

MEMO# 18930

June 8, 2005

ICI LETTERS TO GAO AND HOUSE SUBCOMMITTEE ADDRESSING CONCERNS WITH RECENT GAO REPORT ON MUTUAL FUND ABUSES

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [18930] June 8, 2005 TO: BOARD OF GOVERNORS No. 28-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 46-05 COMPLIANCE ADVISORY COMMITTEE No. 43-05 PRIMARY CONTACTS - MEMBER COMPLEX No. 25-05 SEC RULES MEMBERS No. 76-05 SMALL FUNDS MEMBERS No. 55-05 RE: ICI LETTERS TO GAO AND HOUSE SUBCOMMITTEE ADDRESSING CONCERNS WITH RECENT GAO REPORT ON MUTUAL FUND ABUSES In April of this year, the Government Accountability Office (GAO) published a report on the lessons learned from the recent mutual fund trading abuses.* The Institute has written to the GAO expressing concern with two points discussed in the Report. The Institute's first concern relates to the GAO Report's absence of a full discussion of the actions taken by funds prior to the scandal to address concerns with market timing. As a result of this omission, the Institute believes that the GAO Report leaves the impression that most funds failed to take necessary actions to prevent or deter market timing – rather than just the few funds that were implicated in the scandals. The Institute's second concern relates to the discussion in the GAO Report of the new compliance rule of the Securities and Exchange Commission, Rule 38a-1 under the Investment Company Act of 1940. In particular, the GAO Report expresses concern about the ability of those fund chief compliance officers (CCOs) who are employed by the fund's investment adviser to be independent and effective. The Institute's letter notes that, like the Commission, we are concerned that precluding a fund's CCO from being employed by the fund's investment adviser might actually make the CCO less effective in that the CCO may wind up divorced from all fund operations. Also, as previously noted by the Commission, such a prohibition would be costly for funds, particularly small funds. * See Report to the Committee on the Judiciary, House of Representatives, Mutual Fund Trading Abuses: Lessons Can Be Learned from SEC Not Having Detected Violations at an Earlier Stage, Government Accountability Office (April 2005) ("GAO Report"), which was summarized in Institute Memorandum to Board of Governors No. 17-05, Chief Compliance Officer Committee No. 35-05, Compliance Advisory Committee No. 31-05, Primary Contacts – Member Complex No. 16-05, SEC Rules Members No. 53-05, and Small Funds Members No. 36-05 [18801], dated April 27, 2005. 2 The Institute's letter also expresses concern with the GAO Report's recommendation that the annual self-assessments required of fund CCOs under Rule 38a-1 be filed with the Commission. According to the letter, requiring such routine filing would likely detract from

the reports' candor, minimize their value to fund boards, and, by requiring their review by Commission staff, further strain the Commission's limited resources. In addition, the Commission's review of such documents would take place outside of an onsite inspection of the firm in which the Commission staff can consider the self-assessment in the context of the firm's overall compliance program. This would further limit the utility of requiring the routine filing and review of such reports. On June 7th, the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee held a hearing on the GAO Report. In anticipation of this hearing, a copy of the Institute's letter to the GAO was sent to the Chairman and Ranking Member of this Subcommittee. A copy of the letters to the GAO and to the Chairman and Ranking Member of the Subcommittee is attached. Tamara K. Salmon Senior Associate Counsel Attachment (in pdf format) Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 18930, or call the ICI Library at (202) 326-8304 and request the attachments for memo 18930.

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