

**MEMO# 11204**

August 25, 1999

## **SEC ADOPTS AMENDMENTS TO RULE 17J-1 UNDER THE INVESTMENT COMPANY ACT**

1 Investment Company Act Release No. 23958 (August 20, 1999). 2 The amended rule clarifies that the board must approve the code of an investment adviser or principal underwriter only when the fund initially engages the investment adviser or principal underwriter and not upon each contract renewal. 1 [11204] August 25, 1999 TO: BOARD OF GOVERNORS No. 56-99 CLOSED-END INVESTMENT COMPANY MEMBERS No. 31-99 COMPLIANCE ADVISORY COMMITTEE No. 33-99 DIRECTOR SERVICES COMMITTEE No. 24-99 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 18-99 INVESTMENT ADVISER MEMBERS No. 15-99 SEC RULES MEMBERS No. 51-99 UNIT INVESTMENT TRUST MEMBERS No. 19-99 RE: SEC ADOPTS AMENDMENTS TO RULE 17j-1 UNDER THE INVESTMENT COMPANY ACT

The Securities and Exchange Commission ("SEC") has adopted amendments to Rule 17j-1 under the Investment Company Act of 1940. 1 Rule 17j-1 addresses conflicts of interest that arise from personal trading activities of investment company personnel. In particular, Rule 17j-1 prohibits fraudulent, deceptive or manipulative acts by fund personnel in connection with their personal transactions in securities held or to be acquired by the fund. The rule also requires funds and their investment advisers and principal underwriters ("rule 17j-1 organizations") to adopt a code of ethics containing provisions reasonably necessary to prevent fraudulent, deceptive or manipulative acts and requires certain persons to report their personal securities transactions to their rule 17j-1 organization. A copy of the SEC's adopting release is attached. The amendments are summarized below. Role of a Fund's Board of Directors Rule 17j-1 currently requires each rule 17j-1 organization to adopt a code of ethics but does not identify specific requirements for a fund's board of directors with respect to the codes. The amended rule, however, requires that a fund's board, including a majority of independent directors on the board, approve the fund's code and the code of any investment adviser or principal underwriter of the fund, as well as any material changes to the codes. 2 If an investment adviser or principal underwriter makes a material change to its code of ethics, the board will have six months in which to approve the material change. Under amended rule 17j-1, a fund's board 3 "Investment personnel" is defined in Rule 17j-1 to include portfolio managers and other employees of the fund or its investment adviser who participate in making investment recommendations to the fund as well as persons in a control relationship to the fund who obtain information about investment recommendations made to the fund. 2 must base its approval of a code of ethics, or a material change to a code, upon a determination that the code contains provisions reasonably necessary to prevent "access persons" (as defined in the rule) from

violating the anti-fraud provisions of the rule. The amended rule also requires that each rule 17j-1 organization report periodically to the board on issues raised under its code of ethics. Specifically, under the amended rule, the management of a rule 17j-1 organization, at least once a year, must provide the fund's board with a written report that (1) describes issues that arose during the previous year under the code or procedures applicable to the rule 17j-1 organization, including, but not limited to, information about material code or procedure violations and sanctions imposed in response to those material violations and (2) certifies to the fund's board that the rule 17j-1 organization has adopted procedures reasonably necessary to prevent its access persons from violating its code of ethics.

Reports by Access Persons Rule 17j-1 currently requires an access person to report personal securities transactions to his or her rule 17j-1 organization at least quarterly. The adopting release states that in order to improve the information that a rule 17j-1 organization currently receives under the rule, the amendments also will require initial and annual holdings reports from access persons. In particular, each access person will be required to provide an initial holdings report to its rule 17j-1 organization listing all securities beneficially owned by the access person no later than 10 days after he or she becomes an access person, as well as an annual holdings report containing information that must be current as of a date no more than 30 days before the report is submitted.

Amended Rule 17j-1 also requires the review of all securities transaction and holdings reports. Under the amended rule, the procedures instituted by a rule 17j-1 organization to prevent a violation of a code must include procedures requiring that appropriate management or compliance personnel of the rule 17j-1 organization review transaction and holdings reports submitted by access persons and that the rule 17j-1 organization maintain the names of the persons responsible for reviewing these reports.

