

SECURITIES AND EXCHANGE COMMISSION**17 CFR Parts 270, 275, and 279**

[Release Nos. IA-2204; IC-26299; File No. S7-03-03]

RIN 3235-A177

Compliance Programs of Investment Companies and Investment Advisers**AGENCY:** Securities and Exchange Commission.**ACTION:** Final rule; request for comments.

SUMMARY: The Securities and Exchange Commission is adopting new rules under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 that require each investment company and investment adviser registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws, review those policies and procedures annually for their adequacy and the effectiveness of their implementation, and designate a chief compliance officer to be responsible for administering the policies and procedures. In the case of an investment company, the chief compliance officer will report directly to the fund board. These rules are designed to protect investors by ensuring that all funds and advisers have internal programs to enhance compliance with the federal securities laws.

DATES: *Effective Date:* February 5, 2004.*Comment Date:* Comments requested in section II.F of this release should be received on or before February 5, 2004.*Compliance Date:* October 5, 2004. Section III of this release contains more information on the compliance date.**ADDRESSES:** To help us process and review your comments more efficiently, comments may be sent to us in either paper or electronic format. Comments should not be sent by both methods.

Comments in paper format should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

Comments in electronic format may be submitted at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7-03-03; if e-mail is used, this file number should be included on the subject line. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Electronicallysubmitted comment letters will also be posted on the Commission's Internet Web site (<http://www.sec.gov>).¹**FOR FURTHER INFORMATION CONTACT:**

Hester Peirce, Senior Counsel, Office of Regulatory Policy at (202) 942-0690, or Jamey Basham, Special Counsel, Office of Investment Adviser Regulation at (202) 942-0719, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("SEC" or "Commission") is adopting new rule 38a-1 (17 CFR 270.38a-1) under the Investment Company Act of 1940 (15 U.S.C. 80a) ("Investment Company Act"), new rule 206(4)-7 (17 CFR 275.206(4)-7) under the Investment Advisers Act of 1940 (15 U.S.C. 80b) ("Investment Advisers Act" or "Advisers Act"), and amendments to rule 204-2 (17 CFR 275.204-2) under the Advisers Act, and to Part 1, Schedule A, Item 2(a) of Form ADV (17 CFR 279.1).²**Table of Contents**

- I. Background
- II. Discussion
 - A. Adoption and Implementation of Policies and Procedures
 - 1. Investment Advisers
 - 2. Investment Companies
 - B. Annual Review
 - 1. Investment Advisers
 - 2. Investment Companies
 - C. Chief Compliance Officer
 - 1. Investment Advisers
 - 2. Investment Companies
 - D. Recordkeeping
 - E. Private Sector Initiatives
 - F. Additional Request for Comment
- III. Effective Date
- IV. Cost-Benefit Analysis
 - A. Benefits
 - B. Costs
- V. Consideration of Promotion of Efficiency, Competition and Capital Formation
- VI. Paperwork Reduction Act
 - A. Rule 38a-1
 - B. Rule 206(4)-7

¹ We do not edit personal or identifying information, such as names or e-mail addresses, from electronic submissions. Submit only information you wish to make publicly available.

² Unless otherwise noted, when we refer to rule 38a-1 or any paragraph of the rule, we are referring to 17 CFR 270.38a-1 of the Code of Federal Regulations in which the rule is published, as amended by this release; when we refer to rule 206(4)-7 or any paragraph of the rule, we are referring to 17 CFR 275.206(4)-7 of the Code of Federal Regulations in which the rule is published, as amended by this release; and when we refer to rule 204-2 or any paragraph of the rule, we are referring to 17 CFR 275.204-2 of the Code of Federal Regulations in which the rule is published, as amended by this release.

C. Rule 204-2

VII. Summary of Final Regulatory Flexibility Analysis

VIII. Statutory Authority Text of Rules

I. Background

Earlier this year the Commission proposed rules that would require investment companies ("funds")³ and investment advisers to adopt written compliance procedures, review the adequacy of those procedures annually, and designate a chief compliance officer responsible for their administration.⁴ We proposed the rules because it is critically important for funds and advisers to have strong systems of controls in place to prevent violations of the Federal securities laws and to protect the interests of shareholders and clients. The proposed rules were designed to foster, among other things, improved compliance by clarifying the compliance obligations of fund management and to strengthen the hand of fund boards and compliance personnel when dealing with them.⁵

In recent months, the Commission and State securities authorities have discovered unlawful conduct involving a number of fund advisers, broker-dealers, and other service providers that confirms the need for these rules. Fund advisory or distributor personnel have engaged in, or actively assisted others in engaging in, inappropriate market timing, late trading of fund shares, and the misuse of material, nonpublic information about fund portfolios.⁶

³ In this release, we use the term "fund" to mean a registered investment company or a business development company, which is an unregistered closed-end investment company. See section 2(a)(48) of the Investment Company Act (15 U.S.C. 80a-2(a)(48)). We use the term "mutual fund" to mean a registered investment company that is an open-end management company defined in section 5(a) of the Investment Company Act (15 U.S.C. 80a-5(a)).

⁴ Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 25925 (Feb. 5, 2003) (68 FR 7038 (Feb. 11, 2003)) ("Proposing Release").

⁵ Forty-eight commenters, most of which were investment advisers, fund management companies, and organizations representing those groups, submitted comments in response to the Proposing Release. Commenters generally supported the proposal to require funds and advisers to adopt and implement compliance programs, but many sought changes. The comment letters and a summary of comments prepared by our staff are available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC (File No. S7-03-03). The comment summary is also available on the Commission's Internet Web site (<http://www.sec.gov/rules/extra/s70303summary.pdf>).

⁶ The Commission has already obtained settlements in a number of actions arising from such violations. See, e.g., *In re Putnam Investment Management, Investment Advisers Act Release No. 2192* (Nov. 13, 2003) (finding that an investment adviser failed to disclose potentially self-dealing