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Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Room 6184
Mail Stop 6-9
Washington, D.C. 20549

Re: File No. S7-11-90


Dear Mr. Katz:

Fidelity Management & Research Company ("FMR") appreciates this opportunity to comment on the Commission's concept release relating to reform of the regulation of investment companies. FMR is the investment manager for The Fidelity Group of Funds. These funds currently have assets of over \$100 billion and over 7 million shareholder accounts.

I. Introduction

FMR believes that now, after 50 years of operation, is a particularly appropriate time to review the Investment Company Act of 1940 (the "1940 Act"). Much has changed over these 50 years. In 1940, each investment company was typically sponsored by a specific underwriter in a specific offering; in 1990, there are complexes, including Fidelity Investments, with over 100 investment company portfolios organized by the same sponsor. In 1940, almost all investment companies were sold with a sales load; in 1990, more than one-third are sold without loads. In 1940, there were no money market funds; in 1990, money market funds constitute 40% of the assets of the investment company industry.

While the 1940 Act continues to work relatively well, it is apparent that modification would benefit both investors and the industry. The Commission has implemented a number of important initiatives in the disclosure area--for example, standardized



expense tables which greatly facilitate investor understanding and comparison of funds, and standardized performance calculations which put all fund performance data on the same footing. But more needs to be done in this area by recognizing the existence of fund complexes and eliminating the application of "continuous offering" consequences to mutual funds.

FMR believes that the broad array of substantive prohibitions in the 1940 Act can be significantly relaxed by relying on competition among the large number of investment complexes and the standardized disclosures referred to above, which permit ready comparison by investors. Moreover, such a wide ranging rethinking of the 1940 Act is becoming a necessity because of the growing internationalization of the securities markets. Investment companies in Europe are generally not subject to the broad array of regulatory prohibitions applicable in the U.S. If foreign investment companies are to be sold in the U.S. and vice versa, the 1940 Act will have to become more consistent with foreign approaches to regulating investment companies.


The text of this letter discusses various suggestions for revision. It is divided into three broad areas: Distribution, where we believe general Securities Act of 1933 ("1933 Act") principles must be further relaxed as they apply to the offer and sale of fund shares; Substantive Regulation, where we propose significant enhancements in the ability to use classes of shares, broader exemptions for funds offered solely to institutional investors and an optional ability to utilize unitary investment companies; and Administrative Areas, where we propose improvements in the procedures for issuance of exemptive orders and a narrowing focus for state substantive regulation of funds.

II. Distribution

a. Advertising and Prospectus Delivery

There are two fundamental difficulties with the disclosure approach embodied in the 1940 Act, and the intertwined application of the 1933 Act. First, the concept of continuous offering--since a fund sells shares each day (which it must do to be able to continually redeem shares on demand), it is deemed to be in a continuous underwriting subject to the intensive set of public offering rules in the 1933 Act. These rules were designed for an entity that is raising capital for the first time, or adding substantial capital through a secondary offering. They were not designed specifically for, and do not easily accommodate, a fund selling shares on a daily basis.

The second related difficulty is the emergence of fund complexes--a large number of funds with the same investment manager and a high degree of overlap among fund shareholders. The underwriting rules were implicitly based on the premise that the investor had little prior knowledge of the entity making the




offering and therefore needed to be provided the details in the statutory prospectus. This set of rules is unnecessarily restrictive where fund investors already own shares of the fund being purchased or already know about the manager, service features and the basic investment policies as a result of being a shareholder of a fund in the complex.

The overly restrictive nature of the 1933 Act's limits on advertising as they pertain to mutual funds arises from the prohibition that no written offer precede delivery of a prospectus meeting the requirements of Section 10. The Commission has ameliorated these difficulties to a degree--e.g., through expansion of Rule 134, elimination of the Statement of Policy and adoption of Rule 482. It is not surprising that industry assets increased dramatically in the years following liberalization of the advertising rules (and adoption of Rule 12b-1). However, more needs to be done.

