EXHIBIT A

David Becker
Mark Cahn
Jacob Stillman
Mark Pennington
Jeffrey Berger
U.S. SECURITIES AND EXCHANGE COMMISSION
100 F Street, N.E.
Washington, D.C. 20549-8030B
Telephone: (202) 551-5112 (Berger)
E-mail: bergerje@sec.gov

Attorneys for *Amicus Curiae* Securities and Exchange Commission

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

IN RE CHARLES SCHWAB CORP. SECURITIES LITIGATION

Master File No. C-08-01510-WHA

CLASS ACTION

SECURITIES AND EXCHANGE COMMISSION'S BRIEF *AMICUS CURIAE*

Date: March 25, 2010
Time: 8:00 a.m.
Judge: Hon. William H. Alsup

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES (CONTINUED)

Miscellaneous (Continued) **Page**

ISSUE PRESENTED

Section 13(a) of the Investment Company Act of 1940 (the Act), 15 U.S.C. § 80a-13(a), prohibits an investment company from deviating from "its policy in respect of concentration of investments in any particular industry * * * as recited in its registration statement" unless authorized by the majority of its outstanding voting securities. In its registration statement, the "YieldPlus" fund (YieldPlus or the Fund) identified non-agency mortgage-backed securities (MBS) "as a separate industry for purposes of a fund's concentration policy" and stated that the Fund would "limit its investments in each identified industry to less than 25% of its total assets." The registration statement also recited that the Fund would not "[c]oncentrate investments in a particular industry or group of industries, as concentration is defined under" the Act. Without first obtaining shareholder approval, the Fund invested nearly 50% of its assets in MBS after amending its registration statement to define MBS as *not* being part of any industry. The issue addressed in this brief, submitted in connection with the parties' motions for partial summary judgment, is:

Whether, in light of the recitations in the registration statement, Section 13(a) required the Fund to obtain shareholder approval before investing more than 25% of its assets in MBS.[1]

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission (the Commission) administers and enforces the federal securities laws, including the Act. The Commission has a substantial interest in the correct interpretation and application of Section 13 of the Act, which serves a significant investor protection function.

---

[1] The Commission takes no position at this time on any other issue arising in this litigation, including any issues involving the proper interpretation of California law, such as whether a violation of the Act gives rise to a state-law cause of action.

BACKGROUND

A. The Act protects investors by prohibiting investment companies from deviating from concentration policies recited in their registration statements without shareholder approval.

Widespread abuses in the management of investment companies prompted Congress to pass the Act. *See generally* Section 1 ("Findings and Declaration of Policy"), 15 U.S.C. § 80a-1. As we discuss in more detail, the Act declared that "the national public interest and the interest of investors[,] are adversely affected" when, among other things: (1) investors deal in investment company securities without "adequate, accurate, and explicit information, fairly presented, concerning the character of such securities," as well as "the circumstances" and "policies" of "such companies and their management," and (2) companies "change the character of their business * * * without the consent of their security holders." Section 1(b)(1), (6), 15 U.S.C. § 80a-1(b)(1), (6).

The Act prohibits any investment company from doing business unless it is registered under Section 8, 15 U.S.C. § 80a-8. *See* Section 7, 15 U.S.C. § 80a-7.[2] Section 8(a), 15 U.S.C. § 80a-8(a), in turn requires each investment company to file a registration statement with the Commission in such form and containing such information and documents as the Commission shall prescribe as necessary or appropriate in the public interest. In 1983 the Commission adopted a new form, Form N-1A, for the registration of open-end investment companies, such as the Fund. *Registration Form Used by Open-End Management Investment Companies*, Investment Company Act Release No. 13436, 48 Fed. Reg. 37,928 (1983) (*1983 Release*). The Commission revised this Form N-1A in 1998. *Registration Form Used by Open-End Management Investment Companies*, Investment Company Release No. 23064, 63 Fed. Reg. 13,916 (1998) (*1998 Release*).

