

MEMO# 17809

July 23, 2004

SEC STAFF AFFIRMS ABILITY TO RELY ON SUMMARIES OF SERVICE PROVIDERS' POLICIES AND PROCEDURES UNDER RULE 38A-1

[17809] July 23, 2004 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 51-04 COMPLIANCE ADVISORY COMMITTEE No. 75-04 SEC RULES MEMBERS No. 105-04 SMALL FUNDS MEMBERS No. 81-04 UNIT INVESTMENT TRUST MEMBERS No. 32-04 TRANSFER AGENT ADVISORY COMMITTEE No. 64-04 OPERATIONS MEMBERS No. 28-04 RE: SEC STAFF AFFIRMS ABILITY TO RELY ON SUMMARIES OF SERVICE PROVIDERS' POLICIES AND PROCEDURES UNDER RULE 38A-1 Members of the Institute have inquired whether Rule 38a-1 under the Investment Company Act requires a fund's Chief Compliance Officer ("CCO") to obtain and review all of the policies and procedures of a fund's service providers (including subadvisers) or whether the CCO may rely instead on summaries that are prepared by the service provider or a third party.* The Institute has discussed this issue informally with the Commission's staff, who indicated that a CCO may rely on summaries when appropriate, as described below. According to the staff, the rule is intended to provide flexibility to the fund's CCO in determining what information she will review. The staff indicated that the CCO should consider the fund's compliance risk exposure in light of the operations and services provided by the service provider, as well as the fund's experience with the service provider. For example, under this risk-based approach, the staff would expect a CCO for a money market fund to review the Rule 2a-7 compliance policies and procedures of a subadviser hired to advise the fund because such policies and procedures address a core risk exposure of the fund. The CCO could, however, rely on summaries of policies and procedures in areas that do not present the same degree of compliance risk (e.g., the subadviser's code of ethics). Where a service provider presents limited risk exposure, the CCO could reasonably determine to rely on a summary of all of the service provider's policies and procedures. Examples of such circumstances could include where a subadviser manages a limited amount of the fund's assets or where, based upon the fund's long-standing relationship with a subadviser and the subadviser's experience, the CCO has confidence that the subadviser's policies and procedures are reasonably designed * Rule 38a-1 requires that a fund's board approve policies and procedures that are reasonably designed to prevent violations of the federal securities laws by the fund and its service providers. The rule charges the fund's CCO with the responsibility for administering the fund's policies and procedures and annually reporting to the fund's board on the operation of the compliance program of the fund and its oversight of the fund's service providers. 2 to prevent violations of the federal securities laws. The

staff emphasized that, as part of her diligent evaluation of the fund's service providers, the CCO must have a reasonable belief that the information she relies upon concerning their policies and procedures is sufficient to enable the fund's board to determine that such policies and procedures are reasonably designed to prevent violation of the federal securities laws. The Institute continues to follow issues relating to the implementation of Rule 38a-1. If you have any questions or issues relating to the rule's implementation, please contact the undersigned at either (202) 326-5825 or tamara@ici.org. Tamara K. Salmon Senior Associate Counsel

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