

Investment Management Industry News Summary - January 2004

JANUARY 31, 2004

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

ICI submits letter to Department of Labor ("DOL") seeking guidance on responding to market timing in participant-directed retirement plans

January 26, 2004 10:23 AM

Some retirement plan administrators have been reluctant to take specific action against plan participants who engage in market timing transactions, asserting that such action may be inconsistent with their fiduciary obligations to plan participants under ERISA. In a letter, dated January 21, 2004, the ICI asked the DOL to provide guidance to retirement plan fiduciaries in responding to market timing activity by plan participants in funds offered by the plan when the funds have determined that such market timing activity may be harmful to the fund and its shareholders. Specifically, the ICI has requested that the guidance:

- clarify that nothing in ERISA prohibits plan fiduciaries from restricting the activities of participants who engage in market timing of plan investment alternatives;
- clarify that a plan sponsor should take into account and, under ordinary circumstances, be entitled to rely upon a determination made by an investment vehicle or its manager that certain trading activity is harmful to the interests of other shareholders (and, therefore,

other plan participants);

- clarify that it is consistent with ERISA's fiduciary rules for a plan sponsor to take reasonable steps to facilitate the application of any restrictions imposed at the fund level to plan participants; and
- clarify the continued availability of ERISA Section 404(c) relief for plan fiduciaries who select an investment option that imposes measures to restrict market timing and apply such restrictions to individual participants.

The ICI asked that any such guidance be issued by the DOL (i) in the form of an interpretive bulletin, advisory opinion or other statement of general application, (ii) be prospective in scope, and (iii) provide plan fiduciaries with a reasonable period of time to implement it. The ICI also requested that any clarification of a plan fiduciary's responsibilities in this area apply to the entire range of pooled investments that have instituted policies to limit market timing activity. The ICI commented that it believes the clarification it has requested from the DOL will help bridge the current gap between the protections afforded investors in mutual funds generally and those afforded persons investing in mutual funds through a retirement plan, where a fund generally does not have access to participant-level trading information or participant identities. We note that even in situations where the fund has access to individual participant information, the fund should still work with the plan fiduciary to (i) address the individual trading activity of plan participants, (ii) to ensure that the plan documents are complied with, and (iii) that the plan official takes action consistent with its responsibilities under ERISA.

(ICI Memo 16983, January 22, 2004)

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

SEC's Office of Compliance Inspections and Examinations ("OCIE") sends letter to Investment Company Institute ("ICI") setting forth policy on providing copies of deficiency letters to boards of directors

January 26, 2004 10:21 AM

In response to questions from investment company board members, the SEC sent a letter, dated January 21, 2004, to the ICI outlining its policy with respect to providing to investment company boards copies of deficiency letters. Deficiency letters are sent by the SEC to registrants following inspections which document and highlight violations of law and regulations as well as weaknesses in risk management and control processes in the areas reviewed by the SEC. The SEC stated that to assist fund boards in their oversight of compliance matters, its policy is to mail a deficiency letter directly to a fund's (1) chairman, (2) chief compliance officer, or (3) other senior management official, with a directive that the letter be provided to the fund's board. The SEC noted that deficiency letters regarding examinations resulting in "serious findings" may ask a fund's board to review the issue and respond in writing or may request a meeting directly with the board.

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

SEC sanctions four mutual fund independent directors for failure to address funds' pricing deficiencies

January 26, 2004 10:17 AM

On December 11, 2003, the SEC settled an administrative action against four mutual fund independent directors (the "Independent Directors"), finding the Independent Directors failed (i) to adequately assure that the bonds held in certain of the funds (the "Funds") overseen by the Independent Directors were priced at "fair value," and (ii) to adequately monitor and assure the bonds' liquidity, in violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 (the "Securities Act").