---

[2] "Investment company" is defined to include any issuer of securities which "is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading securities." Section 3(a)(1)(A), 15 U.S.C. § 80a-3(a)(1)(A).

The information that funds must disclose in their registration statements includes:

> a recital of the policy of the registrant in respect of each of the following types of activities, such recital consisting in each case of a statement whether the registrant reserves freedom of action to engage in activities of such type, and if such freedom of action is reserved, a statement briefly indicating, insofar as is practicable, the extent to which the registrant intends to engage therein: * * * (E) *concentrating investments in a particular industry or group of industries*.

Section 8(b)(1)(E), 15 U.S.C. § 80a-8(b)(1)(E) (emphasis added).[3]

Pursuant to Section 13(a), investment companies cannot deviate from certain policies recited in their registration statements, including their concentration policies, without shareholder approval:

> No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities * * * :
>
> (3) deviate from its policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement, deviate from any investment policy which is changeable only if authorized by shareholder vote, or deviate from any policy recited in its registration statement pursuant to section 8(b)(3).

Section 13(a)(3), 15 U.S.C. § 80a-13(a)(3).

B. Without first obtaining shareholder approval, the Fund deviated from its recited policy of not concentrating more than 25% of its assets in MBS.

The Fund's first registration statement was filed in 1999. Defs.' SJ Br. Ex. A, at *3. Beginning in November 2001, the registration statement, which covers multiple funds, began identifying non-agency mortgage-backed securities (MBS) as a separate industry for purposes of the Fund's concentration policy. Defs.' Opp'n Br. 9. (Consistent with the language of the registration statement, the term "MBS" in this brief refers only to privately issued MBS.)

---

[3] The Act also permits the Commission to mandate—and the Commission has mandated in Form N-1A—that an investment company include in its registration statement "a recital of all investment policies of the registrant, not enumerated in paragraph (1), which are changeable only if authorized by shareholder vote" (Section 8(b)(2), 15 U.S.C. § 80a-8(b)(2)), and "a recital of all policies of the registrant, not enumerated in paragraphs (1) and (2), in respect of matters which the registrant deems matters of fundamental policy" (Section 8(b)(3), 15 U.S.C. § 80a-8(b)(3)).

Under the heading "Investment Objectives, Strategies, Securities, Risks, and Limitations," the registration statement recited:

> The following descriptions of investment securities, risks and limitations supplement those set forth in the prospectus and may be changed without shareholder approval *unless otherwise noted*:
> * * *
> CONCENTRATION means that substantial amounts of assets are invested in a particular industry or group of industries. Concentration increases investment exposure. *Based on the characteristics of mortgage-backed securities, each fund has identified mortgage-backed securities issued by private lenders and not guaranteed by U.S. government agencies or instrumentalities as a separate industry for purposes of a fund's concentration policy*. For purposes of a fund's concentration policy, the fund will determine the industry classification of asset-backed securities based upon the investment adviser's evaluation of the risks associated with an investment in the underlying assets. For example, asset-backed securities whose underlying assets share similar economic characteristics because, for example, they are funded (or supported) primarily from a single or similar source or revenue stream will be classified in the same industry section. In contrast, asset-backed securities whose underlying assets represent a diverse mix of industries, business sectors and/or revenue streams will be classified into distinct industries based on their underlying credit and liquidity structures. *A fund will limit its investments in each identified industry to less than 25% of its total assets*.

Pls.' SJ Br. Ex. E (emphasis added).

A subsequent section of the registration statement, which appears under the sub-heading "Investment Limitations," recited that "the following investment limitations are fundamental investment policies and restrictions and may be changed *only by vote of a majority of a fund's outstanding voting shares*." Pls.' SJ Br. Ex. B, at 37 (emphasis added). Among other limitations, the Fund could not "[c]oncentrate investments in a particular industry or group of industries, as concentration is defined under the 1940 Act, or the rules or regulations thereunder, as such statute, rules and regulations may be amended from time to time." *Id*. at 39.

