessee's tax benefits. The temporary regulations implement the rules relating to leased property by requiring lessees to include in gross income an amount substantially

equivalent to the limitation on depreciation and providing rules for computing this amount.

The provisions of the temporary regulations were published as a notice of proposed rulemaking in 57 FR 2862 (January 24, 1992). No comments were received on the proposed regulations, and no hearing was requested. Accordingly, the proposed regulations are adopted without change.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these final regulations is Bernard P. Harvey of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries), Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

List of Subjects in 26 CFR 1.261-1 through 1.280H-1T

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

For the reasons set out in the preamble, 26 CFR part 1 is amended by adopting the rules in § 1.280F-7T as final regulations, by making conforming amendments to §§ 1.280F-1T and 1.280F-5T, and by updating the authority citation as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "Section 1.280F-7T" and adding the following citations to read as follows:

Authority: 26 U.S.C. 7805 * * * Section 1.280F-1T also issued under 26 U.S.C. 280F. * * * Section 1.280F-7 also issued under 26 U.S.C. 280F(c).

§ 1.280F-1T [Amended]

Par. 2. Section 1.280F-1T is amended as follows:

1. The heading in the fourth column of the table of paragraph (b) is amended by removing "Sections 1.280F-5T and 1.280F-7T" and adding "Sections 1.280F-5T and 1.280F-7" in its place.

2. The last sentence in paragraph (c)(1) is amended by removing "Section 1.280F-7T" and adding "Section 1.280F-7" in its place.

3. The last sentence in paragraph (c)(3) is amended by removing "Section 1.280F-7T(a)" and adding "Section 1.280F-7(a)" in its place.

4. The authority citation following § 1.280F-1T is removed.

§ 1.280F-5T [Amended]

Par. 3. Section 1.280F-5T is amended as follows:

1. The last two sentences in paragraph (a) are amended by removing "§ 1.280F-7T(a)" and "§ 1.280F-7T(b)" and adding "§ 1.280F-7(a)" and "§ 1.280F-7(b)", in their respective places.

2. The last sentence in paragraph (f)(1) is amended by removing "§ 1.280F-7T(b)" and adding "§ 1.280F-7(b)" in its place.

3. The first sentence in the introductory text of paragraph (g) is amended by removing "§ 1.280F-7T(b)" and adding "§ 1.280F-7(b)" in its place.

§ 1.280F-7T [Redesignated as § 1.280F-7]

Par. 4. Section 1.280F-7T is redesignated as § 1.280F-7 and the word "(temporary)" is removed from the section heading.

Michael P. Dolan,
Acting Commissioner of Internal Revenue.

Approved: March 19, 1993.

James Fields,
Acting Assistant Secretary of the Treasury
[FR Doc. 93-8464 Filed 4-9-93; 8:45 am]

BILLING CODE 4380-04-M

Bureau of Alcohol, Tobacco and Firearms**27 CFR Part 22**

[T.D. ATF-337]

RIN: 1512-AB15

Distribution and Use of Tax Free Alcohol: Special (Occupational) Tax Exception for Certain Educational Institutions (92-D-007)

AGENCY: Bureau of Alcohol, Tobacco and Firearms (ATF), Department of the Treasury.

ACTION: Final rule, Treasury decision.

SUMMARY: This final rule implements provisions contained in section 7816(o)

of the Omnibus Budget Reconciliation Act of 1989. These provisions amended the Technical and Miscellaneous Revenue Act of 1988 by providing an exception from paying special (occupational) tax to certain educational institutions which procure less than 25 gallons of distilled spirits free of tax for experimental or research use.

EFFECTIVE DATE: Amendments made by this Treasury decision to regulations in 27 CFR part 22 are made retroactive to July 1, 1989.

FOR FURTHER INFORMATION CONTACT: Mary Lou Blake, (202) 927-8210, Distilled Spirits and Tobacco Branch, 650 Massachusetts Avenue, NW., Washington, DC 20226.