The SEC noted that the Independent Directors previously had approved pricing procedures that entrusted the pricing committee of the Funds' investment adviser (the "Pricing Committee") with the day-to-day responsibility for valuing the Funds' portfolio securities. None of the Independent Directors were members of the Pricing Committee. These pricing procedures stated that because the Board had previously determined that market quotations for the Funds' securities were not readily available, the Pricing Committee was required to use valuations provided by FT Interactive Data ("Interactive Data") as benchmarks to fair value the Funds' securities and to determine the Funds' daily net asset values per share ("NAVs"). The pricing procedures required the Members of the Pricing Committee to review the valuations provided by Interactive Data daily to ensure they were sufficiently timely and accurate. The SEC commented that despite the Board's delegation of the day-to-day pricing of the Funds' bonds to the Pricing Committee, the Investment Company Act of 1940 (the "Investment Company Act") imposes on the Board the ultimate obligation to ensure that the prices of the Funds' securities reflect their fair value. While mutual fund directors are permitted to delegate some responsibility for pricing a fund's securities to a separate committee, the SEC further noted that each director retains responsibility to be involved meaningfully in the valuation process and may not passively rely on securities valuations provided by such a committee.

In this case, the SEC asserted that the Board did not, as expressly undertaken in the Funds' statement of additional information, adequately monitor the financial liquidity of the bonds' issuers or the liquidity of the Funds, to assure that the Funds could sell sufficient bonds to meet redemption requests. The SEC found that the Independent Directors encountered the following indications of

the increasing illiquidity of the Funds and the mispricing of the securities held by the Funds,

- the deteriorating credit quality and liquidity of the bonds in the Funds' portfolios;
- the Funds' growing borrowing and cash-flow problems; and
- the failure by the Funds' investment adviser to sell sufficient bonds to meet redemptions at prices based on valuations provided by Interactive Data.

The SEC determined that as a result of these indications of problems, the Independent Directors should have known that the prices at which the Funds carried their bonds did not reflect the bonds' "fair value", and that the bonds held by the Funds were not sufficiently liquid. The SEC ordered the Independent Directors to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rule 22c-1(a) of the Investment Company Act.

(SEC Release Nos. 33-8346, IC-26290; File No. 3-11351)

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any

transaction or matter addressed herein.

SEC proposes new rules and rule amendments requiring certain disclosure by broker-dealers to customers at the point of sale and in transaction confirmations to promote more informed decision-making by investors

January 26, 2004 10:02 AM

On January 29, 2004, the SEC proposed two new rules and rule amendments under the Securities Exchange Act of 1934 (the "Exchange Act") that would require broker-dealers to provide customers with targeted information, at the point of sale and in transaction confirmations, regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares, unit investment trust ("UIT") interests (including insurance securities), and securities issued by education savings plans ("529 plans"). The SEC is also proposing conforming amendments to its general confirmation rule, Rule 10b-10.

In the proposing release, the SEC commented that in reviewing its position, with respect to mutual fund transactions, that a broker-dealer may satisfy its Rule 10b-10 obligations without providing customers with a transaction-specific document that discloses information about sales loads or third-party remuneration, so long as the customer receives a fund prospectus that adequately discloses that information. The SEC noted that the exponential growth in the number of mutual funds and mutual fund customers, combined with the increased complexity of mutual fund distribution arrangements and potential for conflicts of interest, have raised significant concerns about that current disclosure practice. In particular, the SEC commented that more complete disclosure may be necessary to help customers understand the costs associated with purchasing fund share classes that carry deferred sales loads, as well as the potential conflicts of interest that broker-dealers and their associated persons have in connection with the sale of those share classes. The SEC also noted that investors lack information about whether their broker-dealers receive revenue sharing or other third-party remuneration to distribute particular mutual funds and that prospectus disclosure does not identify which individual broker-dealers receive revenue sharing or quantify with any specificity those arrangements.

