

MEMO# 15820

March 28, 2003

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

[15820] March 28, 2003 TO: SEC RULES COMMITTEE No. 29-03 COMPLIANCE ADVISORY COMMITTEE No. 26-03 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 20-03 UNIT INVESTMENT TRUST COMMITTEE No. 9-03 RE: DRAFT INSTITUTE LETTER ON SEC PROPOSAL TO IMPLEMENT STANDARDS OF PROFESSIONAL CONDUCT FOR ATTORNEYS As we previously informed you,¹ the Securities and Exchange Commission issued a release requesting comments on a proposed rule prescribing minimum standards of professional conduct for attorneys appearing and practicing before the Commission in the representation of issuers. In particular, the release extends the comment period for, and proposes an alternative to, the provisions of the proposed rule relating to an attorney's obligation to notify the Commission when that attorney, after reporting evidence of a material violation "up the ladder" within an issuer, reasonably believes the issuer has made no response or has not made an appropriate response ("noisy withdrawal"). The Institute has prepared a draft comment letter (attached) on the proposal, the most significant aspects of which are summarized below. Comments on the proposed rule must be received by the SEC no later than April 7. If you have any comments on the draft Institute letter, please provide them to the undersigned by phone at (202) 371-5408, by fax at (202) 326-5841, or by e-mail at aburstein@ici.org no later than April 3. In general, the draft letter states that the Institute continues to have concerns with the "noisy withdrawal" provisions. If the Commission determines to move forward with the proposal, however, the draft letter recommends that it should adopt the proposed alternative, which would require the issuer, rather than the attorney, to report to the Commission an attorney's notice, subject to several recommendations regarding the alternative. 1 Memorandum to SEC Rules Members No. 15-03, Compliance Advisory Committee No. 11-03, Closed-End Investment Company Members No. 12-03 and Unit Investment Trust Members No. 4-03, dated February 6, 2003. 2 I. "Noisy Withdrawal" Provisions Under the "noisy withdrawal" provisions, if an outside attorney retained by the issuer makes a "noisy withdrawal," that attorney is required to withdraw from representing the issuer; an in-house attorney under the same circumstances is not required to resign. The Commission specifically resolicited comment on whether an attorney who is employed by an investment adviser and who is representing the investment company before the Commission should be treated as an outside attorney retained by the investment company or an in-house attorney. As a preliminary matter, the draft letter reiterates the Institute's position that attorneys representing an investment adviser to an investment company do not jointly represent the investment company.

Nevertheless, the draft letter states that for purposes of this provision, an attorney employed by an investment adviser should be considered an in-house attorney of the investment company. If this were not the case, it would be disruptive if that attorney would be required to resign from his position because of the rule.

II. Alternative Proposal to “Noisy Withdrawal” Provisions

The draft letter states that the alternative proposal is preferable to the “noisy withdrawal” provisions because, at least on its face, it avoids direct conflict with an attorney’s duties of confidentiality and privilege. If the Commission determines to adopt the alternative proposal, however, the draft letter recommends several changes to that proposal to facilitate compliance with the rule.

A. Determination by Committee of Independent Directors

The Commission requests comment on whether an issuer should not be required under the rule to disclose an attorney’s written notice where a committee of independent directors of the issuer’s board determines, based on the advice of counsel that was not involved in the matters underlying the reported material violation, (i) that the attorney providing the written notice acted unreasonably in providing the notice, or (ii) that the issuer has, subsequent to the written notice, implemented an appropriate response. The draft letter strongly supports allowing such a determination by a committee of independent directors. Nevertheless, the letter recommends that several changes and clarifications be made to this provision prior to the rule’s adoption. First, the letter recommends that the Commission revise the standard under which the committee would have to make its determination in order to eliminate ambiguity surrounding the determination by the committee. The draft letter also recommends that the Commission clarify that directors who are not “interested persons” as defined in Section 2(a)(19) of the Investment Company Act would be considered “independent” for purposes of the rule and that once directors qualify as “independent” for purposes of the Act, those directors will remain “independent” for purposes of the rule.

B. Form 8-K Filing Requirement

The proposal would require an issuer that has received notice from an attorney to notify the Commission on Form 8-K within two business days of receiving the notice. The draft letter urges the Commission not to adopt the proposed Form 8-K filing requirement for investment 3 companies and instead create a new form specifically for investment companies. The draft letter states that a new form would be more appropriate and less confusing for investment companies in meeting their disclosure obligations under the rule. In addition, the draft letter states that two business days after receiving notice from an attorney is not an appropriate amount of time in which to require investment companies or other issuers to make the necessary filing under the rule. In particular, if the provision relating to the determination by the committee of independent directors is adopted, two days would be an insufficient time within which reasonably to expect the independent directors and their counsel to investigate the circumstances giving rise to the attorney’s report and make substantive determinations. Moreover, the draft letter states that a fixed two-day period of time does not provide the necessary flexibility to deal with various situations that may arise under the rule. The draft letter therefore recommends that an issuer be required to notify the Commission “promptly” after receipt of an attorney’s written notice.

Ari Burstein Associate Counsel Attachment (in .pdf format)