SUPPLEMENTARY INFORMATION:

Background

Special (occupational) tax is imposed under the Internal Revenue Code of 1986 (IRC) on persons engaged in certain specified occupations. The Omnibus Budget Reconciliation Act of 1987 (Pub. L. 100-203) amended the IRC by increasing the tax on these persons and by imposing new special tax on persons who did not previously have to pay special tax including persons holding permits under 26 U.S.C. 5271. The provisions of Public Law 100-203 concerning special tax became effective January 1, 1988.

Congress later amended the IRC to exempt certain taxpayers from having to pay special tax. These changes to the IRC were brought about by passage of the Technical and Miscellaneous Revenue Act of 1988.

One of the changes made by the Technical and Miscellaneous Revenue Act of 1988 was to amend 26 U.S.C. 5276 to exempt, under certain circumstances, scientific universities, colleges of learning, or institutions of scientific research that hold permits issued under section 5271(a)(2) (authorizing them to procure, deal in, or use specially denatured alcohol), from the payment of the \$250 per year special (occupational) tax that is currently imposed on all persons holding permits under section 5271. Specifically, these institutions were exempt from the payment of special tax if they procured less than 25 gallons of specially denatured alcohol in any calendar year for experimental or research use but not for consumption (other than organoleptic tests) or sale. This provision was effective on July 1, 1989.

In Section 7816 of the Omnibus Budget Reconciliation Act of 1989 (Pub. L. No. 101-239), amendments were made to extend the exception to those educational institutions that hold

permits and procure less than 25 gallons of tax free distilled spirits (rather than just specially denatured alcohol) in a calendar year. This provision was made retroactive to July 1, 1989, the same effective date as the Technical and Miscellaneous Revenue Act of 1988 which exempted from the payment of special (occupational) tax those institutions that procured less than 25 gallons of specially denatured alcohol in any calendar year.

Regulatory Flexibility Act

The provisions of the Regulatory Flexibility Act relating to a final regulatory flexibility analysis (5 U.S.C. 604) are not applicable to this final rule because the agency was not required to publish a general notice of proposed rulemaking under 5 U.S.C. 553 or any other law. A copy of this final rule was submitted to the Chief Counsel for Advocacy of the Small Business Administration in accordance with 26 U.S.C. 7805(f). No comments were received.

Executive Order 12291

It has been determined that this final rule is not a major regulation as defined in E.O. 12291, and a regulatory impact analysis is not required because it will not have an annual effect on the economy of \$100 million or more; it will not result in a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies or geographic regions; and it will not have significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

Administrative Procedure Act

Because this final rule merely reflects a specific statutory exception for the payment of special (occupational) tax for certain educational institutions, it is found to be unnecessary to issue this Treasury decision with notice and public procedure thereon under 5 U.S.C. 553(b) or subject to the effective date limitation in 5 U.S.C. 553(d).

Paperwork Reduction Act

The provisions of the Paperwork Reduction Act of 1980, Public Law No. 96-511, 44 U.S.C. chapter 35, and its implementing regulations, 5 CFR part 1320, do not apply to this final rule because it does not impose any new reporting requirements. This final rule eliminates the payment of special (occupational) tax for certain educational institutions.

Drafting Information

The principal author of this document is Mary Lou Blake, Distilled Spirits and Tobacco Branch, Revenue Programs Division, Bureau of Alcohol, Tobacco and Firearms.

List of Subjects in 27 CFR Part 22

Administrative practice and procedure, Advertising, Alcohol and alcoholic beverages, Authority delegations (Government agencies), Claims, Excise taxes, Reporting and recordkeeping requirements, Surety bonds.

Authority and Issuance

PART 22—DISTRIBUTION AND USE OF TAX FREE ALCOHOL

Paragraph 1. The authority citation for part 22 continues to read as follows:

Authority: 26 U.S.C. 5001, 5121, 5142, 5143, 5146, 5206, 5214, 5271-5276, 5311, 5552, 5555, 6056, 6061, 6065, 6109, 6151, 6806, 7011, 7805; 31 U.S.C. 9304, 9306.