Because sales of mutual fund shares, UIT interests and 529 plan shares involve special distribution and compensation practices, the SEC decided to address those disclosure requirements in new Rule 15c2-2 under the Exchange Act, rather than in existing Rule 10b-10. Rule 10b-10 would continue to set forth the confirmation requirements that apply to broker-dealer transactions in other securities. Specifically, proposed Rule 15c2-2 would require:

- specific confirmation disclosure of information about front-end and deferred sales fees ("loads") and other distribution-related costs that directly impact the returns earned by investors in mutual fund shares, UIT interests and 529 plan securities;
- brokers, dealers and municipal securities dealers to disclose their compensation for selling those securities, and to disclose information about revenue sharing arrangements and portfolio brokerage arrangements that create conflicts of interest for them; and
- brokers, dealers and municipal securities dealers to inform customers about whether their

salespersons or other associated persons receive extra compensation for selling certain fund shares or fund share classes.

The SEC commented in the proposing release that it does not intend for proposed Rule 15c2-2 to preempt other provisions of law that may apply, such as NASD rule 2830(k)(1) which prohibits broker-dealers from favoring the distribution of funds that pay portfolio brokerage commissions. Form N-1A would also be amended to require improved disclosure regarding these new requirements concerning sales loads and revenue sharing arrangements.

Proposed Rule 15c2-3 under the Exchange Act would govern the obligation of brokers, dealers and municipal securities dealers to disclose information to investors prior to effecting transactions in mutual fund shares, UIT interests and 529 plan securities regarding costs and conflicts of interest at the point of sale. The SEC stated that it believes investors would consider this information in determining whether to enter into a transaction to purchase a particular type of security. The proposed new point of sale disclosure and confirmation rules and rule amendments also would clarify that the rules do not provide safe harbors for activity that would violate the antifraud provisions of the federal securities laws or other legal requirements.

The SEC also is proposing amendments to the general confirmation rule, Rule 10b-10, to:

- require broker-dealers to provide customers with additional information in connection with transactions in callable preferred stock and debt securities;
- exclude certain transactions in mutual fund shares, UIT interests and 529 plans from the rule's scope, which transactions would instead be covered by new Rule 15c2-2; and
- clarify, consistent with proposed Rule 15c2-2, that the rule does not provide a safe harbor for activity that would violate the antifraud provisions of the federal securities laws or other legal requirements.

Comments must be received 60 days after the date of publication in the Federal Register. (SEC Release Nos. 33-8358; 34-49148; IC-26341; File No. S7-06-04)

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained

in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

SEC's Division of Investment Management (the "Division") in the process of preparing a proposed rule to govern hedge fund advisers

January 19, 2004 10:44 AM

Robert Plaze, Associate Director of the Division, stated that the Division is drafting a proposed rule to present to the SEC for consideration that would require certain investment advisers of hedge funds to register with the SEC. Mr. Plaze clarified that the rulemaking process is not on the "back-burner" but that the Division is actively working on the proposed rule. Hedge funds currently are excepted from the Investment Company Act but are subject to SEC antifraud regulation. Many hedge fund advisers are exempt from registration under the Advisers Act because each hedge fund is considered only one client, and these advisers typically qualify for an exemption available to advisers with fewer than 15 clients. Mr. Plaze commented that the registration of hedge fund advisers would subject the advisers to routine SEC inspection which in turn could lead to early detection of actual and potential misconduct, help deter fraud and encourage a culture of greater compliance and controls. He added that it is not necessary for the hedge fund itself to be registered with the SEC for the SEC to be able to obtain more information about the hedge fund if its adviser is registered with the SEC.

Mr. Plaze commented that any rule requiring registration of hedge fund advisers would comply with the 1996 National Securities Markets Improvement Act ("NSMIA"), which divides investment advisers into two categories of regulation: (1) advisers that manage assets of \$25 million or more which are regulated by the SEC, and (2) advisers that manage less than \$25 million which are regulated by the states. As a result, an investment adviser to a hedge fund that manages less than \$25 million in assets (including the hedge fund's assets) would not be subject to SEC regulation.