Under current law, funds are restricted in their advertising in a way that most other providers of financial services are not. Rule 482 allows only information in ads the substance of which appears in a fund's full prospectus. Thus, funds are forced to include otherwise unnecessary information in their prospectuses solely to maintain flexibility in advertising. This unduly lengthens prospectuses and often precludes inclusion in advertising of useful information. Use of Rule 134 is not a solution because that rule so severely limits what information can be provided.

The current rules have the effect of distinguishing between directly marketed (generally no load) funds and those sold through brokers, which rely more on oral offers. Most oral offers are not subject to 1933 Act restrictions, other than the anti-fraud provisions, since they are not prospectuses. These anomalies should be addressed by permitting mutual funds to make written, as well as oral, offers prior to prospectus delivery, which offers would not be subject to prospectus liability. This would place funds on a more equal footing with other financial providers and more evenly equate written and oral offers. Of course, standardized methods of calculating and disclosing performance and yield can, and should, be retained.

Additionally, FMR believes that "off the page" sales should be permitted. In this way, an investor could respond to an advertisement by sending in an application included in the advertisement, along with a check. The fund's prospectus would be delivered along with the confirmation. This would facilitate investors' ability to utilize fund products and vastly simplify the process for direct marketers--it would also put them on a more equal footing with broker distributed funds, where initial offers are often made orally (rather than in an advertisement) and prospectuses frequently accompany confirmations.



Various requirements could be instituted to deal with "friction" costs if investors changed their mind after receiving the prospectus. Any load paid could be refunded; in fluctuating net asset value funds, the monies could be escrowed for several days in order to allow for a reversal by the investor. If not reversed, the monies would then be used to purchase fund shares. To eliminate even these "friction" issues, FMR believes that initially "off the page" sales could be permitted only for money market funds. After experience is gained, consideration could be given to expanding the program to other types of funds.

b. Margin Sales

The SEC's rules allow investors generally to purchase stocks and bonds on margin--currently with a down payment of 50%. On the other hand, these rules prohibit an investor from purchasing on margin shares offered pursuant to a primary or secondary offering. The SEC has consistently ruled that investors may not initially purchase fund shares from a broker participating in the selling group on margin because the fund is engaged in a continuous offering. This position places form over substance and ignores the concerns underlying the general prohibition.

In an offering of new securities by an industrial entity, the SEC has historically been concerned that margin sales could be used to create "speculative" interest by brokers and artificially allow the offering to be completed. By contrast, in margin sales of open end funds, the investor is purchasing shares of an established entity which is not trying to complete an underwriting. Use of margin merely provides an optional financing technique which, under current rules, the investor could utilize, in any event, 30 days after their initial purchase.

c. Periodic Reports

The SEC's disclosure requirements for periodic reports to fund shareholders--annual and semi-annual reports--could be greatly improved by providing a degree of flexibility. Current rules require these reports to list every security in the fund's portfolio regardless of materiality. The result in many cases is a securities listing of many pages which for the most part is not useful to shareholders--in addition to imposing substantial printing costs on the fund.

The solution is simple--funds should be permitted the flexibility to list only the largest holdings, overall industry groupings and, possibly, geographic distribution where that is relevant. Funds could offer to send a full listing of the portfolio free of charge to any investor who requested it. This approach would result in a more readable and useful report for shareholders, save funds money, and at the same time provide those shareholders who wish it with full detail of the portfolio.



II Substantive Regulation

a. Classes of Shares

The marketplace for financial products, including fund shares, has become increasingly complex. There are a myriad of types of customers and customer demands which sponsors must seek to satisfy. In order to meet these needs, sponsors must provide more and more specialized products and services. This ultimately means that they must be able to create differentiation in distribution methods and servicing. Currently, such differentiation must largely be accomplished through a separate investment portfolio for each variation. This tremendously increases the costs and risks to fund sponsors as launching and operating these separate portfolios is a quite expensive proposition. If separate portfolios continue to be required, investors will become greatly confused by the multitude of products and sponsors will be burdened by many small, uneconomic funds when sufficient investor demand does not materialize.