Par. 2. Section 22.37 is amended by revising the first sentence of paragraph (a) and by adding new paragraphs (d) and (e), to read as follows:

§ 22.37 Liability for special tax.

(a) *Tax-free alcohol permittee.* Except as otherwise provided in this section, every person who is required to hold a permit under 26 U.S.C. 5271 to procure, use, sell, and/or recover alcohol free of tax for nonbeverage purposes shall pay a special (occupational) tax at the rate of \$250 per year. * * *

(d) *Exception for United States.* Agencies and instrumentalities of the United States are not required to pay special tax under this subpart.

(e) *Exception for certain educational institutions.* (1) On and after July 1, 1989, a scientific university, college of learning, or institution of scientific research as specified in § 22.104, which holds a permit to procure and use distilled spirits free of tax under this part, is not required to pay special tax under this subpart if—

(i) The university, college, or institution procures less than 25 gallons of tax free spirits per calendar year; and

(ii) Such spirits are procured for use exclusively for experimental or research use and not for consumption (other than organoleptic tests) or sale.

(2) A scientific university, college of learning, or institution of scientific research, which holds a permit under this part, and which does not operate as described in paragraphs (e)(1)(i) and (ii) of this section during any calendar year, shall pay special tax as provided in

paragraph (a) of this section for the special tax year (July 1 through June 30) commencing during that calendar year.

(26 U.S.C. 5143, 5276)

Signed: March 16, 1993.

Stephen E. Higgins,
Director.

Approved: March 22, 1993.

John P. Simpson,
Deputy Assistant Secretary (Regulatory, Tariff
and Trade Enforcement).
[FR Doc. 93-8421 Filed 4-9-93; 8:45 am]
BILLING CODE 4810-31-U

27 CFR Part 24

[T.D. ATF-338; Re: Notice No. 746]

Change in the Frequency of Filing Reports of Bonded Wine Premises Operations and Wine Excise Tax Returns (92F030P)

AGENCY: Bureau of Alcohol, Tobacco and Firearms (ATF), Department of the Treasury.

ACTION: Treasury decision, final rule.

SUMMARY: This final rule amends the wine regulations to allow certain bonded wine premises proprietors to file reports annually instead of monthly and allow certain bonded wine premises proprietors who pay less than \$1000 annually in wine excise tax to file tax returns and pay such tax annually instead of semimonthly.

EFFECTIVE DATE: May 12, 1993.

FOR FURTHER INFORMATION CONTACT: James A. Hunt and Marjorie Ruhf, Wine and Beer Branch, 650 Massachusetts Avenue, NW., Washington, DC 20226, (202) 927-8230.

SUPPLEMENTARY INFORMATION:

Background

On July 29, 1992, as part of a regulatory review, ATF published Notice No. 746 (57 FR 33467), proposing changes to the wine regulations to: (1) Allow certain wine premises proprietors whose inventory, receipts and production activities do not total more than 20,000 gallons per month to file their reports of bonded wine premises operations annually instead of monthly and (2) allow certain bonded wine premises proprietors who pay less than \$1000 annually in wine excise tax to pay such tax annually instead of semimonthly.

ATF received only one comment on this proposal. The comment, which supported the proposal, was from Duncan Peak Vineyards, Hopland, California. Additionally, a commentary supporting the proposal appeared in the

"Wise and Otherwise" column of the September, 1992, issue of *Wines & Vines*.

The final rule adopts the regulation as proposed, with a few clarifying changes. The final rule makes clear that the "annual" filing of reports means filing on a calendar year basis, gives more detail on the bond coverage changes, and clarifies the criteria for filing the report on an annual basis. ATF also inserted effective dates where appropriate.