On September 1, 2006, after its Board of Trustees decided that the Fund would identify MBS as *not* being part of any industry "for purposes of [the] [F]und's concentration policy," the

Fund amended its prospectus to state:

> Based on the characteristics of mortgage-backed securities, the funds have determined that mortgage-backed securities issued by private lenders and not guaranteed by U.S. government agencies or instrumentalities are *not part of any industry for purposes of a fund's concentration policy*. This means that a fund may invest more than 25% of its total assets in privately-issued mortgage backed securities, which may cause the fund to be more sensitive to adverse economic, business or political developments that affect privately-issued mortgage-backed securities.

Pls.' SJ Br. Ex. F (at SCH-YP0002098) (emphasis added).

Thereafter, Schwab invested nearly 50% of the Fund's assets in MBS. It never obtained shareholder approval to do so.

ARGUMENT

The Act required the Fund to obtain shareholder approval before deviating from the concentration policy recited in its registration statement, which defined MBS as an industry for purposes of that policy.

In the Commission's view, the Fund was required to obtain shareholder approval before it invested 25% or more of its assets in MBS. Schwab's arguments are contrary to Section 13(a)'s plain language and are inconsistent with the purposes of the Act. If Schwab's arguments were accepted, investment companies could deviate from their concentration policies without giving shareholders a voice, a result that is contrary to the Act's language and purpose.

A. Pursuant to the Act, investment companies may not deviate from concentration policies recited in their registration statements without shareholder approval.

1. Congress authorized the Commission to require investment companies to recite investment and other important policies, including any concentration policy, in their registration statements.

A "major problem" that prompted the enactment of the Act was "the absence of any legal requirement for adherence to any announced investment policies or purposes," such as policies regarding concentration in industries or diversification of investments. S. Rpt. No. 1775, 76th

Cong., 3d Sess. at 7 (1940). A shareholder had "no assurance of the stability of any announced investment policies of his company and no voice in the determination of any desire of the management to change such policies." H. Rep. No. 2639, 76th Cong., 3d Sess. at 9 (1940). In particular, investors suffered when "investment companies substantially changed the nature and character of their business without stockholders' approval." Alfred Jaretzki, Jr., *The Investment Company Act of 1940*, 26 WASH. U. L.Q. 303, 317 (1941). Indeed, "[o]ne of the greatest abuses of investment company practice had been the rapidity and irresponsibility with which some managements totally changed the nature of their business. Stockholders who had invested in self-styled diversified companies were committed overnight to highly illiquid positions in banks, barge-lines, transportation, manufacturing, or other business which caught the managerial fancy." Note, *The Investment Company Act of 1940*, 50 YALE L.J. 440, 444 (1941). *See also* Note, *The Investment Company Act of 1940*, 41 COLUM. L. REV. 269, 285–86 (1941) (investors suffered harm when they purchased fund shares from companies "stressing the diversification of investment" only "to learn later that the expected diversification was a myth").

The Commission study that served as the Act's foundation catalogued these abuses.[4] For example, General Investment Company, which was formed to invest in diverse public utilities, instead invested nearly all of its assets in a subway in Buenos Aires, which the investment company later sold for a loss of nearly 90%. REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON INVESTMENT TRUSTS AND INVESTMENT COMPANIES (1939), pt. III, c. 2, at 497, 592–601 (H.R. Doc. 709, 76th Cong., 1st. Sess.). Similarly, Eastern Utilities Investing Company claimed that it would diversify its investments among the securities "of a number" of public utilities, but in reality it placed nearly all of its assets in a single company, with disastrous results. *Id.*, pt. III, c. 2, at 676. Investors in the Founders Group, which promised international

[4] Congress relied on this study when it created the Act, and the Supreme Court has referred to it when interpreting the Act. *United States v. NASD*, 422 U.S. 694, 706 (1975) (The study "as Congress has recognized, see 15 U.S.C. § 80a-1, forms the initial basis for any evaluation of the Act."). *See also* 15 U.S.C. § 80a-1(a)–(b) (making findings and declarations "upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission").

diversification of assets, lost significant sums after the company concentrated in domestic securities just as the United States market crashed in 1929. *Id*., pt. III, c. 6, at 2224–30.