Pre-Approval of Investments in IPOs and Private Placements Amended Rule 17j-1 requires the fund or its investment adviser to review and pre-approve any investment in an initial public offering ("IPO") or in a private placement by "investment personnel."<sup>3</sup> The adopting release states that the amendments do not prohibit these investments because, according to the SEC, there may be situations in which an investment in these offerings does not raise the types of conflicts that the rule is designed to address. Amended rule 17j-1 also requires funds and investment advisers to retain a record of the approval of, and the rationale supporting, any direct or indirect acquisition by investment personnel of a beneficial interest in securities in an IPO or private placement.

Disclosure of Policies Concerning Personal Investment Activities Rule 17j-1 currently does not require funds to disclose publicly any information about their codes of ethics. Under the amended rule, however, each fund will be required to disclose the following information in its registration statement (the disclosure may be in the Statement of Additional Information): (1) that the fund and its investment adviser and principal underwriter have adopted codes of ethics; (2) whether these codes permit fund personnel to invest in securities for their own accounts; and (3) that the codes are on public file with, and are available from, the SEC. The amended rule also requires a fund to file with the SEC, through the SEC's EDGAR system, all codes of ethics applicable to the fund as an exhibit to its registration statement.

Excepted Securities and Funds Rule 17j-1 currently excepts from the rule's requirements transactions in certain money market instruments, certain U.S. Government securities, and securities issued by mutual funds. The amended rule expands these exceptions to cover a wider range of money market instruments, and to exclude from the rule's requirements all money market funds, as well as their investment advisers and principal underwriters. As a result, under the amended rule, all funds that are money market funds, or that limit their investments to certain money market instruments, certain U.S. Government securities and securities of other mutual funds, will not be required to adopt codes of ethics. In addition, access persons of these organizations will not be required to make holdings or transaction reports to their rule 17j-1 organization. Access

persons of rule 17j-1 organizations that are required to adopt codes of ethics under the rule also will not have to file transaction reports concerning transactions in these instruments or report them in their initial or annual holdings reports. Conforming Amendments to Advisers Act Rules The Commission is revising Rule 204-2(a) under the Investment Advisers Act to conform that rule's requirements to those of Rule 17j-1. The SEC also is adding an exception to the recordkeeping requirements under Rule 204-2(a) to allow an investment adviser not to make certain records under the rule if the information required under Rule 204-2(a) would duplicate information contained in a broker trade confirmation or account statement received and kept by the investment adviser. Effective Date and Compliance Dates The amendments to Rule 17j-1 will become effective October 29, 1999. The adopting release states that in order to permit the individuals and entities that are subject to Rule 17j-1 sufficient time to comply with the new provisions and to avoid conflicts with plans to address Y2K issues, the SEC is providing transition time for several of the new requirements. The following are the compliance dates for the various requirements under amended Rule 17j-1. 1. March 1, 2000 No later than March 1, 2000, rule 17j-1 organizations must have: (1) identified access persons and notified them of their reporting obligations; (2) adopted procedures for management or compliance personnel to review transaction and holdings reports; and (3) established a record of access persons who are required to make transaction and holdings reports, and of persons who are responsible for reviewing those reports. After March 1, 2000, investment personnel may not directly or indirectly acquire any beneficial interest in securities in an IPO or in a private placement without prior approval from the fund or the fund's investment adviser, and the fund and investment adviser must retain records of the approval and reasons for granting the approval. In addition, each person who becomes an access person on or after 4March 1, 2000 must file his or her initial holdings report with his or her rule 17j-1 organization within 10 days after becoming an access person. Finally, in the next post-effective amendment filed by a fund after March 1, 2000, the fund must file copies of codes of ethics of the rule 17j-1 organizations as an exhibit to the registration statement, and disclose certain information about those codes. 2. April 10, 2000 Each quarterly transaction report filed for the calendar quarter ending March 31, 2000 and for subsequent quarters must include all information required under the amended rule. Additional information required under the amended rule includes: (1) the date that the quarterly transaction report is filed; (2) the name of any covered securities account established by the access person during that quarter; and (3) the date the account was established. 3. September 1, 2000 No later than September 1, 2000: (1) each fund's board must have approved the codes of ethics of the fund, its investment advisers and principal underwriters; (2) each rule 17j-1 organization must have provided the fund's board with the first of its annual issues and certification reports; and (3) each access person must have provided the first of his or her annual holdings reports to his or her rule 17j-1 organization. Ari Burstein Assistant Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11204. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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