Report of Bonded Wine Premises Operations, ATF F 5120.17

Currently, the Monthly Report of Wine Cellar Operations must be filed on a monthly basis by all bonded wine premises proprietors. The only exception is that proprietors of bonded wine premises who do not expect to have any inventory change or reportable operation in a subsequent month or months can file a statement to that effect and be exempt from filing a monthly report of bonded wine premises operations until the next change in inventory or reportable operation.

Under the new regulations, a bonded wine premises proprietor may submit the report of operations on a calendar year basis rather than monthly if the proprietor is exempt from filing semimonthly tax returns under § 24.273 and the sum of the proprietor's monthly report columns representing the opening inventories of bulk and bottled wines in all tax classes, and all operations increasing the amounts to be accounted for during the month, such as production, receipt in bond, and bottling did not exceed 20,000 gallons in any month during the previous calendar year. Also, a proprietor who expects to meet these criteria during the current calendar year may file the reports on a calendar year basis, rather than monthly. For purposes of computation, these operations are represented by the sum of all columns in section A line 12 and section B line 7 in part I of the current report form. While the proposed regulation included only the gallonage criterion, ATF has included a tax payment criterion in the final regulation that also must be met in order for the proprietor to be eligible to file the report on an annual basis. The tax payment criterion is necessary to protect the revenue. Even though a proprietor may have a small quantity of reportable activities the proprietor (such as a sparkling wine producer) may still make substantial tax payments. The filing of the report on a monthly basis by such proprietor is necessary in order for ATF to audit timely the

semimonthly returns filed by the proprietor.

To begin the annual filing of a report of bonded wine premises operations, a proprietor will state such intent in the "Remarks" section when filing the prior month's ATF F 5120.17. A proprietor who is commencing operations during a calendar year and who expects to meet these criteria may use a letter notice to the regional director (compliance), and file ATF F 5120.17 for the remaining portion of the calendar year. If a proprietor determines that the 20,000 gallon quantity will be exceeded in any month, or that the wine excise tax liability (including any amounts paid or owed) equals \$1,000 or more for the current calendar year, an ATF F 5120.17 will be filed for that month and for all subsequent months of the calendar year. However, if there is a jeopardy to the revenue, the regional director (compliance) may require any proprietor otherwise eligible for annual filing of a report of bonded wine premises operations to file such report monthly.

ATF also revised the inventory requirements in the final rule to show that proprietors filing calendar year reports should take inventory at the close of the calendar year, so that the physical and "book" inventories may be reconciled.

This final rule also contains conforming changes to the regulations which refer to the report form title and to the monthly reporting requirement.

ATF reminds proprietors that all requirements for retaining and summarizing source records contained in 27 CFR part 24, subpart O, Records and Reports, remain the same. Failure to keep the required records could result in assessment of tax on unexplained losses, administrative actions for recordkeeping violations, or invalidation of a proprietor's label claims. Vintage date, varietal designation or other claims must be supported by adequate source records; if the records are not available, the proprietor may be required to relabel products to remove unsubstantiated claims from the label.

Increasing the Wine Excise Tax Amount To Qualify for Filing Annual Tax Returns to \$1,000

Currently, bonded wine premises proprietors are required to file tax returns and pay wine excise tax semimonthly, except that certain winery proprietors may file tax returns and pay such tax on a calendar year basis instead of semimonthly. In order to qualify for this exception, the proprietor must have paid less than \$500 in wine excise tax for the previous calendar year, and the

anticipated wine excise tax liability must be less than \$500 for the current year.

As proposed, ATF is amending the regulations to authorize the filing of annual tax returns, with payment, by a proprietor whose excise tax liability does not exceed \$1,000 for the calendar year. This will allow approximately 100 more wine premises proprietors to start filing annual tax returns and about another 100 small winery proprietors will not have to be concerned about reaching their \$500 (but not more than \$1,000) per year wine excise tax limit and being required to file semimonthly tax returns.