BNA Securities Law Reporter, Vol. 36, No. 3, January 19, 2004

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

SEC proposes rule amendments to enhance investment company governance

January 14, 2004 10:35 AM

The SEC proposed amendments to ten exemptive rules under the Investment Company Act (collectively, the “Exemptive Rules”) to require any fund that relies on the Exemptive Rules to adopt certain additional fund governance standards. The Exemptive Rules include Rules 10f-3, 12b-1, 17a-7, 17e-1 and 18f-3, among others, and are widely relied upon by a significant percentage of the mutual fund industry.

Board Composition. The proposed rules would require any fund relying on any of the Exemptive Rules to have a board of directors whose independent directors constitute at least seventy-five percent of the board. The SEC believes such a requirement would: (i) strengthen the hand of independent directors when dealing with fund management, and (ii) assure that independent directors maintain control of the board in the event of the illness or absence of other independent

directors.

Independent Chairman of the Board. The proposed rules would require that the chairman of the fund board be an independent director. Currently, a director who is also a very senior officer of the fund's investment adviser serves as chairman of most, but not all, fund boards. The SEC believes this practice may contribute to the adviser's ability to dominate the actions of the board of directors. According to the SEC, having a chairman who is not affiliated with the adviser will likely result in:

- a boardroom culture more conducive to decisions favoring the long-term interest of fund shareholders; and
- a fund board able more effectively to negotiate with the fund adviser over matters such as the advisory fee.

Annual Self-Assessment. The proposed rules would require fund directors to perform an evaluation, at least annually, of the effectiveness of the board and its committees. The self-evaluation must focus on both substantive and procedural aspects of the board's operations. The following two procedural matters would be required considerations in the evaluation:

1. The effectiveness of the board's committee structure. The SEC stated that this requirement is designed to focus the board's attention on the need to create, consolidate or revise the various board committees. The requirement also is designed to facilitate a critical assessment of the current board committees.
2. Whether board members have taken on the responsibility for overseeing too many funds within a fund complex. The SEC noted that while it would be difficult to determine the optimum number of funds over which a particular director or group of directors should serve, based upon a number of factors, it believes directors should evaluate annually this aspect of their service on fund boards.

Separate Sessions. The proposed rules would require that independent directors meet at least once quarterly in a separate session at which no interested persons of the fund are present. The SEC believes such meetings would afford independent directors the opportunity for a frank and candid discussion regarding the management of the fund, and would help strengthen the collegiality and cohesiveness of the independent directors.

Independent Director Staff. Under the proposed rules, any fund relying on any Exemptive Rule would be required explicitly to authorize the independent directors to hire staff and experts to help the independent directors fulfill their fiduciary duties.

Recordkeeping for Approval of Advisory Contracts. Rule 31a-2, the fund recordkeeping rule, would be amended to require that funds retain copies of written materials considered by directors in approving an advisory contract under Section 15 of the Investment Company Act for at least six years, the first two years in an easily accessible place. Section 15 requires that fund directors, including a majority of independent directors, approve the fund's advisory contract each year, after first obtaining from the adviser the information reasonably necessary to evaluate the contract. The

SEC stated that, as part of examinations of funds, its staff has reviewed the materials that directors considered in approving an advisory contract and found the nature and quality of these materials varied widely among funds. This new requirement would allow SEC staff to determine whether a fund board has failed to acquire information sufficient to scrutinize the advisory fee and other fund expenses to effectively negotiate on a fund's behalf.

Comments must be received by March 10, 2004. (SEC Release No. IC-26323; File No. S7-03-04)

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

SEC proposes three regulatory initiatives to further reform the mutual fund industry

January 14, 2004 10:27 AM

On January 14, 2004, the SEC voted to propose three regulatory initiatives with the goal of reforming: (1) investment company governance requirements, (2) investment adviser codes of ethics requirements and (3) confirmation and point of sale disclosure requirements. Through the

period covered by this Summary, only the proposing release for the first initiative had been published by the SEC and that initiative is covered in greater detail below. We will provide additional information on the second and third initiatives in next week's edition.

