COMMENT LETTER

February 24, 2003

Institute Sends Letter to Congress Addressing Effective SEC Regulation (pdf)

February 21, 2003 The Honorable Michael G. Oxley Chairman Committee on Financial Services U.S. House of Representatives 2129 Rayburn House Office Building Washington, D.C. 20515 The Honorable Richard H. Baker Chairman Subcommittee on Capital Markets, Insurance & GSEs Committee on Financial Services U.S. House of Representatives 2129 Rayburn House Office Building Washington, D.C. 20515 Dear Chairman Oxley and Chairman Baker: Your February 14th letter to SEC Chairman Donaldson stated that the protection of mutual fund investors should be at the forefront of the SEC's agenda. We agree completely. That is why we have repeatedly expressed our support for strong and effective SEC regulation, substantially increased SEC funding and pay parity for SEC staff. Before the close of the last Congress, we urged leaders in both Houses to appropriate the full level of increased SEC funding authorized in the Sarbanes-Oxley Act.1 Our support for additional SEC resources is based on our longstanding conviction that strong and effective regulation of the securities marketplace generally and mutual funds in particular benefits fund shareholders and the fund industry. Your letter also said that your "objective is to extend the reforms of Sarbanes-Oxley – greater transparency and accountability – to the fund industry." As you know, most of the Act's key provisions already extend to mutual funds. Enclosed is a list that identifies many of the important reforms established by the Act that apply to mutual funds. Equally significant, the regulatory system governing mutual funds already embraces the transparency and accountability principles that underlie the Sarbanes-Oxley Act. 1 Letter from Matthew P. Fink, ICI President, to The Hon. Dennis Hastert, Speaker, U. S. House of Representatives, October 10, 2002 . Text available at at http://www.ici.org/statements/cmltr/2002/02_house_sec_funding_com.html. The Honorable Michael G. Oxley The Honorable Richard H. Baker February 21, 2003 Page 2 The Investment Company Act of 1940 requires mutual funds to calculate the value of their shares, on a mark-to-market basis, every business day. Mutual fund accounting principles and financial statements are straightforward. Among other things, mutual funds are flatly prohibited from using off-balance sheet entities and complex capital structures. Mutual funds are the only companies required by federal law to have independent directors on their boards. Moreover, various SEC rules make it a virtual necessity for mutual funds to have a majority of independent directors. These same rules also require that a mutual fund's independent directors be nominated and selected by incumbent independent directors, not by fund managers. The Investment Company Act strictly prohibits mutual funds from engaging in self- dealing transactions. Moreover, the mutual fund industry has fought to maintain strict prohibitions in the face of repeated proposals to repeal or weaken

them. Every investor who purchases mutual fund shares receives a plain English prospectus. The SEC carefully designed the format of fund prospectuses (and requires strict adherence to this design) to focus an investor's attention on the most important issues relevant to an investment decision. Indeed, as public attention to corporate reform issues has grown, some observers have noted that the mutual fund industry's governance and investor protection standards "read like a blueprint for the guidelines publicly traded companies are only now being urged to follow.2 The frauds and egregious conduct that led to the enactment of the Sarbanes-Oxley Act clearly have shaken investor confidence in the integrity of our financial markets. Fortunately, mutual funds have remained largely free of scandal. We believe this record is due to the fact that funds are, and have been for over 60 years, subject to stringent regulation under the Investment Company Act and effective and direct oversight by the SEC. As we have in the past, we will continue to support regulatory initiatives that offer real hope of enhancing the strong protections already enjoyed by mutual fund investors and restoring the trust and confidence that have made American capital markets the envy of the world. Sincerely, 2 See, e.g., Beth Healy, "A Model of Independence: Guidelines For Mutual Funds Might Have Prevented Recent Corporate Troubles," The Boston Globe, July 5, 2002. The Honorable Michael G. Oxley The Honorable Richard H. Baker February 21, 2003 Page 3 cc: The Honorable William Donaldson Chairman, U.S. Securities and Exchange Commission The Honorable Paul Atkins Commissioner, U.S. Securities and Exchange Commission The Honorable Raul Campos Commissioner, U.S. Securities and Exchange Commission The Honorable Cynthia Glassman Commissioner, U.S. Securities and Exchange Commission The Honorable Harvey Goldschmid Commissioner, U.S. Securities and Exchange Commission Mr. Paul F. Roye Director, Division of Investment Management Attachment Provisions of the Sarbanes-Oxley Act That Apply to Mutual Funds • Pursuant to Section 201 of the Act, a mutual fund's auditors are subject to the restrictions on certain non-audit services and the requirement to approve other non-audit services. In fact, the SEC extended the scope of this provision to cover services performed for the mutual fund's adviser and other affiliates. • Pursuant to Section 202 of the Act, the pre-approval requirements for audit committees apply to mutual funds. • Pursuant to Section 203 of the Act, rotation requirements for audit partners apply to the auditors of mutual funds. • Pursuant to Section 204 of the Act, the reporting requirements for auditors apply to the auditors of mutual funds. • Pursuant to Section 206 of the Act, the employment restrictions applicable to auditors and their clients apply to mutual funds and their auditors. • Pursuant to Section 301 of the Act, audit committee requirements for listed companies are applicable to listed closed-end funds. • Pursuant to Section 302 of the Act, periodic reports of funds must be certified by the fund's principal executive officer and principal financial officer. • Pursuant to Section 303 of the Act, the prohibition on improperly influencing audits applies to mutual funds. • Pursuant to Section 306 of the Act, restrictions on insider trading during blackout periods apply to apply to directors and officers of funds. • Pursuant to Section 307 of the Act, rules regarding attorney conduct apply to attorneys representing mutual funds. In fact, the SEC extended the scope of these rules and applied them to certain attorneys representing mutual fund advisers. • Pursuant to Section 403 of the Act, the enhanced disclosures required for insider transactions apply to closed-end funds. • Pursuant to Section 406 of the Act, disclosure requirements regarding code of ethics apply to mutual funds. It is also notable that, prior to the enactment of the Sarbanes-Oxley Act, funds already were required, under Section 17(j) of the Investment Company Act, to adopt codes of ethics. • Pursuant to Section 407 of the Act, disclosure requirements regarding the presence of a "financial expert" on the audit committee apply to mutual funds. • Pursuant to Section 906 of the Act, mutual fund officers responsible for certifying periodic reports will be subject to the same criminal liability as officers of operating companies, as of the date when recently adopted SEC rules take effect.