Under the current regulations, up to \$500 in excise tax which has been determined but not paid is already covered by the wine operations bond. This amount was increased from \$100 when the wine regulations were recodified in 1990. As proposed, ATF is amending the regulations to allow up to \$1,000 of the wine bond to be designated as coverage for wine on which tax has been determined but not paid in order to allow this new filing option. The wine bond will be revised to reflect this change. Proprietors should be aware that this amendment of the regulations to increase the dollar amount of the wine bond available for wine removed from bonded wine premises on which the tax was determined but not paid does not automatically raise this limit on existing bonds. In order to obtain this additional coverage, the proprietor must procure a new bond or a consent of surety expressly providing for the \$1,000 amount. For example, some proprietors still have wine bonds showing a \$100 amount, while other proprietors' bonds show \$500. For either of these proprietors to use the new option of making a single annual tax payment of up to \$1,000, such proprietor must obtain a new bond or consent of surety providing for the \$1,000 coverage. Otherwise the proprietor must pay the tax when its liability reaches the limit of its coverage for wine removed but not taxpaid. That amount will be \$100 or \$500, depending on the existing bond terms. The wording of the bond regulations is revised in this final rule to show that a proprietor may only designate \$1,000 of the operations coverage for this purpose if the total penal sum of the bond is \$2,000 or more.

Modification of Forms

The Monthly Report of Wine Cellar Operations (ATF F 5120.17) will be revised. These revisions will include a new title, Report of Wine Cellar

Operations, new instructions for filing either monthly or annually, and updated references to the regulations. Titles will be added to blank rows and columns for activities which must currently be written in each month by the proprietor. Finally, Part II, Summary of Domestic Wines in Taxpaid Rooms, will be eliminated. When the revised form is printed, copies will be distributed to each wine premises proprietor, and the existing form will become obsolete. Proprietors should continue using the existing form until the new supply is received.

The Wine Bond (ATF F 5120.36) will be revised to allow proprietors to elect additional coverage of removals under the operations portion of the bond, so that they may take advantage of annual filing of returns. Bonds written on the current version of the form will remain in effect until terminated by action of the surety or principal. If a proprietor wishes to increase coverage of removals before the new form is available, or without superseding an existing bond, ATF F 1533 (5000.18), Consent of Surety, may be used.

Executive Order 12291

In compliance with Executive Order 12291 issued February 17, 1981, ATF has determined that this document does not constitute a "major rule" since it will not result in:

- (a) An annual effect on the economy of \$100 million or more;
- (b) A major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; and,
- (c) Significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets.

Regulatory Flexibility Act

The provisions of the Regulatory Flexibility Act relating to an initial and final regulatory flexibility analysis (5 U.S.C. 604) are not applicable to this rule because it will not have a significant economic impact on a substantial number of small entities. As discussed elsewhere in this preamble, this final rule will reduce the reporting burden on certain small proprietors and will not: (1) impose, or otherwise cause, any increase in recordkeeping or other compliance burdens on small entities, or (2) have significant secondary or incidental effects on a substantial number of small entities. Accordingly, it is hereby certified under the provisions of section 3 of the Regulatory Flexibility

Act (5 U.S.C. 605(b)) that this final rule will not have a significant economic impact on a substantial number of small entities.

Paperwork Reduction Act

The provisions of the Paperwork Reduction Act of 1980, Public Law No. 96-511, 44 U.S.C. chapter 35, and its implementing regulations, 5 CFR part 1320, do not apply to this final rule because it does not impose any new reporting requirements. This rule will eliminate some of the reporting and filing requirements applicable to certain bonded wine premises proprietors.

Drafting Information

The principal authors of this document are James A. Hunt and Marjorie Ruhf, Wine and Beer Branch, Bureau of Alcohol, Tobacco and Firearms.

List of Subjects in 27 CFR Part 24

Administrative practice and procedure, Authority delegations, Claims, Electronic Fund Transfers, Excise Taxes, Exports, Food Additives, Fruit juices, Labeling, Liquors, Packaging and containers, Reporting and recordkeeping requirements, Research, Scientific equipment, Spices and flavorings, Surety bonds, Taxpaid wine bottling houses, Transportation, Vinegar, Warehouses, Wine.