Currently, the SEC has granted exemptive orders to permit separate classes of shares of the same investment portfolio to accommodate different distribution arrangements. However, the exemptive order process is too long and cumbersome to provide the flexibility and timeliness which this area demands. Further, the requirement that the performance of each class be set forth in advertising and sales literature creates significant practical problems. Similarly, the staff's prior positions concerning a fund's ability to provide different services to different types of shareholders severely inhibit use of the same investment portfolio for varying types of investors. These restrictions have been imposed on the grounds that a "senior security" is created through varying service levels.

FMR believes this "senior security" issue is misplaced. Clearly, charges for investment management should be the same for all investors in the same investment portfolio. However, servicing costs do vary by size and type of investor, and rational differences in charges should be permitted. Changes need to be made which will facilitate use of the same investment portfolio by separate classes of shares for differing groups of shareholders. Alternatively, a more workable framework for the recently developed "hub and spoke" products might be erected. However, the use of the unit investment trust structure results in significant complication which would need to be addressed.

If these types of initiatives can be accomplished, investors would be better served through classes of shares more finely tuned to their sales and servicing needs. Additionally, lower costs would be produced through the avoidance of small, uneconomic portfolios.



b. Institutional Funds


The Commission has carefully and effectively expanded the exceptions available in connection with sales to, and trading activity among, institutional investors, e.g., Rule 144A and Regulation D. These exemptions correctly recognize that institutional investors do not need the same level of protection as smaller, retail investors in making investment decisions. However, these exemptions from the registration process are explicitly inapplicable to purchases of mutual funds.

If qualified institutional buyers ("QIBs" under Rule 144A) are sufficiently sophisticated to buy and trade foreign equities and junk bonds that have never been registered with the Commission, then QIBs also should be allowed to purchase shares of investment companies which are exempt from various provisions of the securities laws. There is simply no good policy reason for subjecting a fund held entirely by QIB-type institutional investors to 1933 Act registration and the complex and costly requirements of the 1940 Act solely because the fund is deemed to be engaged in a continuous offering.

In addition to the merits of exemptions for funds sold only to QIBs, institutional fund exemptions could very effectively be used as controlled pilot programs for consideration of broader expansion of a number of the proposals suggested in this letter. For example, the unitary investment fund (discussed below), greater flexibility in establishing classes of shares, relaxation of advertising regulations, and hybrid arrangements regarding redemption rights (discussed below) are areas which readily lend themselves to institutional fund exemptions. Since these investors are able to fend for themselves, this approach can provide a fertile ground to test concepts which can bring the 1940 Act into the 1990s and beyond.

c. Unitary Investment Funds ("UIF")

The idea of UIFs has been advanced from time to time in connection with broad-based considerations of the 1940 Act, but has never reached the point of specific proposals. Continuing progress in the internationalization of securities markets, however, requires a renewed and more serious focus on these ideas. UIF types are the predominant organizational structure in many (primarily European) foreign markets. Numerous discussions among industry, SEC and foreign fund representatives have been held seeking to find means to accommodate U.S. offerings of funds with unitary organizational structures and other foreign market based distinctions. If real progress in internationalization is to be made, foreign UIFs must be accommodated within the 1940 Act structure. If so, and in the interest of equal treatment, U.S. funds must also be provided an optional UIF organizational form.



