

We understand that many funds and advisers have designated a person to serve as the chief compliance officer.³⁹ Not all firms have taken this step, which we believe is critical to an effective compliance program. We expect that the primary effect of the rule on funds and larger advisory firms would be to require the compliance personnel to report to one individual with overall responsibility to coordinate the fund's (or firm's) compliance efforts and to establish procedures for annual review of its compliance programs.⁴⁰

In the case of a fund, the fund's board of directors, including a majority of the independent directors, would have to approve the chief compliance officer, who would have additional duties that reflect the important role of fund boards in overseeing fund compliance with the federal securities laws.⁴¹ Proposed rule 38a-1 would require the chief compliance officer to furnish the fund's board of directors annually with a written report on the operation of the fund's policies and procedures, including (i) any material changes to the policies and procedures since the last report, (ii) any recommendations for material changes to the policies and procedures as a result of the annual review, and (iii) any material compliance matters requiring remedial action that occurred since the date of the last report.⁴² The rule would thus require board oversight of the fund's compliance program, but would not require directors to become involved in the day-to-day administration of the program. We designed the proposed rule to reflect the way many fund complexes' compliance personnel currently administer fund codes of ethics under

to supervise. A compliance officer that does have supervisory responsibilities will have available the defense discussed above. *See supra* note 13.

³⁹ Form ADV, the registration form that advisers use to register with us under the Advisers Act, requires each adviser to report the name of its chief compliance officer, but does not require the adviser to have a chief compliance officer. Form ADV, Part 1, Schedule A, Item 2(a) [17 CFR 279.1].

⁴⁰ The ICI, in its 1994 submission to us, urged that multiple individuals be permitted to perform this role because the knowledge about compliance in specific areas may not be concentrated in any one individual. *See* ICI Proposal, *supra* note 15, at 23. Our proposal, which would require appointment of a single individual, would accommodate a large and diverse compliance organization, but would require the many compliance officers to report ultimately to one individual. The Hong Kong Securities and Futures Commission has taken a similar approach. *See* Fund Manager Code of Conduct at § 1.6.1 (1997) (Hong Kong registered fund managers must have a "designated compliance officer").

⁴¹ Proposed rule 38a-1(a)(4)(i). If the fund is a unit investment trust, the fund's principal underwriter or depositor must approve the chief compliance officer. Proposed rule 38a-1(b).

⁴² Proposed rule 38a-1(a)(4)(ii).

rule 17j-1 of the Investment Company Act.

- Rule 17j-1 requires that funds, their investment advisers, and principal underwriters certify annually that they have adopted procedures reasonably necessary to prevent violations of their codes of ethics adopted under the rule.⁴³ Should we similarly require each chief compliance officer to certify the fund's compliance policies and procedures?

- The USA PATRIOT Act requires funds to establish anti-money laundering programs that designate an anti-money laundering compliance officer,⁴⁴ but the implementing rules permit multiple persons to serve in this role.⁴⁵ Should our rule permit multiple compliance officers?

- Should we require that the chief compliance officer be a member of senior management of the fund or the adviser?⁴⁶

D. Recordkeeping

We are proposing to require that funds and advisers maintain a copy of their policies and procedures.⁴⁷ Funds would have to keep the annual written report by the fund's chief compliance officer.⁴⁸ Advisers would have to keep records documenting their annual review.⁴⁹ Funds and advisers would have to keep the required documents for five years.⁵⁰ These records are designed

⁴³ Rule 17j-1(c)(1)(2).

⁴⁴ *See* section 352 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 ("USA PATRIOT Act"), amending 31 U.S.C. 5318(h).

⁴⁵ 31 CFR 103.130(c)(3).

⁴⁶ In the United Kingdom, the FSA requires that firms allocate to a "director" or "senior manager" responsibility for oversight of the firm's compliance and reporting. FSA Handbook of Rules and Guidance, Systems and Controls § 3.2.8 ("Areas covered by systems and controls: Compliance") (United Kingdom).

⁴⁷ Proposed rules 38a-1(c)(1) and 204-2(a)(17)(i).

⁴⁸ Proposed rule 38a-1(c)(2). A fund's board's deliberations in connection with the approval of the compliance policies and procedures and their annual review of the chief compliance officer's report would be documented in the minute books of the fund board, which must be maintained pursuant to rule 31a-1(b)(4) under the Investment Company Act [17 CFR 270.31a-1(b)(4)].

⁴⁹ Proposed rule 204-2(a)(17)(ii).

⁵⁰ Funds and advisers would be required to maintain copies of all policies and procedures that are in effect or were in effect at any time during the last five years. Proposed rules 38a-1(c)(1) and 204-2(a)(17)(i). Funds would be required to maintain the annual compliance reports to the board for at least five years after the end of the fiscal year in which the report was provided to the board, the first two years in an easily accessible place. Proposed rule 38a-1(c)(2). Advisers would be required to maintain any records documenting their annual review in an easily accessible place for at least five years after the end of the fiscal year in which the review was conducted, the first two years in an appropriate

to provide our examination staff with a basis to determine whether the adviser or fund has complied with the rules.

We request comment on the recordkeeping requirements. Specifically, as required by section 31(a)(2) of the Investment Company Act [15 U.S.C. 80a-30(a)(2)], we request commenters to address whether there are feasible alternatives to the Proposed Rules that would minimize the recordkeeping burdens, the necessity of these records in facilitating the examinations carried out by our staff, the costs of maintaining the required records, and any effects that the proposed recordkeeping requirements would have on the nature of firms' internal compliance policies and procedures.

E. Request for Comment on Further Private Sector Involvement

As we note above, the number of funds and advisers (and the amount of assets they control) has grown significantly.⁵¹ This growth has substantially exceeded the growth in our resources⁵² as well as those resources we have been able to allocate to our investment company and investment adviser programs.⁵³ Although the Commission's resources may increase substantially in the future,⁵⁴ other program areas will have competing needs for those resources.⁵⁵

office of the investment adviser. Proposed rule 204-2(e)(1).

⁵¹ The number of registered investment companies has increased approximately 44% in the past 10 years, from approximately 3,500 in 1991 to approximately 5,030 currently. Investment company assets have grown over 400%, from \$1.2 trillion to \$6.4 trillion over the same period. Although the number of advisers registered with us decreased during the period (as a result of the enactment of the National Securities Markets Improvement Act, Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified in Section 203A of the Advisers Act [15 U.S.C. 80b-3a] and other scattered sections of the United States Code)), which prohibited most smaller state-registered advisers from registering with us, the amount of assets under the management of registered advisers has grown from \$10.7 trillion in 1997 to over \$21 trillion currently, an increase of nearly 100%.

⁵² *See* United States General Accounting Office, *SEC Operations: Increased Workload Creates Challenges*, at 11 (Mar. 2002) ("GAO Study") (during the past decade, "the increases in SEC's workload substantially outpaced the increases in SEC's staff").

⁵³ *See* GAO Study, *supra* note 52, at 13 ("total assets under management by investment companies (IC) and investment advisers (IA) increased by about 264 percent over 10 years, while the number of IC and IA examination staff increased by 166 percent").

⁵⁴ Section 601 of the Sarbanes-Oxley Act, *supra* note 22, authorized us to spend \$776 million in fiscal year 2003, which, if appropriated, would be a substantial increase over our appropriation of \$487.2 million in fiscal year 2002.

⁵⁵ Section 408 of the Sarbanes-Oxley Act, *supra* note 22, for example, requires us, based upon