Authority and Issuance

Title 27, Code of Federal Regulations, Part 24—Wine, is amended as follows:

PART 24—WINE

Paragraph 1. The authority citation for part 24 continues to read as follows:

Authority: 5 U.S.C. 552(a); 26 U.S.C. 5001, 5008, 5041, 5042, 5044, 5061, 5062, 5081, 5111-5113, 5121, 5122, 5142, 5143, 5173, 5206, 5214, 5215, 5351, 5353, 5354, 5356, 5357, 5361, 5362, 5364-5373, 5381-5388, 5391, 5392, 5511, 5551, 5552, 5661, 5662, 5684, 6065, 6091, 6109, 6301, 6302, 6311, 6651, 6676, 7011, 7302, 7342, 7502, 7503, 7606, 7805, 7851; 31 U.S.C. 9301, 9303, 9304, 9306.

Par. 2. Section 24.65(b) introductory text is amended by revising the third sentence to read as follows:

§ 24.65 Claims for wine or spirits lost or destroyed in bond.

- * * * * *
- (b) * * * Any other claim for allowance of loss will be attached to and submitted with the ATF F 5120.17, Report of Bonded Wine Premises Operations, for the reporting period in which the inventory required by § 24.313 is taken or, in the case of discontinuance of the premises or

change in proprietorship, to the final report filed. * * *

Par. 3. Sections 24.75(f) and 24.136(d) and the undesignated paragraph following § 24.140(b)(3) are amended by removing the words "Monthly Report of Wine Cellar Operations" and adding, in their place, the words "Report of Bonded Wine Premises Operations".

Par. 4. Section 24.146, is amended by revising the last sentence of paragraph

(a) and by adding a sentence between the first and second sentences of paragraph (b) to read as follows:

§ 24.146 Bonds.

(a) *Wine bond.* * * * This bond has a tax obligation limit of \$500 for wine removed from bonded wine premises on which the tax has been determined, but not paid, unless the total penal sum of the operations bond is \$2,000 or more and the proprietor and the surety designate \$1,000 of this amount as the

obligation limit for wine on which the tax has been determined, but not paid.

(b) *Tax deferral bond.* * * * Under the conditions provided in paragraph (a) of this section, this amount may be changed to \$1,000 by the terms of the bond or through a consent of surety between the proprietor and the surety. * * *

Par. 5. Section 24.148 is amended by revising the chart to read as follows:

§ 24.148 Penal sums of bonds

Bond	Basis	Penal sum	
		Minimum	Maximum
(a) Wine Bond, AFT F 5120.36.	(1) Not less than the tax on all wine or spirits in transit or unaccounted for at any one time. Where such liability exceeds \$250,000	\$1,000	\$50,000
	(2) Where the unpaid tax amounts to more than \$500, not less than the amount of tax which, at any one time, has been determined but not paid. Except: \$1,000 of the wine operations coverage may be allocated to cover the amount of tax which, at any one time, has been determined but not paid, if the total operations coverage is \$2,000 or more.	500	100,000 250,000
(b) Wine Vinegar Plant Bond* ATF F 5510.2.	Not less than the tax on all wine on hand, in transit, or unaccounted for at any one time.	1,000	100,000

*The proprietor of a bonded wine premises who operates an adjacent or contiguous wine vinegar plant with a Wine Bond which does not cover the operation may file a consent of surety to extend the terms of the Wine Bond in lieu of filing a wine vinegar plant bond.

Par. 6. Section 24.176 is amended by revising paragraph (b) to read as follows:

§ 24.176 Crushing and fermentation.

(b) *Determination of wine produced.* Upon completion of fermentation or removal from the fermenter, the volume of wine will be accurately determined, recorded and reported on ATF F 5120.17, Report of Bonded Wine Premises Operations, as wine produced. Any wine or juice remaining in fermentation tanks at the end of the reporting period will be recorded and reported on ATF F 5120.17.

