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October 10, 2002

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Re: File No. S7-33-02  
Certification of Management Investment Company  
Shareholder Reports and Designation of Certified  
Shareholder Reports as Exchange Act Periodic Reporting Forms

Dear Mr. Katz:

The Committee on Investment Management Regulation of the Association of the Bar of The City of New York (the "Committee") is composed of lawyers with diverse perspectives on investment management issues, including members of law firms, and counsel to financial services firms, investment company complexes and investment advisers. A list of our current members is enclosed.

This letter responds to the request of the Securities and Exchange Commission (the "Commission") in Release No. 34-46441; IC-25723 (August 30, 2002) (the "Release") seeking specific and general comments on the certified shareholder report to be filed on proposed Form N-CSR, the scope of the certification requirement, the uniform application of the certification requirement and the disclosure controls and procedures mandated thereby.

The Committee understands the importance of the matters covered in the Release and the desire of the Commission to implement fully the intent of the Sarbanes-Oxley Act of 2002 (the "Act"). By consensus, the Committee is commenting only on certain issues raised by the Commission in the Release. These issues are whether: (1) the Commission should require both the filing of certified shareholder reports on Form N-CSR and the certification of Form N-SAR; (2) the certification requirement should apply to part or all of the information contained within a shareholder report; (3) it is appropriate for unit investment trusts to have a certification requirement at all; and (4) the disclosure controls and procedures should be extended to cover filings made under the Securities Act of 1933 (the "Securities Act") and the Investment Company Act of 1940 (the "Investment Company Act"). The Committee also is commenting on the reporting and cost burden estimates of the Commission relating to the proposed certification requirements.

### Certifications of Form N-CSR and Form N-SAR

As a preliminary matter, the Committee believes that it is appropriate for the Commission to amend Rule 30b2-1 under the Investment Company Act to require a registered management investment company to file a shareholder report with the Commission on new Form N-CSR. The Committee further believes it is appropriate to designate reports on Form N-CSR as periodic reports filed with the Commission under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"). As stated in the Release, "[f]or registered management investment companies, the required reports to shareholders, rather than Form N-SAR, are the primary vehicle for providing financial statements to investors."<sup>1</sup> (citations omitted)

In light of the foregoing and for the reasons discussed below, the Committee believes that the certification requirement should be applicable to Form N-CSR, but should not apply to Form N-SAR.<sup>2</sup> As proposed, Form N-CSR will be required to be filed in respect of any required shareholder report.<sup>3</sup> Form N-CSR will therefore contain the full complement of financial information that the Commission has deemed appropriate in prescribing the contents of shareholder reports as well as the additional information regarding disclosure controls and procedures that the Commission has deemed appropriate in formulating Form N-CSR. In contrast, Form N-SAR does not contain financial statements and contains only limited financial information derived from the investment company's financial statements as well as certain additional information that is not financial in nature. Form N-SAR was not designed to provide disclosure to investors; the statistical and short-handed nature of its responses do not facilitate shareholder comprehension. Although, as a technical matter, Form N-SAR is deemed to satisfy an investment company's requirement to file an annual report pursuant to Section 13(a) or 15(d) of the Exchange Act,<sup>4</sup> it is in no way comparable to the periodic reports prepared by other reporting companies under the Exchange Act (*e.g.*, annual reports on Form 10-K and quarterly reports on Form 10-Q). The Committee does not believe that Form N-SAR contains any information that improves the quality of the disclosure that an investment company provides about its financial condition in its periodic reports to investors. Moreover, it was designed primarily to gather information for the Commission and for registrants to respond to specific compliance questions; it was not designed to provide information that might be relevant to an investment decision. Therefore, since the Form N-SAR certifications do not advance the

intention of Section 302 of the Act, the Committee believes that the certifications should not be required to be filed with Form N-SAR.

Further, the Committee believes that requiring certifications to be included with the filings of both Form N-CSR and Form N-SAR would be redundant. Because Form N-SAR does not contain financial statements, its Section 302 certifications under new Rule 30a-2 relate to the financial information included in Form N-SAR as well as the financial statements on which such financial information is based. However, as noted above, proposed Form N-CSR will include an investment company's financial statements and certain other condensed financial information. Thus, the same financial statements from which the Form N-SAR financial information is derived will be filed and certified as part of Form N-CSR. Accordingly, because the certifications included in Form N-CSR will encompass substantially identical financial information, the Committee believes that it would be duplicative and unnecessary to continue to require certifications to be included with Form N-SAR upon the adoption of Form N-CSR. Moreover, since it did not elect to except registered investment companies from the certification requirement of Section 302, the Commission had little choice in the period of time directed by Congress<sup>5</sup> but to designate Form N-SAR as the form required to include the Section 302 certifications because Form N-SAR was the only report filed by investment companies in satisfaction of the reporting requirements of Section 13(a) or 15(d) of the Exchange Act. However, with the adoption of Form N-CSR, which is more analogous to the periodic reports prepared by other reporting companies than Form N-SAR, the Commission has a more appropriate form by which to implement the Section 302 certification requirement for investment companies.

