

ethics pursuant to rule 17j-1 under the Investment Company Act, and that in any event, investment companies are highly regulated under the Investment Company Act, which addresses the underlying ethical concerns substantively rather than simply through disclosure.⁵⁹

We continue to believe, however, that the rule should apply with equal force to investment companies and operating companies, and we note that the Sarbanes-Oxley Act does not distinguish between them with respect to the code of ethics requirements. We recognize that rule 17j-1 currently requires investment companies, and their investment advisers and principal underwriters, to adopt codes of ethics designed to prevent fraud resulting from personal trading in securities by portfolio managers and other employees. The amendments we are adopting today, however, will address a broader range of conduct, including disclosure provided in filings with the Commission; compliance with governmental laws, rules, and regulations; and ethical conduct generally, including the ethical handling of actual or apparent conflicts of interest.⁶⁰

The rules we are adopting will require disclosure of an investment company's code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the investment company or a third party.⁶¹ Our proposed rules would also have required disclosure of certain codes of ethics of an investment company's investment adviser and principal underwriter that apply to the adviser's and underwriter's principal executive officer and senior financial officers.⁶²

We are persuaded by commenters that including codes of ethics of the investment adviser and principal underwriter goes beyond the intended scope of Section 406. In large financial services organizations, the principal executive officer and senior financial officers may have little to do with the

operations or financial reporting of the investment company, but are instead responsible principally for the adviser's or underwriter's own operations and financial reporting.

In addition, we have determined to exclude UITs from the code of ethics disclosure requirements. Because UITs are unmanaged, passive investment companies, they typically do not have principal executive officers, principal financial officers, principal accounting officers or controllers, or persons performing similar functions. In light of the fact that we have limited the rules we are adopting to these persons, we believe that it is appropriate to exclude UITs from the disclosure requirements. We note that we have provided a similar exclusion to issuers of asset-backed securities.⁶³

C. Section 407 of the Sarbanes-Oxley Act—Audit Committee Financial Experts

We are adopting, with modifications to address commenters' concerns, our proposals that implement Section 407 of the Sarbanes-Oxley Act with respect to registered management investment companies. These requirements are similar to those that we recently adopted for operating companies, and we direct investment companies to that release for guidance concerning these requirements.⁶⁴ Under the provisions that we are adopting, a registered management investment company must disclose annually that its board of directors has determined that the company either: (i) Has at least one "audit committee financial expert" serving on its audit committee, and if so, the name of the expert and whether the expert is "independent"; or (ii) does not have an audit committee financial expert serving on its audit committee. An investment company disclosing that it does not have an audit committee financial expert must explain why it does not have such an expert.⁶⁵

The rules, as adopted, reflect modifications that are similar to those that we recently made to the proposed financial expert disclosure requirements for operating companies, for the reasons

described in the release adopting these disclosure requirements for operating companies. These modifications include:

- Use of the term "audit committee financial expert" rather than "financial expert;"⁶⁶
- Modification of the proposals that would have required disclosure of the number and names of audit committee financial experts serving on a company's audit committee to more closely track the language used in Section 407 of the Sarbanes-Oxley Act, and to require a company to disclose that its board of directors has determined that the company either has at least one audit committee financial expert serving on its audit committee or does not have an audit committee financial expert serving on its audit committee;⁶⁷
- Modification of the proposals to permit, but not require, an investment company to disclose that it has more than one audit committee financial expert on its audit committee. Therefore, once an investment company's board determines that a particular audit committee member qualifies as an audit committee financial expert, it may, but is not required to, determine whether additional audit committee members also qualify as experts. Every investment company subject to the audit committee disclosure requirements would, however, have to determine whether or not it has at least one audit committee financial expert; a company will not satisfy the new disclosure requirements by stating that it has decided not to make a determination or by simply disclosing the qualifications of all of its audit committee members. Furthermore, if the company's board determines that at least one of the audit committee members qualifies as an expert, the company must accurately disclose this fact. It will not be appropriate for a company to disclose that it does not have an audit committee financial expert if its board has determined that

⁵⁹ 17 CFR 270.17j-1.

⁶⁰ General Instruction D to Form N-CSR permits a registered management investment company to incorporate its code of ethics by reference from another document, such as its registration statement. See Item 23(p) of Form N-1A; Item 24.2.r of Form N-2; Item 28(b)(17) of Form N-3 (requiring codes of ethics required by rule 17j-1 to be filed as exhibits to registration statements).

⁶¹ Item 2 of Form N-CSR; Instruction 102P3(a) of Form N-SAR.

⁶² Section 406/407 Proposing Release, *supra* note, 67 FR at 66217.

⁶³ See Instruction 3 to Item 406 of Regulation S-K [17 CFR 229.406]; Section II.D., "Asset-Backed Issuers," in Section 406/407 Adopting Release, *supra* note 8.

⁶⁴ See Section II.A., "Audit Committee Financial Experts," in Section 406/407 Adopting Release, *supra* note 8.

⁶⁵ Registered management investment companies other than SBICs will be required to provide the audit committee financial expert disclosure in Item 3 of Form N-CSR. SBICs will be required to provide this disclosure in an exhibit to Form N-SAR, pursuant to Instruction 102P3(b) of Form N-SAR (SBICs).

⁶⁶ Item 3 of Form N-CSR; Instruction 102P3(b) of Form N-SAR; Section II.A.1, "Title of the Expert," in Section 406/407 Adopting Release, *supra* note 8. Throughout this release, we refer to both "audit committee financial experts" and "financial experts" as appropriate in a particular context. For example, when discussing statutory provisions, we refer to "financial experts." For purposes of the discussions in this release, the meanings of these terms are identical.

⁶⁷ Item 3(a)(1) of Form N-CSR; Instruction 102P3(b)(1) of Form N-SAR; Section II.A.2, "Disclosure of the Number and Names of Audit Committee Financial Experts," in Section 406/407 Adopting Release, *supra* note 8.