1. **Investment Company Governance.** As summarized below, the SEC is proposing amendments to exemptions under the Investment Company Act of 1940 (the "Investment Company Act") to enhance the independence and effectiveness of fund boards and to improve their ability to oversee the activities of the fund's adviser.
2. **Codes of Ethics for Investment Advisers.** The SEC voted to propose new rule 204A-1 and related rule amendments under the Investment Advisers Act of 1940 (the "Advisers Act") which would require registered investment advisers to adopt and enforce codes of ethics applicable to their supervised persons. According to the SEC, the proposed rule is designed to prevent fraud by strengthening the fiduciary principles governing the conduct of investment advisers.
3. **Confirmation Requirements and Point of Sale Disclosure Requirements.** The SEC voted to propose two new rules and rule amendments designed to enhance the information broker-dealers provide to customers in connection with transactions in certain types of securities. The proposed rules would require broker-dealers to provide customers with targeted information, at the point of sale and in transaction confirmations, regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares, unit investment trust interests and municipal fund securities used for education savings (529 plans).

SEC Press Release, January 14, 2004

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

NASD reminds members of obligation to re-file advertising materials

January 8, 2004 10:51 AM

On January 8, 2004, the NASD issued a Member Alert which reminds members of their obligations under NASD Conduct Rule 2210 to re-file advertisements and sales literature which the member continues to use and which has been materially changed to comply with recent amendments to Rule 482 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act. The SEC approved amendments to Rules 482 and 34b-1, which govern advertising by mutual funds, by eliminating the requirement that mutual fund sales material under Rule 482 contain only information the substance of which is included in the mutual fund's prospectus. However, the amendments also require mutual fund sales material to provide improved narrative information and present explanatory information more prominently and for sales material that contains performance information to make available to investors total returns that are current to the most recent month-end.

NASD Member Alert, January 8, 2004

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of

Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

FinCEN issues frequently asked questions (“FAQs”) providing guidance on customer identification program (“CIP”) rule

January 8, 2004 10:46 AM

The staffs of both FinCEN and five banking regulatory agencies issued FAQs regarding the CIP rule applicable to banks and other depository institutions. While the FAQs do not specifically apply to mutual funds or broker-dealers, many of the questions address issues that also arise in the mutual fund and broker-dealer contexts. In the preamble to the FAQs, FinCEN stressed that the specific minimum requirements in the CIP rule, such as the four basic types of information to be obtained from each customer, should be supplemented by risk-based verification procedures, where appropriate, to ensure that the bank has a reasonable belief that it knows each customer's identity. These procedures should take into account all relevant risks, including those presented by the types of accounts maintained, the various methods of opening accounts provided, the type of identifying information available, and the bank's size, location, and type of business or customer base.

Definition of Customers. FinCEN notes that when an account is opened by an individual who has power-of-attorney for a competent person, the individual with a power-of-attorney is merely an agent acting on behalf of the person that opens the account. Therefore, the “customer” will be the named owner of the account rather than the individual with a power-of-attorney over the account. By contrast, an individual with power-of-attorney will be the “customer” if the account is opened for a person who lacks legal capacity.

Rural Addresses. For customers who live in rural areas who do not have a residential or business address or the residential or business address of next of kin or another contact individual, a rural route number is acceptable. In the absence of a residential or business address for next of kin or another contact individual, a description of the customer's physical location is sufficient.

Verification of Customer Information. A bank need not establish the accuracy of every element of identifying information obtained for a customer but must do so for enough information to form a

reasonable belief it knows the true identity of the customer.

Reliance on Service Provider's CIP. The CIP rule applicable to mutual funds allows a fund to satisfy its obligations under the rule by relying on another financial institution to perform those obligations, provided the financial institution certifies annually to the mutual fund that:

1. it has implemented its anti-money laundering program; and
2. will perform the specific requirements of the mutual fund's CIP.

