

of the Sarbanes-Oxley Act of 2002. In addition, we are providing that, for registered management investment companies other than small business investment companies, Form N-SAR will be filed under the Investment Company Act of 1940 only and not the Securities Exchange Act of 1934. We are also removing the requirement that Form N-SAR be certified by a registered investment company's principal executive and financial officers. Furthermore, we are adopting a new rule to require every registered management investment company, other than small business investment companies, to maintain disclosure controls and procedures designed to ensure that the information required in reports on Form N-CSR is recorded, processed, summarized, and reported on a timely basis. Finally, we are requiring registered management investment companies to include new disclosures on Form N-CSR or Form N-SAR, as appropriate, in order to implement the requirements of Sections 406 and 407 of the Sarbanes-Oxley Act of 2002. First, the rules require a management investment company to disclose whether it 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 of management. A management investment company that does not have an audit committee financial expert must disclose this fact and explain why it has no such expert. Second, the rules require a management investment company to disclose whether it has adopted a code of ethics that applies to the company's principal executive officer and senior financial officers, or persons performing similar functions, regardless of whether they are employed by the management investment company or a third party. A management investment company disclosing that it has not adopted such a code must disclose this fact and explain why it has not done so. A management investment company also will be required to disclose amendments to, and waivers from, the code of ethics relating to any of those officers.

A. Need for, and Objectives of, Amendments

The purpose of the new rules and rule and form amendments is to more fully implement the intent of Section 302 of the Sarbanes-Oxley Act that we adopt rules requiring the officers of investment companies to certify the accuracy of their periodic reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act.

The amendments will require registered management investment companies to file with the Commission certified shareholder reports on Form N-CSR, and will designate these reports as filings which satisfy the reporting requirements of Sections 13(a) and 15(d) of the Exchange Act for management investment companies. We believe that by requiring the certification required by Section 302 of the Sarbanes-Oxley Act to be included in a management investment company's certified shareholder report on Form N-CSR, which contains financial statements, we are more fully implementing the intent of Section 302, which is to improve the quality of the disclosure that companies provide about their financial condition in their shareholder reports. In addition, we are adopting new disclosure requirements required to comply with Sections 406 and 407 of the Sarbanes-Oxley Act.

B. Significant Issues Raised by Public Comment

In both the IRFA for the release proposing Form N-CSR and the IRFA for the release proposing to implement Sections 406 and 407 of the Sarbanes-Oxley Act, we requested comment on any aspect of the IRFAs, including the number of small entities that would be affected by the proposal, the nature of the impact, how to quantify the numbers of small entities that would be affected, and how to quantify the impact of the proposals. We received one comment letter concerning the IRFA for the release proposing Form N-CSR. The commenter raised a concern that more flexible alternatives should have been considered for small investment companies (such as not mandating Form N-CSR or new reporting requirements at all) because a small amount of fraud is committed by such investment companies. We note that Congress' mandate for the Commission to require the certification specified by Section 302 of the Sarbanes-Oxley Act does not distinguish between small and large investment companies. Further, our disclosure rules generally do not distinguish between small and large investment companies. While we have the discretion to require that only larger investment companies file new Form N-CSR, it would not be appropriate to provide investors in larger investment companies with greater confidence in the accuracy and completeness of the disclosure contained in the annual and semi-annual reports that they receive from their investment companies, but not investors in small investment companies.

C. Small Entities Subject to the Rule

The new rules and rule and form amendments will affect registered investment companies that are small entities. For purposes of the Regulatory Flexibility Act ("RFA"), an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.¹¹⁹ We estimate that there are approximately 205 investment companies together with other investment companies in the same group of related investment companies that have net assets of \$50 million or less as of the end of its most recent fiscal year.¹²⁰

D. Reporting, Recordkeeping, and Other Compliance Requirements

The new rules and rule and form amendments will require management investment companies to file certified shareholder reports on Form N-CSR, containing (i) a copy of any required shareholder report, (ii) additional information regarding disclosure controls and procedures, and (iii) the certification required by Section 302 of the Sarbanes-Oxley Act. The form of the certification will parallel the form of the certification we adopted on Form N-SAR, and on Forms 10-K and 10-Q. The certification will require the management investment company's principal executive and financial officers to state, in part, that, based on their knowledge, the information in the certified shareholder report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading with respect to the period covered by the report, and that the financial statements, and other financial information included in the report, fairly present the financial condition, results of operations, changes in net assets, and cash flows (if the financial statements are required to include a statement of cash flows) of the registrant. The certification also will require the signing officers to certify that they have established and maintained disclosure controls and procedures to ensure that material

¹¹⁹ 17 CFR 270.0-10.

¹²⁰ This estimate is based on figures compiled by the Commission staff regarding investment companies registered on Form N-1A, Form N-2, and Form N-3. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are aggregated with the assets of their sponsoring insurance companies. Investment Company Act rule 0-10(b) [17 CFR 270.0-10(b)].