The study's findings, along with other facts disclosed by the legislative record, led to the congressional declaration that "the interest[s] of investors are adversely affected" when investors purchase "securities issued by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management." Section 1(b)(1), 15 U.S.C. § 80a-1(b)(1). *See also* Note, 41 COLUM. L. REV. at 285 ("One of the principal objections to the past conduct of many investment companies is that their investors remained in complete ignorance of the way in which their investments were handled"). Consequently, Congress sought to protect "investors by promoting full disclosure of information thought necessary to informed investment decisions." *SEC v. Ralston-Purina*, 346 U.S. 119, 124 (1953). *See also Eckstein v. Balcor Film Investors*, 58 F.3d 1162, 1168 (7th Cir. 1995) ("the whole purpose of the registration statement for an issue of securities is to provide information to the purchaser"). It authorized the Commission to require investment companies to "furnish certain information peculiarly requisite for an intelligent appraisal of an investment company." Timothy Ansberry, *Investment Company Act of 1940*, 29 GEO. L. J. 614, 621 (1941). *See also id*. at 222 (Congress sought to "make available one of the best of all weapons for preventing shady financial practices—publicity").

The information that the Commission can require to be disclosed includes a statement regarding any policy of concentration—"do you expect to have concentration of investments in a particular industry or group of industries[,] like a chemical fund or an aviation fund?"—which would "indicate to all persons what general type the company is going to be." Hearings on S. 3580 Before a Subcomm. of the Sen. Comm. on Banking and Commerce, 76th Cong., 3d Sess., at 1115–16 (1940) (statement of David Schenker, Chief Counsel of the Commission). Section 8(b)(1)(E) is the key provision; it authorizes the Commission to require a registered investment

company to file a registration statement that recites any policy in respect of "concentrating investments in a particular industry." As one commentator has noted, "[t]his provision prevents an investment company from formulating charter provisions that provide management with almost limitless discretion as to the businesses the company may enter." Thomas Lemke, et al., REGULATION OF INVESTMENT COMPANIES, § 7.10[1], at 7-58 (2009).

2. The Commission requires funds to disclose concentration policies in their registration statements.

Since shortly after the Act's passage, the Commission has required funds to recite their concentration policies in their registration statements. *E.g.*, *Adoption of Detailed Registration Form*, Investment Company Act Release No. 133, 6 Fed. Reg. 2,573 (1941); *Statements of Investment Policies of Money Market Funds Relating to Industry Concentration*, Investment Company Act Release No. 9011, 40 Fed. Reg. 54,241, 1975 SEC Lexis 481 (1975).

The Act does not define "concentrating investments in a particular industry." However, the current version of Form N-1A reflects the Commission's long-standing view that "25% is an appropriate benchmark to gauge the level of investment concentration that could expose investors to additional risk," and thus "a fund investing more than 25% of its assets in an industry is concentrating in that industry." *1998 Release*, 63 Fed. Reg. at 13,927. The Fund accordingly informed investors that "[t]he SEC has presently defined concentration as investing 25% or more of an investment company's net assets in an industry" (Pls.' SJ Br. Ex. B, at 39), and YieldPlus would "limit its investments in each identified industry to less than 25% of its total assets" (*Id.*, Ex. E).

The Act also does not define "industry or group of industries." When the Commission first adopted Form N-1A, it issued guidelines to assist registrants in the form's preparation. *1983 Release*, 1983 SEC Lexis at *207–*08. In Guide 19 of the guidelines, the staff stated:

> In determining industry classifications, [a registrant] * * * may select its own industry classifications, but such classifications must be reasonable and should not be so broad that the primary economic characteristics of the companies in a single class are

materially different.