The latter requirement has raised the concern that it is impractical, if not impossible, for a service provider to many different fund families to adapt to the different specific requirements of each fund family's CIP. In the context of the bank CIP rule, which contains nearly identical language, the FAQ clarifies that the reliance provision does not impose on the other financial institution the obligation to duplicate the procedures in the bank's CIP. Instead, the reliance provision permits a bank to rely on another financial institution to perform any of the procedures of the bank's CIP, which means any of the elements that the CIP rule requires to be in a bank's CIP: (1) identity verification procedures; (2) keeping records related to the CIP; (3) determining whether a customer appears on a designated list of known or suspected terrorists or terrorist organizations; and (4) providing customers with adequate notice that information is being requested to verify their identities.

FinCEN Bulletin: FAQs: Final CIP Rule, January 8, 2004 (www.occ.treas.gov/ftp/bulletin/2004-3a/pdf)

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

SEC proposes amendments to rules governing disclosure of breakpoint discounts by mutual funds

January 5, 2004 1:02 PM

On December 17, 2003, the SEC proposed amendments to Form N-1A under the 1940 Act to require mutual funds to provide enhanced disclosure regarding breakpoint discounts on front-end sales loads. The proposed amendments would require a mutual fund to describe in its prospectus any arrangements that result in breakpoints in sales loads and to provide a brief summary of shareholder eligibility requirements.

Under the proposed amendments, mutual funds would be required to make the following disclosures in Form N-1A:

- Arrangements that Result in Breakpoints in Sales Loads. A mutual fund would be required to include the description required by Item 8(a)(2) of arrangements that result in breakpoints in, or elimination of, sales loads in its prospectus and not in its Statement of Additional Information ("SAI"). Item 18(a) would be amended to require that information regarding breakpoints that is not included in the prospectus be included in the SAI. The prospectus would need to state, if applicable, that additional information concerning sales load breakpoints is available in the SAI.
- Methods Used to Value Accounts. A mutual fund would be required to describe in its prospectus the methods used to value accounts in order to determine whether a shareholder has met sales load breakpoints, and the circumstances in which and the classes of individuals to whom each method applies. Such methods would include historical cost, net amount invested and offering price.
- Information and Records Necessary to Aggregate Holdings. A mutual fund would be required to state in its prospectus, if applicable, that, in order to obtain a breakpoint discount, at the time of purchase a shareholder may need to inform the fund or his or her financial intermediary of the existence of other accounts in which there are holdings eligible to be aggregated to meet sales load breakpoints. The fund would be required to describe any information or records that the shareholder may need to provide to the fund or intermediary in order to verify his or her eligibility for a breakpoint discount. If the fund permits breakpoints to be determined based on historical cost, it would be required to state in its prospectus that a shareholder should retain any records necessary to substantiate historical costs.

- Availability of Sales Load and Breakpoint Information on Fund's Website. A mutual fund would be required to state in its prospectus whether it makes available free of charge, on or through its website at a specified Internet address, and in a clear and prominent format, the information that would be required regarding the fund's sales loads and breakpoints in the prospectus and SAI pursuant to Items 8(a) and 18(a), including whether the website includes hyperlinks that facilitate access to the information. If a fund does not make such information available in this manner, it would need to disclose the reasons why it does not do so.

The proposed amendments also include the following presentation requirements:

- All sales load disclosure required by Item 8(a) would need to be adjacent to the table of sales loads and breakpoints required by Item 8(a)(1).
- A mutual fund would be required to present the information required by Item 8(a) in a clear, concise and understandable manner, and include tables, schedules and charts as expressly required by Item 8(a)(1) or where doing so would facilitate understanding.
- Item 7(f) would continue to permit the information required by Item 8(a)(2) to be included in a separate purchase and redemption document, and would be amended to permit the breakpoints information required by proposed Items 8(a)(3), (4) and (5) to be included in such document.

If the proposed disclosure requirements are adopted, the SEC expects to require all new registration statements, and all post-effective amendments that are annual updates to effective registration statements or that add a new series, filed on or after the effective date of the amendments to comply with the proposed amendments. Comments on the proposed amendments must be received by the SEC on or before February 13, 2004. SEC Release No. 33-8347, 34-48939, IC-26298; File No. S7-28-03.