As FMR envisions it, a U.S. UIF would follow very closely the European format. The fund would be governed by a trust indenture, which would establish a contractual relationship between the manager and shareholders and cover all corporate governance matters, consistent with requirements set forth in the 1940 Act. The UIF would have no directors; an independent custodian would perform a very limited oversight role in connection with affiliated transactions--e.g., supervision of affiliated brokerage under Rule 17e-1. Areas which currently require director review, e.g., Rule 2a-7 amortized cost valuation and Rule 17a-7 transactions, would need to be structured so as to be covered entirely through appropriate rules. Shareholder voting would be required in only limited circumstances--e.g., merger or liquidation.


The trust indenture would provide a single fee for all fund expenses (excluding types of expenses currently not covered by expense limits--brokerage, taxes and interest). The manager would then be responsible for payment of all expenses; there would be no need for a stated allocation between investment management, distribution and other items. Given this approach and the absence of independent director review, it would be extremely important to exclude these arrangements from challenge by shareholder suits under Section 36(b). Maintenance of such actions would be fundamentally inconsistent with the UIF structure.

Many substantive provisions of the 1940 Act would continue to apply to UIFs where the UIF structure does not suggest different treatment--e.g., self-dealing restrictions, sales load limits, and advertising and performance rules. Otherwise, the trust indenture would govern management action and shareholder rights. Amendments to the trust indenture, including fee revisions, should be handled through appropriate notice to shareholders. In certain cases, there may be a need to deal with "friction" costs, e.g., sales loads, if significant changes are made. Thus, if a significant change were made, loads paid within a specified prior period might be subject to refund.

To gain experience with the UIF format, limitations on its use may be appropriate. Thus, the form might only be available initially to money market funds, where no "friction" costs exist, or funds offered only to institutional investors.

d. Elimination of Shareholder Voting

A less radical change, or possibly an intermediate step on the way to a full UIF structure, would be to eliminate shareholder voting. Independent directors would continue to perform their current role of serving as shareholder "watchdogs" and monitoring areas of potential conflict between funds and their advisers.



As with the UIF structure, shareholders would be provided clear disclosure regarding the material aspects of the fund in the areas of investments, management fees, charges, etc. If changes were to be made after director approval, shareholders would be provided notice. "Friction" issues could be handled as discussed in the UIF section. In this way, a substantial administrative burden and expense could be removed from fund operation.

e. Hybrid Redemption Funds

The 1940 Act creates a relatively inflexible dichotomy between open-end and closed-end funds. Thus, open-end funds must stand ready to redeem shares on a daily basis while closed-end funds, under current interpretations, cannot make a commitment to repurchase shares at definite times or intervals.


FMR believes that a middle ground needs to be created. Various products have liquidity constraints which make daily redeemability impractical--e.g., certain foreign-oriented funds--but where closed-end status is not desired by the sponsor. An ability to make periodic, rather than daily, redemptions would provide various benefits: discounts that frequently arise in closed-end funds would be reduced, greater investor receptivity would develop through the limited assurance of redemption at net asset value, and a broader array of products would become available.

Various steps could be taken to deal with the original fears regarding investor confusion which lead to adoption of the current regime: require redeemability at regular intervals; provide enhanced disclosure regarding redemption rights; and utilize different terminology for daily redemption and periodic redemption funds. Today's investors are sufficiently knowledgeable to understand these concepts.

In order to enhance portfolio liquidity, periodic redemption funds could impose notice requirements to provide portfolio managers sufficient time to raise cash. In this way, SEC-imposed liquidity standards for daily redemption funds (currently 90%) could be reduced.

f. Riskless Principal Transactions

Section 17(3) and Rule 17e-1 under the 1940 Act recognize the benefits that may accrue to funds through agency transactions with an affiliated broker. Carefully considered conditions apply in these situations, which have effectively worked to provide adequate protection to funds while at the same time allowing them to enjoy advantages in service and price that may accrue through these transactions. However, Sections 17(a) and (c) of the 1940 Act currently prohibit a fund from engaging in all principal transactions with an affiliate, including riskless principal transactions.



