

Sample of 1940 Act Investment Guidelines Sections

Investment Company Act of 1940 regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public. The regulation is designed to minimize conflicts of interest that arise in these complex operations. The focus of this Act is on disclosure to the investing public of information about the fund and its investment objectives, as well as on investment company structure and operations.

Below is sample of directives listed in 1940 Act. It is very important to interpret and implement these complex directives to ensure a competent regulatory compliance framework.

It shall be unlawful for any registered investment company, in contravention of such rules and regulations or orders as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors:

1. to purchase any security on margin, except such short-term credits as are necessary for the clearance of transactions;
2. to participate on a joint or a joint and several basis in any trading account in securities, except in connection with an underwriting in which such registered company is a participant; or
3. to effect a short sale of any security, except in connection with an underwriting in which such registered company is a participant.

Restriction Summary: Do not engage in short selling (except within 1940 Act parameters)

a. Purchase of securities on margin; joint trading accounts; short sales of securities; exceptions. It shall be unlawful for any registered investment company, in contravention of such rules and regulations or orders as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors:

1. to purchase any security on margin, except such short-term credits as are necessary for the clearance of transactions;

Restriction Summary: Do not purchase securities on margin

S 13(a)(2) - No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities:

2. borrow money, issue senior securities, **underwrite securities** issued by other persons, purchase or sell real estate or commodities or make loans to other persons, except in each case in accordance with the recitals of policy contained in its registration statement in respect thereto;

Restriction Summary: Do not invest in real estate

An acquiring company may acquire any security issued by any person that, in its most recent financial year, derived more than 15% of its gross revenues from securities related activities, provided that:

1. immediately after the acquisition of any equity security, the acquiring company owns no more than 5% of the outstanding securities of that class of the issuer's equity securities;

Restriction Summary: Max 5% of the outstanding shares of a securities related issuer

S 13(a)(2) - No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities:

2. borrow money, issue senior securities, underwrite securities issued by other persons, purchase or sell real estate or commodities or make loans to other persons, except in each case in accordance with the recitals of policy contained in its registration statement in respect thereto;

Restriction Summary: Do not invest in real estate

Section 20:

c. No registered investment company shall purchase any voting security if, to the knowledge of such registered company, cross-ownership or circular ownership exists, or after such acquisition will exist, between such registered company and the issuer of such security. Cross ownership shall be deemed to exist between two companies when each of such companies beneficially owns more than 3% of the outstanding voting securities of the other company. Circular ownership shall be deemed to exist between two companies if such companies are included within a group of three or more companies, each of which:

1. beneficially owns more than 3% of the outstanding voting securities of one or more other companies of the group
2. has more than 3% of its own outstanding voting securities beneficially owned by another company, or by each of two or more other companies, of the group.

Restriction Summary: Max 3% in outstanding voting securities during circular/cross ownership (in aggregate)

S 13(a)(2) - No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities:

AND

2. borrow money, issue senior securities, underwrite securities issued by other persons, purchase or sell real estate or commodities or make loans to other persons, except in each case in accordance with the recitals of policy contained in its registration

statement in respect thereto;

Restriction Summary: Do not invest in commodities (client specific considerations, if any)

It shall be unlawful for any registered management company to lend money or property to any person, directly or indirectly, if:

- a. the investment policies of such registered company, as recited in its registration statement and reports filed under this subchapter, do not permit such a loan; or
- b. such person controls or is under common control with such registered company; except that the provisions of this paragraph shall not apply to any loan from a registered company to a company which owns all of the outstanding securities of such registered company, except directors' qualifying shares.

Restriction Summary: Do not execute loans (except within 1940 Act parameters)

S 18(f)(1) - It shall be unlawful for any registered open-end company to issue any class of senior security or to sell any senior security of which it is the issuer, except that any such registered company shall be permitted to borrow from any bank: Provided, That immediately after any such borrowing there is an asset coverage of at least 300 per centum for all borrowings of such registered company: And provided further, that in the event that such asset coverage shall at any time fall below 300 per centum such registered company shall, within three days thereafter (not including Sundays and holidays) or such longer period as the Commission may prescribe by rules and regulations, reduce the amount of its borrowings to an extent that the asset coverage of such borrowings shall be at least 300 per centum.