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be

considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

SEC adopts final rules on compliance policies

January 5, 2004 12:48 PM

As reported in the Industry News Summary for the week of 12/08/03 to 12/15/03, on December 17, 2003, the SEC adopted new rules under the Investment Company Act of 1940 (the "1940 Act") and the Investment Advisers Act of 1940 (the "Advisers Act") that require funds and advisers to adopt procedures to enhance compliance with the federal securities laws, review the adequacy of those procedures annually, and designate a chief compliance officer responsible for their administration. The SEC notes in the release that failure of an adviser or a fund to have adequate compliance policies and procedures constitutes a violation in itself, regardless of whether an actual breach of the federal securities laws and regulations has occurred. The new rules are very broad in scope and application and may impose a significantly increased regulatory burden on investment advisers. However, the release also indicates that the policies need to be reasonable in light of the nature of the adviser's operations and, consequently, a smaller adviser with other business lines that may create conflicts of interest would be able to adopt simpler procedures.

New rule 38a-1 under the 1940 Act and new rule 206(4)-(7) under the Advisers Act include the following provisions:

Adoption and Implementation of Policies and Procedures

It is unlawful for an adviser to provide investment advice unless the adviser has adopted and implemented written policies and procedures reasonably designed to prevent violation of the Advisers Act by the adviser or any of its supervised persons. In designing its policies and procedures, each adviser should first identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks. While the new rule does not expressly identify procedures to be adopted, the release specifies issues that, if applicable, an adviser's policies and

procedures should address:

- Portfolio management processes, including allocation of investment opportunities among clients and consistency of portfolios with clients' investment objectives, disclosures by the adviser, and applicable regulatory restrictions;
- Trading practices, including procedures by which the adviser satisfies its best execution obligation, soft dollar arrangements and trade allocation policies;
- Proprietary trading of the adviser and personal trading activities of supervised persons;
- The accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements;
- Safeguarding of client assets;
- The execution and maintenance of required records;
- Marketing advisory services;
- Valuation procedures;
- Privacy protection of client records and information; and
- Business continuity plans.

A fund's board, including a majority of its independent directors, is required to adopt written policies and procedures reasonably designed to prevent the fund from violating the federal securities laws. The board must also approve the compliance policies and procedures of the fund's advisers, principal underwriters, administrators and transfer agents, and the fund's procedures must include provisions for the fund to oversee compliance by such service providers. Determining the appropriate standard of review, which not clearly defined in the new rules or the release, is one of the major challenges facing fund boards, advisers and their counsel in 2004. Directors may satisfy their obligations under the rule by reviewing summaries of compliance programs prepared by persons familiar with the programs and, in evaluating the compliance programs of a service provider, they may use a third-party report instead of the procedures themselves.

In addition to the areas discussed above with respect to advisers, the staff identified some other important areas of compliance for funds. These highlighted areas include:

- Pricing of portfolio securities and fund shares;
- Processing of purchase and redemption orders for fund shares;
- Identification of affiliated persons;
- Trading on the basis of non-public information;
- Compliance with fund governance requirements; and
- Market timing.

While the SEC identified these broad areas of compliance, the release does not provide any significant guidance as to the scope or nature of the procedures that funds and advisers will be required to adopt.

Annual Review

- A fund is required to review annually its policies and procedures and those of its service providers. Although the board is not required to conduct the review, it would have the benefit of the review in the fund's compliance officer's report.
- Each adviser must review its policies and procedures annually to determine their adequacy and effectiveness. Advisers should also consider the need for interim reviews in response to significant compliance events, changes in business arrangements and regulatory developments.