Id. Although the 1983 guidelines do not apply to registration statements currently filed under Form N-1A (*1998 Release*, 63 Fed. Reg. at 13,940 n. 214), the Commission agrees with the portion of Guide 19 quoted above, upon which the investment company industry continues to rely (as reflected by the parties' arguments here).

3. The Act requires investment companies to obtain shareholder approval before deviating from recited concentration policies.

Mere disclosure of concentration policies would not protect investors if funds could change them at the discretion of management. Thus, Congress declared that investors' interests are imperiled "when investment companies are reorganized, become inactive, *or change the character of their business*, or when the control or management thereof is transferred, *without the consent of their security holders*." Section 1(b)(6), 15 U.S.C. § 80a-1(b)(6) (emphasis added).

Congress accordingly enacted Section 13(a)(3) to require shareholder approval as a prerequisite to a fund's deviation from its "policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement."[5] The Senate Report accompanying the Act described Sections 8 and 13 as broadly ensuring that "[n]o shift in the company's fundamental policies as stated in the registration statement may be made without the approval of a majority of the company's outstanding voting securities." S. Rpt. No. 1775, 76th Cong., 3d Sess., at 13 (1940). *See also* Jaretski, 26 WASH. U. L.Q. at 317 (Section 13 prevents "any fundamental change in the character of the business to be conducted without stockholders' approval").

"Section 13 complements Section 8(b) by prohibiting an investment company from

[5] A fund must also obtain shareholder approval before deviating from "any investment policy which is changeable only if authorized by shareholder vote" or from "any policy recited in its registration statement pursuant to section 8(b)(3)," *i.e.*, any matters which the registrant deems matters of fundamental policy. Section 13(a)(3), 15 U.S.C. § 80a-13(a)(3).

changing certain investment and other policies without a shareholder vote." Lemke, REGULATION OF INVESTMENT COMPANIES, § 7.10[2], at 7-59. Thus, "once the investment is offered, the investment policy underlying the investment cannot be changed without the approval of a majority of the shareholders of the investment company." 3 Tamar Frankel, THE REGULATION OF MONEY MANAGERS ch. XVIII, § 2, at 15. Congress did not "attempt to tell investment trusts that they can or cannot engage in this or that activity," but it did require investment companies to "have the consent of its security holders to engage" in such activities. Hearings on S. 3580 Before a Subcomm. of the Sen. Comm. on Banking and Commerce, 76th Cong., 3d Sess., at 44 (1940) (statement of Robert Healy, Chairman of the Commission). *See also id*. at 1116 ("As the company enumerates these policies in its registration statement, it will not be able to change them without a majority vote") (statement of Schenker).

B. Section 13(a) and the registration statement required the Fund to obtain shareholder approval before investing 25% or more of its assets in MBS.

The Commission's conclusion that the Fund was required to obtain shareholder approval before concentrating its assets in MBS relies on a straightforward reading of Section 13(a) and the registration statement. Section 13(a) requires shareholder approval before a fund may deviate from the concentration policy "as recited in its registration statement." The Fund recited that policy in two different portions of the registration statement, one general and one specific. In the general statement, the Fund disclosed that it would not "[c]oncentrate investments in a particular industry or group of industries, as concentration is defined under" the Act. In the more specific statement, the Fund disclosed that it would "limit its investments in each identified industry to less than 25% of its total assets" and that "for purposes of [the] fund's concentration policy," the Fund "identified [MBS] issued by private lenders and not guaranteed by U.S. government agencies or instrumentalities as a separate industry."