In addition, the Committee believes that to require investment companies to provide certifications with the filings of both Form N-CSR and Form N-SAR places a greater burden on investment companies than Section 302 of the Act has placed on any other reporting company under the Exchange Act. No other reporting company is required to provide Section 302 certifications for multiple periodic reports filed for the same period. For example, the Commission has not required certifications in connection with filings made by operating companies under Rule 14a-3(c) of the Exchange Act of a "glossy" printed annual report, presumably because the financial statements and MD&A contained in such reports are also contained in the reporting company's annual report on Form 10-K.

In light of the foregoing, the Committee recommends that Form N-SAR be designated as exclusively an Investment Company Act filing and no longer be deemed to satisfy an investment company's requirement to file an annual report pursuant to Section 13(a) or 15(d) of the Exchange Act. As noted above, Form N-SAR was not designed to provide disclosure to investors and cannot be considered a meaningful periodic report given the technical nature of the responses required thereby. It in no way resembles the periodic reports prepared by other reporting companies in satisfaction of their reporting obligations under the Exchange Act. Thus, the filing of Form N-SAR should not be designated as a periodic report filed under Section 13(a) or 15(d) of the Exchange Act, particularly since Form N-CSR is to be designated as such.<sup>6</sup>

#### Scope of the Certifications

The Committee believes that the Section 302 certifications included in Form N-CSR should be limited only to the financial statements required (and for the periods specified) by Regulation S-X and the financial information required to be included in shareholder reports (and for the periods specified) by Form N-1A, in the case of open-end investment companies, or Form N-2, in the case of closed-end investment companies.<sup>7</sup> The Commission has stated that the purpose of implementing the Section 302 certification requirement is to improve the quality of the disclosure that a reporting company provides about its financial condition in its periodic reports to investors. Shareholders of an investment company seeking to evaluate the fund's financial condition and results of operations would look to the financial statements and condensed financial information contained within the fund's shareholder report.

An investment company's officers should not be required to make the Section 302 certifications with respect to other information included in the fund's shareholder report, much of which is included therein voluntarily, such as Management's Discussion of Fund Performance ("MDFP")<sup>8</sup> and letters from the fund's president. MDFP is not the substantive equivalent of the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), which is required to be included in an operating company's annual reports on Form 10-K and quarterly reports on Form 10-Q and certified in accordance with the Section 302 Adopting Release. MD&A is among the most meaningful of all portions of the report on Form 10-K and Form 10-Q and is intended to provide a narrative explanation of an operating company's financial statements as well as to provide the context within which the financial statements should be analyzed. The MDFP, on the other hand, is significantly more limited in scope and merely provides some insight into the reasons for an investment company's comparative performance. Moreover, the comparative data, such as market indices required to be, and general economic data typically, included in the MDFP are not prepared by or within the financial records of an investment company. Accordingly, the Committee does not believe that the MDFP should be included in the Section 302 certifications filed with Form N-CSR.

If the Commission determines to include MDFP within the scope of the certifications filed with Form N-CSR, it should limit the scope of the certification to the information in or derived from the investment company's financial statements and included in the MDFP and the investment company's financial statements and financial information, as discussed above. Any other information voluntarily included in an investment company's shareholder report is purely supplemental to the information that the Commission has prescribed as the relevant information required to be disclosed to investors. Expanding the certifications to incorporate voluntarily-included information will lead to certifications of nonuniform contents among investment companies, since the shareholder reports of different investment companies will likely contain different types of information. Moreover, the Committee believes that requiring the certifications to include voluntary information in shareholder reports is likely to reduce the amount and nature of information available to investors.

Furthermore, other reporting companies under the Exchange Act that meet their reporting obligations thereunder by filing annual reports on Form 10-K and quarterly reports on Form 10Q (each of which contains rigorous disclosure requirements) generally also prepare and distribute "glossy" annual reports to shareholders containing financial statements, MD&A and other information.<sup>9</sup> These reports to shareholders are not mandated under Section 13(a) or 15(d) of the

Exchange Act and thus will not include the Section 302 certifications. As noted above, the financial statements and MD&A will be included in the information certified by a reporting company in its annual report on Form 10-K. However, no certification will be made with respect to the other information included in the reporting company's annual report. The Committee believes that it would be anomalous for the Commission to place a more encompassing certification requirement on investment companies with regard to this additional information than on other reporting companies under the Exchange Act, and it would not further the Commission's stated goals.

