

and the Commission would not require the fund to maintain duplicate copies.

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant economic impact on small entities. The IRFA explains that we currently believe that different compliance requirements for small entities could not be established, because the compliance requirements are integral to achieving the objectives of the Proposed Rules. The IRFA also states that we currently believe it would not be necessary to establish different recordkeeping requirements, because the recordkeeping requirements of the Proposed Rules impose an inconsequential burden on small entities. The IRFA also describes our current view that these compliance and recordkeeping provisions could not be consolidated, and that there would be no reason to simplify or clarify them because they are not technical or complex.

As the IRFA explains, the Proposed Rules would rely on performance standards rather than design standards. Each small entity would be afforded the flexibility to implement policies and procedures, and to determine qualifications for its chief compliance officer that are appropriate in light of its business operations.

The IRFA also explains our present view that the objectives of the Proposed Rules could not be achieved if small entities were exempted from coverage of any part of the Proposed Rules, because it has been our experience that small funds and advisers are less likely to have comprehensive, written compliance programs and are more likely to have the kinds of compliance deficiencies that could be remedied by such programs.

We encourage comment with respect to any aspect of the IRFA. We specifically request comment on the number of small entities that would be affected by the Proposed Rules, and the likely impact of the Proposed Rules on small entities. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. These comments will be considered in connection with the adoption of the Proposed Rules, and will be placed in the same public file as comments on the Proposed Rules themselves. A copy of the IRFA may be obtained by contacting Hester Peirce, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0506.

VIII. Statutory Authority

The Commission is proposing new rule 38a-1 under the Investment Company Act pursuant to the authority set forth in sections 31(a) and 38(a) of the Act [15 U.S.C. 80-30(a) and 80a-37(a)].¹⁰⁴ The Commission is proposing new rule 206(4)-7 pursuant to the authority set forth in sections 206 and 211(a) under the Advisers Act [15 U.S.C. 80b-6 and 80b-11(a)].¹⁰⁵ The Commission is proposing amendments to rule 204-2 pursuant to the authority set forth in sections 204 and 211 of the Advisers Act [15 U.S.C. 80b-4 and 80b-11].

List of Subjects

17 CFR 270

Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR 275

Reporting and recordkeeping requirements, Securities.

Text of Proposed Rules

For reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read in part as follows:

¹⁰⁴ Section 38(a) authorizes the Commission to “make * * * such rules and regulations * * * as are necessary or appropriate to the exercise of the functions and powers conferred upon the Commission elsewhere in [the Investment Company Act].” We are proposing rule 38a-1 as necessary and appropriate to the exercise of the authority specifically conferred on us elsewhere in the Act, including section 31(b) of the Investment Company Act [15 U.S.C. 80a-30(b)] (authority to examine funds) and section 42 of the Investment Company Act [15 U.S.C. 80a-41] (authority to enforce the provisions of the Investment Company Act). Further, requiring the maintenance of internal compliance policies and procedures and an annual compliance report would fall under the authority granted to us under section 31(a), which authorizes us to require funds to maintain and preserve records, including memoranda, books, and other documents.

¹⁰⁵ Section 206(4) permits the Commission to define conduct as fraudulent under the Advisers Act, and to adopt rules reasonably designed to prevent fraud. We are proposing rule 206(4)-7 as a means reasonably necessary to prevent fraud by investment advisers. Further, section 211(a) of the Advisers Act authorizes the Commission to “make * * * such rules and regulations * * * as are necessary or appropriate to the exercise of the functions and powers conferred upon the Commission elsewhere in [the Act].” We are proposing rule 206(4)-7 as necessary and appropriate to the exercise of the authority specifically conferred on us elsewhere in the Act, including section 204 of the Advisers Act (authority to examine advisers) and section 209 of the Advisers Act [15 U.S.C. 80b-9] (authority to enforce the provisions of the Advisers Act).

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, 80a-39, unless otherwise noted;

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2. Section 270.38a-1 is added to read as follows:

§ 270.38a-1 Compliance procedures and practices of registered investment companies.

(a) Each registered investment company and business development company (“fund”) must:

(1) *Policies and procedures.* Adopt and implement written policies and procedures reasonably designed to prevent violation of the Federal Securities Laws by the fund, or by its investment adviser, principal underwriter or administrator in connection with their provision of services to the fund;

(2) *Board approval.* Obtain the approval of the policies and procedures of the fund by the board of directors of the fund, including a majority of directors who are not interested persons of the fund;

(3) *Annual review.* Review, no less frequently than annually, the adequacy of the policies and procedures established pursuant to this section and the effectiveness of their implementation;

(4) *Chief compliance officer.*

Designate an individual responsible for administering the policies and procedures adopted under paragraph (a)(1) of this section who must:

(i) Be approved by the board of directors of the fund, including a majority of directors who are not interested persons of the fund; and

(ii) No less frequently than annually, provide a written report to the board on:

(A) Existing policies and procedures, any material changes made to the policies and procedures since the date of the last report, and any material changes to the policies and procedures recommended as a result of the annual review conducted pursuant to paragraph (a)(3) of this section; and

(B) Any material compliance matters requiring remedial action that occurred since the date of the last report.

(b) *Unit investment trusts.* If the fund is a unit investment trust, the fund’s principal underwriter or depositor must approve the fund’s policies and procedures and chief compliance officer, and receive all annual reports.

(c) *Recordkeeping.* The fund must maintain:

(1) A copy of the fund’s policies and procedures that are in effect, or at any time within the past five years were in effect, in an easily accessible place; and

(2) Written reports provided to the board of directors pursuant to paragraph