Reading these statements together, and giving them their ordinary meaning, the Commission believes that it is plain that the Fund's concentration policy expressly stated that it

would not invest 25% or more of its assets in MBS. When the Fund amended the registration statement to state that MBS was not an part of *any* industry and proceeded to invest nearly 50% of its assets in MBS, the Fund deviated (significantly) from the concentration policy as previously recited in its registration statement. Shareholder approval was a prerequisite to this deviation in light of the text and purposes of the Act, which strives "to make certain that the investor can find out just what is happening to his money, and that he will not suddenly awake to see it engaged in a business for which he had not bargained." Ansberry, *Investment Company Act of 1940*, 29 GEO. L. J. at 622.

C. Schwab's position is inconsistent with the Act.

Schwab argues that shareholder approval was not necessary because (1) the Fund did not change its concentration policy, but rather only changed the way it categorized MBS under the policy, and (2) it is reasonable to classify MBS as not being part of any industry. Neither argument justifies the Fund's failure to obtain shareholder approval.

First, Schwab argues that shareholder approval was not required because the Fund "simply changed the way non-agency mortgage-backed securities are categorized under the policy." Defs.' SJ. Br. 17. In Schwab's view, the concentration policy is limited to the general statement of concentration, which stated that Schwab will not invest more than 25% of its assets in any particular industry, and does *not* include the more specific discussion of concentration in which Schwab stated that MBS is an industry for purposes of its concentration policy. Schwab contends that because the general statement did not mention MBS and never changed, there was no deviation and no need for shareholder approval. *Id*. at 18.

The general and specific statements are not as easily walled off from each other as Schwab would lead the Court to believe. There is no "clear difference" between them (Defs.' SJ Opp'n Br. 9) particularly given that the specific statement identifies MBS as an industry "for purposes of [the] fund's concentration policy." Rather, the two provisions *together* constitute the concentration policy, and Schwab cannot deny their interrelationship just because they appear in

different parts of the registration statement. The more specific statement, which expressly informs investors that the Fund will limit its investments in MBS to less than 25% of assets, gives context to the general statement that appears later in the registration statement. Schwab even appears to recognize that the two sections are functionally intertwined; it argues that "to apply, or implement, its [concentration] policy, the fund had to make determinations about which groups of securities would be considered an 'industry' under its concentration policy." Defs.' SJ Br. 18. Changing what constitutes an industry changes the recited concentration policy because, as Schwab notes, the concentration policy cannot be implemented without a determination of what is an industry. Just as "prospectuses must be read 'as a whole'" (*Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2, 5 (2d Cir. 1996)), the two parts of the concentration policy must be understood in conjunction. Schwab cannot evade the Act by dividing its concentration policy into two components and spreading them throughout the registration statement.

Schwab justifies the Fund's conduct by pointing to the 2006 statement that MBS is not an industry, but this only shows that the specific discussion of concentration cannot be separated from the general statement that the Fund would not concentrate in any industry. Shareholder approval was required under the Act because the Fund invested more than 25% of its assets in MBS, not because the Fund changed its classification of MBS as an industry. *See infra* 14–15. By arguing that no deviation occurred because the Fund stated that MBS is not an industry in the specific discussion of concentration, Schwab concedes that the identification of an industry in the specific discussion is a key part of the overall concentration policy.

The prefatory language preceding the specific discussion—which states that "[t]he following descriptions of investment securities, risks and limitations supplement those set forth in the prospectus and may be changed without shareholder approval *unless otherwise noted* " (Defs.' SJ Br. Ex. D, at *2–*3) (emphasis added)—does not suggest a different result, as Schwab implies (*see* Defs.' SJ Opp'n Br. 9). Asserting that shareholder approval is not required does not eliminate the statutory imperative that it be obtained. In any event, the "unless otherwise noted"

language undermines Schwab's argument. The prefatory language to the broad statement announces that the concentration policy "may be changed only by vote of a majority of a fund's outstanding voting shares" (Pl.'s SJ Br. Ex. B, at 37). In light of the interplay between these prefatory statements, the ordinary meaning of the registration statement is that the Fund could not deviate from the entire concentration policy, including both the specific discussion and the general statement of non-concentration, without shareholder approval. Moreover, because the Fund stated that it classified MBS as an industry "[f]or purposes of [its] concentration policy" and later stated that the concentration policy could only be changed by the approval of the shareholders, the industry classification was covered by the "unless otherwise noted" language.