Par. 7. Section 24.197 is amended by revising the last sentence preceding the parenthetical to read as follows:

§ 24.197 Production by fermentation.

* * * The quantity of liquid in fermenters at the close of each reporting period will be reported on the ATF F 5120.17, Report of Bonded Wine Premises Operations. * * *

§ 24.237 [Amended]

Par. 8. Section 24.237 is amended by removing the words "Monthly Report of Wine Cellar Operations" and adding, in their place, the words "Report of Bonded Wine Premises Operations".

§ 24.268 [Amended]

Par. 9. Section 24.268 is amended by removing the word "month" and adding, in its place, the words "reporting period".

Par. 10. Section 24.273 is amended by revising paragraph (a) to read as follows:

§ 24.273 Exception to filing semimonthly tax returns.

(a) Any proprietor who has not given a bond for deferred payment of wine excise tax and who:

(1) Paid wine excise taxes in an amount less than \$1000 (\$500 prior to May 12, 1993, during the previous calendar year, or

(2) Is the proprietor of a newly established bonded wine premises and expects to pay less than \$1000 (\$500 prior to May 12, 1993, in wine excise taxes before the end of the calendar year, may file the Excise Tax Return, ATF F 5000.24, and remittance, within 30 days after the end of the calendar year instead of semimonthly as required by § 24.271. However, if before the close of the current calendar year the wine excise tax owed will exceed the amount of the coverage under the proprietor's operations bond for wine removed from bonded wine premises on which tax has been determined but not paid, the proprietor will file an Excise Tax Return with the total remittance on the date the

wine excise tax owed will exceed such amount and file an aggregate Excise Tax Return within 30 days after the close of the calendar year showing the total wine tax liability for such calendar year. If before the close of the current calendar year the wine excise tax liability (including any amounts paid or owed) equals \$1000 or more, the proprietor will commence semimonthly filing of the wine Excise Tax Returns and making of payments as required by § 24.271.

Par. 11. Section 24.275 is amended by revising paragraph (a)(2) and the first sentence of paragraph (a)(3) to read as follows:

§ 24.275 Prepayment of tax.

(a) * * *

(2) The tax deferral bond is not in the maximum penal sum and the tax determined and unpaid at any one time exceeds the penal sum of the bond by more than the amount of such tax covered by the wine operations coverage of the wine bond; or,

(3) There is no approved tax deferral bond and the total amount of tax unpaid at any one time exceeds the amount of the wine operations coverage of the wine bond designated for wine removed from bonded wine premises on which

tax has been determined but not paid.

* * *

§§ 24.292 and 24.293 [Amended]

Par. 12. Sections 24.292(b) and 24.293(b) are amended by removing the words "Monthly Report of Wine Cellar Operations, for the month" and adding, in their place, the words "Report of Bonded Wine Premises Operations for the reporting period".

§ 24.294 [Amended]

Par. 13. Section 24.294(b) is amended by removing the words "Monthly Report of Wine Cellar Operations" and adding, in their place, the words "Report of Bonded Wine Premises Operations".

§ 24.295 [Amended]

Par. 14. Section 24.295(b) is amended by removing the words "Monthly Report of Wine Cellar Operations, for the month" and adding, in their place, the words "Report of Bonded Wine Premises Operations for the reporting period".

Par. 15. Section 24.300 is amended by revising the last sentence of paragraph (b) and by revising paragraph (g) to read as follows:

§ 24.300 General.

* * *

(b) * * * Source records and supplemental or auxiliary records may be used as a record of an operation or transaction and to prepare the ATF F 5120.17, Report of Bonded Wine Premises Operations, provided the record will readily allow for verification of an operation or transaction by ATF officers.

* * *

(g) ATF F 5120.17, Report of Bonded Wine Premises Operations. A proprietor who conducts bonded wine premises operations will summarize transaction entries and submit an ATF F 5120.17 to the regional director (compliance) on a monthly basis, except that:

(1) A proprietor who files a monthly ATF F 5120.17 and does not expect an inventory change or any reportable operations to be conducted in a subsequent month or months, may attach a statement to the ATF F 5120.17 filed that, until a change in the inventory or a reportable operation occurs, an ATF F 5120.17 will not be filed.