### Unit Investment Trusts

The Release asks whether it would be appropriate, if the certification requirement is removed from Form N-SAR, for unit investment trusts to have no certification requirement. We submit that this result would be entirely appropriate on the basis that the certification requirement contemplated by the Act does not serve to improve disclosure for unit investment trusts or otherwise further the public interest.

The certification requirement of the Act was intended to improve the quality of the disclosure that a company provides about its financial condition in its periodic reports. Inasmuch as unit investment trusts are not required to prepare or distribute any financial information, either to the Commission or to investors, any certification requirement in the context of unit investment trusts is inconsistent with the longstanding regulatory determination that the preparation and distribution of financial information is unnecessary for the protection of investors. Moreover, notwithstanding that such a requirement would serve no useful purpose, it would create a significant administrative burden on unit investment trusts and their sponsors, trustees and other service providers. This does not seem appropriate since there would be no attendant benefits to investors.

The Commission has long recognized the unique nature of unit investment trusts. By definition, unit investment trusts are unmanaged, fixed portfolios of securities. Unlike management investment companies, unit investment trusts do not reinvest or trade their assets. Except for limited authority to dispose of securities, unit investment trusts generally adhere to the marketing principle that "what you see is what you get." Consequently, once the initial portfolio is deposited, there is little material financial information to disclose.

Recognizing the constrained nature of unit investment trusts, the Commission has not required them to provide periodic financial information to investors, and unit investment trusts are required to file Form N-SAR annually only. Moreover, the information required by Form N-SAR from unit investment trusts is primarily statistical information designed to give the Commission a better understanding of the level of activity in unit investment trusts and their potential impact on the securities markets. As previously discussed, Form N-SAR is not designed to inform the public, nor is it even readily accessible to the public.<sup>10</sup>

The Committee also submits that, to the extent that the certification requirement of the Act was intended to force management to act more responsibly in the publication of financial results, this too is irrelevant in the context of a unit investment trust. Under the terms of the trust

indenture for a unit investment trust, administrative responsibility for a trust is assigned to the trustee and is performed primarily by personnel in the trust department of the trust's trustee bank. While unit investment trust sponsors generally maintain an ongoing relationship with a trust after its offering, the sponsors' role focuses mainly on maintaining an orderly secondary market for trust units and on other functions related more to investor relations. Unit investment trusts have no executive officers and neither the trustee nor the sponsors play any role resembling that of any executive officer. Moreover, the information called for by Form N-SAR is generated by a variety of sources, including not only the trustee and the sponsors, but a trust's principal underwriters and evaluators as well. Although the information is collected and compiled by the trustee, no party is truly able to independently verify another party's information. Since no one party is singly responsible, disclosure controls and procedures would not be practical, and the certification requirement would not achieve the desired effect.

### Disclosure Controls and Procedures

For the reasons discussed below, the Committee believes that the disclosure controls and procedures requirement should not extend to an investment company's filings made under the Securities Act and the Investment Company Act (other than Form N-CSR). The Act requires certifications of periodic filings made under Sections 13(a) and 15(d) of the Exchange Act and of the internal controls necessary to ensure the material accuracy of information in those reports. The Committee believes that investment companies should not be treated differently than other public companies subject to the Act by having controls and procedures apply to the Securities Act filings. Moreover, as we commented in our letter, dated August 15, 2002, registered open-end investment companies, constituting the predominant form of registered investment company by number and assets under management, continuously offer shares under the Securities Act on the basis of an effective registration statement.<sup>11</sup> Unlike most other public companies, for which public offerings are discrete events, open-end investment companies are required to file post-effective amendments to their registration statements at least annually in order to update their financial statements and other information and to supplement the document to reflect material intervening events.<sup>12</sup> Accordingly, the liability of an investment company and certain associated individuals, including the chief executive officer and chief financial officer and its directors, are at all times subject to Section 11 of the Securities Act, the highest disclosure standard established in the federal securities laws. Because an investment company and its officers and directors are continually subject to this disclosure standard, they are compelled to ensure that the fund's disclosure controls are thorough and effective. Thus, the Committee submits that extending only to registered investment companies the incremental burden of subjecting their filings under the Securities Act is disproportionately burdensome, and unnecessary.

