The Asset Management Industry
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DRAFT COMMENT LETTER ON SEC PROPOSALS REGARDING FINANCIAL EXPERTS, CODES OF ETHICS AND INTERNAL CONTROLS

[15370] November 19, 2002 TO: DIRECTOR SERVICES COMMITTEE No. 9-02 RE: DRAFT COMMENT LETTER ON SEC PROPOSALS REGARDING FINANCIAL EXPERTS, CODES OF ETHICS AND INTERNAL CONTROLS The Securities and Exchange Commission recently proposed amendments to certain forms under the Securities Exchange Act of 1934 and the Investment Company Act of 1940, and certain rules under the Investment Company Act, to implement the requirements of the Sarbanes-Oxley Act of 2002. Specifically, the proposals relate to Sections 406 (codes of ethics for senior financial officers) and 407 (disclosure of audit committee financial expert) of the Act. The proposals also would make technical changes to the Commission's rules and forms implementing Section 302 of the Act (corporate responsibility for financial reports). The Institute has prepared a draft comment letter on these proposals. A copy of the draft letter is attached and it is briefly summarized below. Because the proposal relating to disclosure of an audit committee financial expert was discussed at the most recent Director Services Committee meeting, we wanted to invite your comments on the Institute's draft letter. Your views on the other proposals are welcome, as well. The Institute intends to file its comment letter on November 26th. Please provide any comments you have to Frances Stadler at 202/326-5822 or frances@ici.org by Friday, November 22nd. Disclosure Regarding Audit Committee Financial Expert The Commission's proposal would require a registered management investment company to disclose annually on proposed Form N-CSR: (1) the number and names of persons that the board of directors has determined to be the financial experts serving on the investment company's audit committee; (2) whether the financial expert(s) are independent and if not, why not; and (3) if applicable, that the investment company does not have a financial expert serving on its audit committee, and an explanation of why. To qualify as a "financial expert," an investment company director would be required to have several specific attributes including, among others, experience preparing or auditing financial statements that present accounting issues that are generally comparable to those raised by the investment company's financial statements. 2 In response to the Commission's request for comments, the Institute's draft letter recommends revising the proposed definition with respect to investment companies so that a director's experience preparing or auditing financial statements that present issues that are generally comparable to those raised by the investment company's financial statements would be a factor to be considered, rather than a requirement that must be met in all cases. The draft letter argues that this change is appropriate because fund financial statements are relatively straightforward and because

the proposed definition in its current form would inappropriately limit the pool of candidates potentially qualified to serve as investment company financial experts. The draft letter also recommends that the Commission take further steps to give effect to its view that identification as a financial expert should not increase individual responsibility, obligation or liability. In addition, it recommends that the commission provide a transition period of eighteen months before requiring any new disclosure regarding financial experts, to allow investment companies that wish to do so sufficient time to recruit new directors to serve in that capacity. Disclosure Regarding Codes of Ethics The Commission's proposal would require investment companies to disclose annually in Form N-CSR or Form N-SAR, as applicable, whether each of the investment company, its investment adviser, and its principal underwriter has adopted a written code of ethics that applies to the principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions, of such entities. In addition, investment companies would be required to disclose any amendment made to or waiver granted from the code during the period covered by the report. The draft letter expresses strong support for the flexible approach of the proposal, under which companies would be permitted to design their own codes and develop appropriate procedures to ensure compliance with those codes. The letter recommends that the Commission clarify that the waivers from codes of ethics required to be disclosed are those that involve action (i.e., an express grant of permission) or inaction with respect to a known or reported violation of the code, either before or after such violation occurs. In response to the Commission's request for comment on the entities covered by the code of ethics disclosure requirements, the draft letter supports the proposal as drafted and opposes extending the requirements to fund administrators. The letter requests a twelve-month transition period before compliance with any new requirements with respect to codes of ethics is required. Technical Changes to Rules and Forms Implementing Section 302 The draft letter opposes the Commission's proposed revisions to Rule 30a-2 under the Investment Company Act of 1940 that would require an investment company's principal executive and financial officers to certify that they are responsible for establishing, maintaining and designing internal controls and procedures for financial reporting. It indicates that these changes constitute a "back door" application of Section 404 of the Sarbanes-Oxley Act to investment companies, directly contrary to Congressional intent. In addition, the letter urges the Commission to retain the current 90-day period within which investment companies must perform an evaluation of their disclosure controls and procedures before filing a report on Form 3 N-SAR or Form N-CSR. It notes that requiring such an evaluation "as of the end of the period covered by the report," as the Commission has proposed, would severely and inappropriately limit the ability of investment company complexes to use a single evaluation for certifications with respect to multiple funds, an approach that the Commission previously had endorsed. Marguerite C. Bateman Senior Associate Counsel Attachment (in .pdf format)