S 13(a)(2) - No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities:

2. borrow money, issue senior securities, underwrite securities issued by other persons, purchase or sell real estate or commodities or make loans to other persons, except in each case in accordance with the recitals of policy contained in its registration statement in respect thereto;

Restriction Summary: Do not issue senior securities (except within 1940 Act parameters)

It shall be unlawful for any registered investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any other investment company (the "acquired company"), and for any investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any registered investment company (the "acquired company"), if the acquiring company and any company or companies controlled by it immediately after such purchase or acquisition own in the aggregate:

- i. more than 3 per centum of the total outstanding voting stock of the acquired company;
- ii. securities issued by the acquired company having an aggregate value in excess of 5 per centum of the value of the total assets of the acquiring company; or
- iii. securities issued by the acquired company and all other investment companies (other than treasury stock of the acquiring company) having an aggregate value in excess of 10 per centum of the value of the total assets of the acquiring company.

Restriction Summary: Max 10% in all investment companies

It shall be unlawful for any registered open-end company to issue any class of senior security or to sell any senior security of which it is the issuer, except that any such registered company shall be permitted to borrow from any bank: Provided, That immediately after any such borrowing there is an asset coverage of at least 300 per centum for all borrowings of such registered company: And provided further, that in the event that such asset coverage shall at any time fall below 300 per centum such registered company shall, within three days thereafter (not including Sundays and holidays) or such longer period as the Commission may prescribe by rules and regulations, reduce the amount of its borrowings to an extent that the asset coverage of such borrowings shall be at least 300 per centum

Restriction Summary: Max 33 1/3% in bank borrowings

It shall be unlawful for any registered investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any other investment company (the "acquired company"), and for any investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any registered investment company (the "acquired company"), if the acquiring company and any company or companies controlled by it immediately after such purchase or acquisition own in the aggregate:

- i. more than 3 per centum of the total outstanding voting stock of the acquired company;
- ii. securities issued by the acquired company having an aggregate value in excess of 5 per centum of the value of the total assets of the acquiring company; or
- iii. securities issued by the acquired company and all other investment companies (other than treasury stock of the acquiring company) having an aggregate value in excess of 10 per centum of the value of the total assets of the acquiring company.

Restriction Summary: Max 5% in each investment company held

It shall be unlawful for any registered investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any other investment company (the "acquired company"), and for any investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any registered investment company (the "acquired company"), if the acquiring company and any company or companies controlled by it immediately after such purchase or acquisition own in the aggregate:

- i. more than 3 per centum of the total outstanding voting stock of the acquired company;
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- ii. securities issued by the acquired company having an aggregate value in excess of 5 per centum of the value of the total assets of the acquiring company; or
- iii. securities issued by the acquired company and all other investment companies (other than treasury stock of the acquiring company) having an aggregate value in excess of 10 per centum of the value of the total assets of the acquiring company.

Restriction Summary: Max 3% of the voting stock of an investment company

A. For purposes of section 35(d) of the Act, a materially deceptive and misleading name of a Fund includes:

- 2. Names suggesting investment in certain investments or industries. A name suggesting that the Fund focuses its investments in a particular type of investment or investments, or in investments in a particular industry or group of industries, unless:
 - i. The Fund has adopted a policy to invest, under normal circumstances, at least 80% of the value of its Assets in the particular type of investments, or in investments in the particular industry or industries, suggested by the Fund's name...

3. Names suggesting investment in certain countries or geographic regions. A name suggesting that the Fund focuses its investments in a particular country or geographic region, unless:

- i. The Fund has adopted a policy to invest, under normal circumstances, at least 80% of the value of its Assets in investments that are tied economically to the particular country or geographic region suggested by its name...

4. Tax-exempt Funds. A name suggesting that the Fund's distributions are exempt from federal income tax or from both federal and state income tax, unless the Fund has adopted a fundamental policy under section 8(b)(3) of the Act:

- i. To invest, under normal circumstances, at least 80% of the value of its Assets in investments the income from which is exempt, as applicable, from federal income tax or from both federal and state income tax; or...

Restriction Summary: Name Test (80%) - May not have a materially deceptive and misleading fund name

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