### Reporting and Cost Burden Estimates

The Committee disagrees with the estimate in the Release that the new certification requirement would result in an increase of only five burden hours per respondent per filing in connection with the certification of annual and semiannual reports on Form N-SAR and Form N-CSR.<sup>13</sup> Rather, the Committee believes that the certification requirement would result in a substantially greater increase of per filing burden hours due to the nature of investment company governance and operations. Even after investment companies and their service providers,

including the adviser, administrator, custodian and transfer agent, have sorted out their respective responsibilities to support the certification and under the disclosure controls and procedures - which will be no small burden in itself - the time and effort which will be required to coordinate those responsibilities and periodically to evaluate the effectiveness of internal controls governing the relevant activities of key service providers have been in the Committee's view seriously underestimated.

The Committee also disagrees with the computation of the Commission's estimate that, in the aggregate, all respondents will incur 37,500 burden hours<sup>14</sup> to comply with the proposed rules and rule and form amendments. This estimation is based upon the number of Forms N-CSR and Forms N-SAR that will be filed with the Commission based on the number of Form N-SAR filings. It does not take into account the fact that series funds prepare separate financial statements for each series. Since the separate financial statements of each series must be reviewed and evaluated by the officers making the Section 302 certifications, the Committee believes that the Commission's estimate substantially understates the burden hours, even using the Commission's estimate of five additional burden hours in the computation. As a result, the Committee believes that in order to generate a more accurate estimation of burden hours associated with making the certifications, it is necessary to base the estimation upon the number of financial statements actually prepared by investment companies rather than on the number of Forms N-CSR and Forms N-SAR to be filed. In light of the significant rule and form amendments proposed in the Release, the Committee believes that it is important that accurate estimates be utilized.

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The Committee appreciates the opportunity to comment on the Release and would be pleased to meet or discuss these comments further with the Commission and its staff.

Very truly yours,

/S/ JOHN E. BAUMGARDNER, JR.

John E. Baumgardner, Jr.  
Chair

Drafting Committee:  
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<sup>1</sup> Text accompanying note 8 of the Release.

<sup>2</sup> In Release No. 33-8124 (August 28, 2002) (the "Section 302 Adopting Release"), the Commission adopted rules to implement the certification requirements of Section 302 of the Act. Among other rules, the Commission adopted Rule 30a-2 under the Investment Company Act, which requires an investment company that files periodic reports under Section 13(a) or 15(d) of the Exchange Act (*i.e.*, Form N-SAR) to include the Section 302 certification in those periodic reports.

<sup>3</sup> Rule 30e-1 under the Investment Company Act requires the dissemination of a report to shareholders of an investment company not less often than semi-annually.

<sup>4</sup> See Rule 30a-1 under the Investment Company Act.

<sup>5</sup> Congress required the Commission to adopt rules to implement Section 302 of the Act for all issuers by August 29, 2002. See Section 302(c) of the Act.

<sup>6</sup> The Committee understands that removing the certification requirement from Form N-SAR would eliminate the certification requirements for unit investment trusts and small business investment companies, which are not required to transmit reports to shareholders containing their financial statements (see Rule 30e-1(a) under the Investment Company Act), and thus would not be obligated to file Form N-CSR. For the reasons discussed below, we submit that this is an appropriate result. In view of the nature of the information reported, and the limited purpose it serves, there is no benefit from certification.

<sup>7</sup> See Items 22(b)(1) and (2) and 22(c)(1) and (2) of Form N-1A. See also Instructions 4.a. and

b. and 5.a. and b. to Item 23 of Form N-2.

<sup>8</sup> Item 5 of Form N-1A requires MDFP to be included in a fund's prospectus unless the fund is a money market fund or the information in MDFP is included in the fund's annual report to shareholders under Rule 30e-1 under the Investment Company Act.

<sup>9</sup> See Rule 14a-3(b) under the Exchange Act.

<sup>10</sup> Form N-SAR limits the information unit investment trusts report to: (1) the names and addresses of the trust's depositors, sponsors, trustees, principal underwriters and independent accountants; (2) whether the trust is part of a family of investment companies or an insurance company separate account; (3) the following numbers aggregated for all series: numbers of series, dollar amounts of deposits and prior series units, sales charges, values of and income from various types of securities and expenses; (4) yes or no questions on insurance and guarantees; and (5) a list of any pre-1972 Investment Company Act file numbers.

<sup>11</sup> Most closed-end investment companies do not continuously offer their securities pursuant to an effective registration statement. However, the Committee does not believe that closed-end investment companies should be distinguished from open-end investment companies.

<sup>12</sup> Section 10 of the Securities Act makes it unlawful to use a prospectus more than nine months after its effective date if the information therein is more than 16 months old.

<sup>13</sup> Text preceding note 28 of the Release.

<sup>14</sup> Text accompanying note 29 of the Release.