Chief Compliance Officer

- Each fund and adviser is required to appoint a chief compliance officer responsible for administering its policies and procedures. The release states that the chief compliance officer should have sufficient seniority and authority to develop and enforce compliance policies and to compel others to adhere to the policies. In the case of a fund, the chief compliance officer serves at the pleasure of, and reports directly to, the fund's board. He or she must provide the board annually with a written report on the operation of the fund's and its service providers' policies and procedures. At least annually, he or she also must meet with the fund's independent directors in executive session with no one representing fund management present. A fund's officers, directors, employees, adviser, principal underwriter, or any person acting under the direction of these persons, is prohibited from directly or indirectly taking action to coerce, manipulate, mislead or fraudulently influence the fund's chief compliance officer in the performance of his or her responsibilities under the rule. The Board must approve the designation of the chief compliance officer, approve the officer's compensation, and may remove the officer or prevent the officer's removal. However, the release recognizes that normally the chief compliance officer will also be an employee of one of the fund's service providers. The provisions of the chief compliance officer position present numerous practical and legal issues as well as potential conflicts of interests. You should begin considering now how this requirement will effectively be implemented. While not addressed by the release, this new position and its responsibilities raise liability issues for the designated officer.

New rule 38a-1 under the 1940 Act and amendments to rule 204-2 under the Advisers Act require funds and advisers to maintain copies of all policies and procedures that are in effect or were in effect at any time during the last five years. Funds must also maintain materials provided to the board in connection with its approval of the fund's and its service providers' policies and procedures and annual written reports by the fund's chief compliance officer. The effective date of the new rules is February 5, 2004; the compliance date is October 5, 2004. Consequently, by October 5, 2004, the board must have designated a chief compliance officer and funds and advisers must have reviewed and adopted comprehensive compliance policies. SEC Release No. IA-2204, IC-26299; File No. S7-03-03.

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

NASD proposes amendments to the “branch office” definition

January 2, 2004 10:52 AM

The SEC published for comment a proposal by the NASD to (1) amend NASD Rule 3010(g)(2) to revise the definition of the term “branch office”; and (2) to adopt IM-3010-1 to provide guidance on factors to be considered by a member firm in conducting internal inspections of offices. The NASD noted that the purpose of the proposed rule change is to facilitate the creation of a branch office registration system through the Central Registration Depository (“CRD”) to provide a centralized method for members to register branch office locations as required by the rules and regulations of states and self-regulatory organizations, including the NASD.

Currently, there is no uniform definition of the term “branch office” among the SEC, NASD, NYSE, and state securities regulators. As a result, the NASD has been working with the North American Securities Administrators Association (“NASAA”) and the NYSE to reduce the inconsistencies that currently exist to increase the utility of the CRD as a central branch office registration system.

The NASD’s proposed rule change would define a “branch office” as any location where one or more associated persons of a member regularly conduct the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security, or that is held out as such. The proposed rule change would exclude from registration as a branch office:

- a location that operates as a back office;
- a representative’s primary residence provided it is not held out to the public and certain other conditions are satisfied;
- a location, other than the primary residence, that is used for less than 30 business days annually for securities business, is not held out to the public as an office, and satisfies certain of the conditions set forth in the primary residence exception;
- a location of convenience used occasionally and by appointment;
- a location used primarily for non-securities business and from which less than 25 securities transactions are effected annually;
- the floor of an exchange; and
- a temporary location used as part of a business continuity plan.

The single difference of opinion among regulators on the issue of a common definition of branch office concerns the registration of certain primary residences as branch offices. The NASD and NASAA support a primary residence exception that provides for limitations on the activities (e.g., no holding out of the residence as a place to conduct securities business, and no handling of funds or securities at the location), that can be performed at a primary residence without triggering branch office registration. The NYSE, however, believes that under no circumstances should associated persons be permitted to engage in securities activities for more than 50 business days annually from their primary residences without requiring members to register such residences as branch offices. The NASD’s proposed definition does not include a similar 50 business day provision.

The SEC is soliciting comments on the NASD's proposed rules. In particular, the SEC noted that it is seeking views on the primary residence exception and the divergent proposals by NASD and the NYSE with respect to the NYSE's proposed annual 50-business day limitation on engaging in securities activities from a primary residence.

SEC Release No. 34-48897, December 9, 2003]

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

IRS CIRCULAR 230 DISCLOSURE:

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.