

**MEMO# 14262**

December 20, 2001

## **SEC SPEECHES AT 2001 SECURITIES LAW DEVELOPMENTS CONFERENCE**

[14262] December 20, 2001 TO: COMPLIANCE ADVISORY COMMITTEE No. 68-01 SEC RULES MEMBERS No. 83-01 SMALL FUNDS MEMBERS No. 37-01 RE: SEC SPEECHES AT 2001 SECURITIES LAW DEVELOPMENTS CONFERENCE Paul F. Roye, Director of the SEC's Division of Investment Management, delivered the keynote address at the Institute's 2001 Securities Law Developments Conference. Stephen M. Cutler, Director of the SEC's Division of Enforcement, spoke at the conference luncheon. Copies of their speeches are attached, and they are summarized below. Paul Roye's Remarks In his speech, Mr. Roye stated the fund industry has been going through "a remarkable period of change," spurred by the market downturn, the tragic events of September 11th, continued consolidation within the fund industry, and the appointment of a new SEC chairman. To illustrate Chairman Pitt's desire to "bring securities regulation into the 21st Century," Mr. Roye highlighted the SEC's proposed amendments to Rule 17a-8, which would significantly expand the rule to allow mergers of funds affiliated for any reason, as well as facilitate mergers of bank common trust funds and collective trust funds into registered investment companies. On the topic of technology and new products, Mr. Roye stated that "the Commission staff will not stand in the way of innovation, as long as investor protections are not compromised." He noted that the Commission accelerated the effectiveness of an "electronic- only" variable annuity - the first product of its kind - that will deliver all of its documentation, including prospectuses, proxy statements and transaction confirmations electronically, without a paper backup. He also stated that "the Commission is currently reviewing whether its guidance regarding electronic delivery of information under the federal securities laws should be modified." Mr. Roye further noted that the Commission recently issued a concept release seeking industry input on actively managed exchange-traded funds so that they can evaluate these proposed products with the benefit of the industry's perspective and experience. Mr. Roye provided assurance that the Commission views itself as a service agency, and that the Division of Investment Management is committed to helping the industry. He noted that "one of the industry's biggest complaints is that it takes too long to get exemptive applications and no-action letters through the regulatory pipeline." He indicated that the 2 Commission will now be able to act with more flexibility in these areas and rely on the "sound judgment of independent directors, now that the Commission has acted to enhance the independence and effectiveness of directors." He encouraged the industry to assist the staff in expediting these processes by providing the Division with requests that identify and thoroughly address all issues. In the aftermath of September 11th, Mr. Roye stressed the importance of contingency planning, and warned funds to expect inspections staff to look at contingency plans and ask questions about alternative physical facilities, back-up records storage, and back-up communications systems, as well as the extent to which funds test and evaluate contingency preparedness. He also encouraged funds to "reassess their fair

valuation procedures in light of the events of September 11th,” to ensure that they can continue to appropriately value securities in the wake of any disaster. Stephen Cutler’s Remarks In his address, Mr. Cutler first summarized several recent Commission enforcement actions, highlighting the lessons to be gained regarding the duty to supervise, namely: (i) a firm can outgrow its supervisory procedures; (ii) market conditions and the market environment must be considered when evaluating supervisory procedures; (iii) good supervision requires functional separation so that the person conducting the business function is not the sole person responsible for supervision of that function; and (iv) supervision does not necessarily stop at organizational boundaries. Noting in particular that advisors are responsible for the actions of their subadvisers, Mr. Cutler provided some policies and procedures advisers should consider adopting to supervise a subadviser, including the following: (a) obtain annual certifications of compliance from employees of the subadviser; (b) conduct periodic meetings with compliance personal at the subadviser; (c) require the subadviser to provide notice of regulatory examinations and copies of any exam reports, and implement procedures to follow-up on any troubling findings in the reports; and (d) periodically reassess supervisory procedures applicable to the subadviser. Mr. Cutler also focused on Chairman Pitt’s introduction of a “real-time” enforcement program. He explained that the program seeks to respond quickly, effectively, and efficiently to wrongdoing, and will consist of taking actions to stop fraud or other investor harm expeditiously, bringing cases in pieces, and obtaining TROs and orders freezing assets. He further noted that the program will reward meaningful cooperation “because doing so will enable [the Commission] to bring more cases faster.” Mr. Cutler emphasized that this does not mean that the Commission will be less than vigorous in enforcing the securities laws or “enable any issuer to violate the law without repercussions, so long as after the fact the company self- reports.” He further stressed that self-reporting is not the only prerequisite for the Commission to extend credit for cooperation – the Commission “will look to the company’s actions both before an after discovery of misconduct, including the rigor of its compliance and/or internal audit program and the tone set by senior management.”<sup>3</sup> In conclusion, Mr. Cutler summarized his message as “hope for the best, but plan for the worst.” He noted that the “mutual fund community has a long history of good supervision as well as cooperation in the broad sense of that term” and encouraged the industry to continue “to build on and nurture that reputation.” Doretha VanSlyke Zornada Associate Counsel Attachments 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 14262, or call the ICI Library at (202) 326-8304 and request the attachments for memo 14262. Attachment no. 1 (in .pdf format)