These riskless principal transactions--e.g., in the case of a fund buying a security from a broker who is simultaneously acquiring that security from another party--do not present the possibilities for abuse found in other principal transactions. However, because of clearing and trading practices in the market--e.g., the other party will only trade debt securities on a principal, non-commission basis, even though the aggregate cost would be the same--the transaction is structured so title momentarily passes through the affiliated broker. These transactions should be treated on a functional basis--as agency transactions subject to Rule 17e-1 type regulations with disclosure of the mark-up on the confirmation.

IV. Administrative Areas

a. Exemptive Orders

The flexibility provided by Section 6(c) of the 1940 Act is very appropriate and has greatly helped in permitting the Commission to act to adapt the 1940 Act to changing times. However, the process to pursue and secure exemptive relief has become too cumbersome, time consuming and expensive. Frequently, novel requests involving limited or no conflict between the fund(s) involved and its affiliates have taken two or more years to successfully complete. Even if substantial revisions are made to substantive provisions of the 1940 Act as a result of the current study, the exemptive order process must also be revamped to deal with developments over the next 50 years, as well as with ongoing areas which require exemptive relief.

Several approaches should be considered. First, providing limited presidential status to exemptive orders would ease the staff's burden and provide funds with an expedited process. Thus, if an applicant(s) followed precisely the relief and conditions in a previously issued order, the Commission might be granted a limited review period--e.g., 30 days. If the Commission did not issue the equivalent of a stop order within that period, the applicant could proceed. If the Commission did object, further time frames for formal denial or approval should be established. However, if an application based on a prior order is subject to new conditions or is denied, the original exemptive order on which the application was based should be subject to review.

A second approach might apply in certain areas, such as Section 17 affiliated person transactions. Under this approach, a time period for review would be established; if no objection was raised by the Commission within that period, the applicant could proceed with its transaction at its own risk. That is, while transactions would not be voidable, the adviser would be subject to damage suits if the fund was in fact injured by the affiliated transaction. This would greatly facilitate many transactions where the parties are comfortable that the transaction is fair and

otherwise satisfies Section 6(c) criteria, but technically requires Commission relief. It may be fruitful to begin, for example, with transactions where the investment manager would not profit from the affiliated transaction.

b. State Regulation

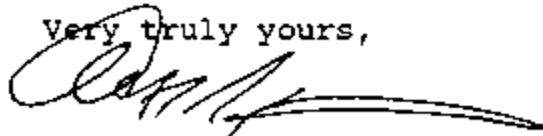
The overlay of state blue sky regulation presents significant burdens to potential foreign entrants into the U.S. market as well as significant costs of nonuniform regulation to U.S. funds. As most funds offer their shares in all states, inconsistent regulations in a single state serve to restrict a fund's operation on a nationwide basis.

While uniform regulation by the states through following North American Securities Administrators Association recommendations would generally resolve this situation, in many cases states have not followed NASAA's proposals. These inconsistent regulations, which frequently are the result of a single state's peculiar regulatory view or a failure to update its regulations, are burdensome and costly to funds and their shareholders. Further, inconsistency with newly adopted federal regulations, e.g., Rule 144A, may frustrate, or at a minimum complicate, utilization of federal rules adopted to create enhanced flexibility.

A sound approach to this issue would be a "blue chip" exemption from substantive state regulation. This form of exemption has, in fact, been adopted by ten states. Under it, experienced investment managers may offer funds without substantive regulation, recognizing that detailed, merit-type regulation is provided under the 1940 Act and through SEC oversight. Of course, notification of registration, registration fees, jurisdiction over sales practices and anti-fraud authority would continue to exist on a state level.

FMR believes that the current re-examination of the 1940 Act presents the opportunity for substantial improvements which will benefit all funds and their shareholders, as well as investment managers and the Commission itself. We appreciate the opportunity to present our views and would be happy to take the time to discuss further any of these matters with the staff.

Very truly yours,



Arthur S. Loring

ASL:sjw