The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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INSTITUTE LETTER ON SEC PROPOSAL TO IMPLEMENT STANDARDS OF PROFESSIONAL CONDUCT FOR ATTORNEYS

[15468] December 18, 2002 TO: SEC RULES MEMBERS No. 114-02 CLOSED-END INVESTMENT COMPANY MEMBERS No. 69-02 COMPLIANCE ADVISORY COMMITTEE No. 113-02 INVESTMENT ADVISER MEMBERS No. 55-02 UNIT INVESTMENT TRUST MEMBERS No. 40-02 RE: INSTITUTE LETTER ON SEC PROPOSAL TO IMPLEMENT STANDARDS OF PROFESSIONAL CONDUCT FOR ATTORNEYS The Institute has filed a comment letter with the Securities and Exchange Commission on a proposed rule implementing the requirements in Section 307 of the Sarbanes-Oxley Act prescribing minimum standards of professional conduct for attorneys appearing and practicing before the Commission in the representation of issuers.1 The most significant aspects of the comment letter are summarized below. The comment letter states that the Institute has serious concerns with the potential impact of certain provisions of the proposed rule on investment companies. In particular, the comment letter states that the two aspects of the proposal that are most problematic are the Commission's treatment of attorneys representing an investment adviser to an investment company as jointly representing the investment company (the "Joint Representation Position") and the proposed rule's "reporting out" provisions. I. Attorneys for Investment Company Advisers The comment letter objects to the Joint Representation Position for several reasons. First, the Commission bases the Joint Representation Position on the fact that fund advisers have fiduciary duties to the funds they advise. The comment letter states that while true, it is also the case that funds and advisers are separate entities, each entitled to their own counsel, and in no area of the law do the fiduciary duties of care and loyalty cause the fiduciary's attorney to owe separately the professional responsibilities of legal representation to the person to whom the fiduciary duties are owed. 1 Memorandum to SEC Rules Members No. 105-02, Closed-End Investment Company Members No. 62-02, Compliance Advisory Committee No. 108-02, Investment Adviser Members No. 52-02 and Unit Investment Trust Members No. 37-02, dated November 27, 2002. 2 The comment letter also states that Section 307 does not require the Commission to adopt rules to implement the Joint Representation Position and that there is nothing in the legislative or administrative record to support adoption of the Position. In proposing the Joint Representation Position, the comment letter states that the Commission also has failed to take into account that the Investment Company Act and the rules thereunder already impose an array of requirements for fund advisers to report information to fund boards. Finally, the comment letter states that the Joint Representation Position could have serious and far-reaching consequences including undermining the attorney-

client privilege and severely damaging the ability of attorneys to conduct internal investigations or other internal compliance inquiries. The comment letter therefore recommends that the proposed rule be amended so that attorneys would be deemed to act “in the representation of” an investment company only insofar as they are employed or retained by the investment company itself, and not by the investment adviser. At a minimum, the letter recommends that the Commission should defer consideration of the applicability of Section 307 to attorneys for investment advisers to funds until it has had sufficient opportunity to thoroughly review this matter. II. “Reporting Out” Requirements The proposed rule would require each attorney appearing and practicing before the Commission in the representation of an issuer to give notice to the Commission of each attorney’s belief of any inappropriate response by the issuer to reported evidence of a material violation that is ongoing or has yet to occur. The rule would permit, but not require, each attorney to the issuer to do so where the material violation has already occurred but is not ongoing. The comment letter states that the proposed rule’s definition of “material violation,” in the context of investment companies, would capture much more than just criminal or fraudulent conduct; it also would encompass a host of substantive regulatory violations that are not the result of bad faith acts. The letter notes that the investment company industry has a successful record in resolving these types of violations through internal procedures and investigations that depend on the confidentiality of the attorneys conducting them. The “reporting out” provisions therefore may seriously damage the self-regulatory mechanisms that today effectively redress the overwhelming majority of violations of the Investment Company Act. The comment letter therefore recommends that the Commission amend the proposed rule so that these provisions would not apply to attorneys representing investment companies or, at the very least, defer adopting these requirements until it has had time to consider the issue more thoroughly. III. Additional Comments The comment letter notes that investment companies and their advisers employ a large number of persons who, though admitted to practice law, are not members of their firm’s legal department and do not act in their capacities as attorneys. The comment letter asserts that such persons should not be subject to the proposed rule’s reporting requirements and that to impose these requirements on such persons would be an unjustified expansion of the proposed rule’s reporting obligations. The letter therefore recommends that the Commission clarify that persons admitted to practice law but who do not serve in the legal department of an issuer or 3 do not act in their capacities as attorneys are not subject to the proposed rule’s reporting requirements. The letter also comments on several other aspects of the proposed rule. In particular, the letter states that the Commission should take greater time to consider the inclusion of non-U.S. attorneys “appearing and practicing” before the Commission in the representation of an issuer; the Commission should amend the proposed rule so that the rule’s written documentation requirements will not be independent grounds for enforcement and/or disciplinary action; and the Commission should expressly provide a “safe harbor” provision prohibiting private rights of action challenging an attorney’s decision to take, or not to take, action under the proposed rule. Ari Burstein Associate Counsel Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 15468, or call the ICI Library at (202) 326-8304 and request the attachment for memo 15468. Attachment (in .pdf format)