(2) A proprietor may file ATF F 5120.17 reports on a calendar year basis if (i) The proprietor expects to be exempt from filing semimonthly returns under § 24.273 for the calendar year and (ii) The sum of the bulk and bottled wine to be accounted for in all tax

classes is not expected to exceed 20,000 gallons for any one month during the calendar year when adding up the bulk and bottled wine on hand at the beginning of the month, bulk wine produced by fermentation, sweetening, blending, amelioration or addition of wine spirits, bulk wine bottled, bulk and bottled wine received in bond, taxpaid wine returned to bond, bottled wine dumped to bulk, inventory gains, and any activity written in the untitled lines of the report form which increases the amount of wine to be accounted for. To begin the annual filing of a report of bonded wine premises operations, a proprietor will state such intent in the "Remarks" section when filing the prior month's ATF F 5120.17. A proprietor who is commencing operations during a calendar year and expects to meet these criteria may use a letter notice to the regional director (compliance), and file an annual ATF F 5120.17 for the remaining portion of the calendar year. If a proprietor determines that the wine excise tax liability for the current year will exceed \$1,000 or that the 20,000 gallon activity level will be exceeded in any month, an ATF F 5120.17 will be filed for that month and for all subsequent months of the calendar year. If there is a jeopardy to the revenue, the regional director (compliance) may at any time require any proprietor otherwise eligible for annual filing of a report of bonded wine premises operations to file such report monthly. The information reported on the ATF F 5120.17 will be maintained in accordance with the requirements of this part.

(Sec. 201, Pub. L. 85-859, 72 Stat. 1381, as amended (26 U.S.C. 5367, 5555))

* * *

Par. 16. Section 24.303 is amended by revising paragraph (d) to read as follows:

§ 24.303 Formula wine record.

* * *

(d) The volume produced and the gain or loss resulting from the production of each lot as determined by comparing the volume finished with the volume used (report the total loss or gain on the ATF F 5120.17 for the period in question);

* * *

Par. 17. Section 24.313 is amended by revising the first four sentences of the introductory text to read as follows:

§ 24.313 Inventory record.

A proprietor who files monthly reports shall prepare a record of the physical inventory of all wine and spirits in storage at the close of business for each tax year, or where a different

cycle has been established, the inventory will be taken at the end of that annual period. Such proprietors may use an annual inventory period different from the period beginning July 1 and ending June 30 by submitting a notice to the regional director (compliance). Proprietors who file reports on a calendar year basis under the provisions of § 24.300(g) of this part shall take the physical inventory at the close of the calendar year. The inventory record will be retained on file with the proprietor's ATF F 5120.17, Report of Bonded Wine Premises Operations, for the reporting period when the inventory was taken. If a proprietor who files monthly reports takes a complete inventory at other times during the year, losses disclosed will be reported on the ATF F 5120.17 and the inventory record will be maintained on file with the report for each month when an inventory was taken. * * *

* * *

Par. 18. Section 24.316 is amended by revising the last sentence preceding the parenthetical to read as follows:

§ 24.316 Spirits record.

* * * The proof gallons of spirits received, used, removed from bonded wine premises, and on hand will be summarized and the account balanced at the end of each reporting period and reported on the ATF F 5120.17. * * *

* * *

Par. 19. Section 24.317 is amended by revising the last sentence preceding the parenthetical to read as follows:

§ 24.317 Sugar record.

* * * At the close of each reporting period, the account will be balanced and the quantity of each kind of sugar remaining on hand will be shown. * * *

* * *

* * *

Signed: March 12, 1993.

Stephen E. Higgins,
Director.

Approved: March 19, 1993.

John P. Simpson,
Acting Assistant Secretary (Enforcement).
[FR Doc. 93-8420 Filed 4-9-93; 8:45 am]
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