If the Court accepted Schwab's argument, an investment company could deviate from its concentration policy without a shareholder vote under the guise of "merely" changing the components of that policy (Defs.' SJ. Br. 19). Under Schwab's interpretation, YieldPlus investors, having been explicitly and unambiguously informed that the Fund would not invest more than 25% of its assets in MBS, could "suddenly awake" to find that the Fund had invested more than 50% of its assets in MBS without having any say in the matter. Ansberry, *Investment Company Act of 1940*, 29 GEO. L. J. at 622. Moreover, under Schwab's interpretation, the Fund could change the 25% threshold without shareholder approval because the explanation that the Fund would "limit its investment in each industry to less than 25% of its total assets" appeared only in the specific discussion of concentration. Schwab's contention that its concentration policy remained constant even as the definitions anchoring that policy changed (and the Fund increased its MBS holdings far beyond the 25% threshold) is no more sound than the argument that the provisions of the Act would somehow stay the same if Congress altered the definitions in Section 2 of the Act.

Second, Schwab contends (a) that "the fund was free to make its own determination about what is, and is not an 'industry'" so long as that determination is reasonable, and (b) that it was reasonable to conclude that MBS are not a part of any industry. Defs.' SJ Br. 19–21; Defs.' SJ

Opp'n Br. 5–7.

Though we note that the defendants do not assert that it was unreasonable for the Fund to identify MBS as an industry in 2001, the reasonableness of the original identification of MBS as an industry (or the subsequent identification of MBS as not being an industry) is not pertinent here. Rather, the issue under the statute is the legality of the deviation without shareholder approval from the policy *recited in the registration statement*, not the reasonableness *vel non* of the industry identification or whether an investment company is required to recite an industry classification in the first place (Defs.' SJ Br. 11). Once an investment company identifies an industry—even if there may be a question about the reasonableness of that initial classification—the investment company must obtain shareholder approval before changing an industry classification and crossing the 25% threshold. The Commission has *not* "distinguished between fundamental concentration policies and industry classifications when it comes to shareholder approval," as Schwab argues. *Id*. Neither the text of Section 13, the Commission's money market fund reform release (as cited by Schwab, *see id*.), nor any other Commission pronouncement permits an investment company to evade the shareholder approval requirement before surpassing the 25% threshold for an industry in which it previously stated it would *not* invest more than 25%.

Schwab's concern that shareholder approval will be necessary every time an investment company changes an industry classification—or commercial classification schemes undergo revision—is unfounded. Def.'s SJ Opp'n Br. 14. "[R]ejiggering" of industry definitions is not what triggers Section 13. *Id*. It is the deviation from a previously recited concentration policy—investing fund assets in ways contrary to the recited policy—that requires shareholder approval. Schwab did not obtain shareholder approval when it first identified MBS as a separate industry in 2001 precisely because that identification did not alter its concentration policy—it did not begin investing more than 25% in that industry. Moreover, what occurred in 2006 was no mere "rejiggering." Schwab declared that billions of dollars of fund assets invested in MBS

were not part of *any* industry and then invested nearly 50% of the Fund's assets in MBS despite what it had previously recited in its registration statement. In the Commission's view, shareholder approval must be obtained before taking such action, and "promptly and fully" disclosing the change to investors after the fact does not cure the failure to obtain such approval. Defs.' SJ Br. 19.

Respectfully submitted,

DAVID BECKER
General Counsel

MARK CAHN
Deputy General Counsel

JACOB STILLMAN
Solicitor

MARK PENNINGTON
Assistant General Counsel

/s/ Jeffrey A. Berger

JEFFREY A. BERGER
Attorney

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-8030B
(202) 551-5112 (Berger)
bergerje@sec.gov

March 19, 2010