

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 WEST 44TH STREET
NEW YORK, NY 10036-6689

COMMITTEE ON INVESTMENT MANAGEMENT REGULATION

JOHN E. BAUMGARDNER, JR., ESQ.

CHAIR
125 BROAD STREET
NEW YORK, NY 10004-2498
(212) 558-3866
FAX # (212) 558-3588
baumgardnerj@sullcrom.com

MARINA PEARLMAN, ESQ.

SECRETARY
125 BROAD STREET
NEW YORK, NY 10004-2498
(212) 558-3188
FAX # (212) 558-3588
pearlmanm@sullcrom.com

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

Re: File No. S7-21-02
Certification of Disclosure in Companies' Quarterly and Annual Reports

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") on the Commission's Release 34-46300 (August 2, 2002) (the "Release") seeking comments on the certification rules required by Section 302 of the Sarbanes-Oxley Act of 2002 (the "Act"). The Committee will address only issues arising out of the application of Section 302 to registered investment companies.

Mindful of the limited time available to the Commission to consider and adopt rules under Section 302 of the Act, the Committee's comments will be summary.

As an initial matter, we support the Commission's approach to seeking comment on the application of Section 302 to registered investment companies rather than simply extending the carefully crafted June 17, 2002 rule proposals to reach investment companies.¹ As discussed below, we believe that Section 302 should not be applied to registered investment companies. Moreover, in order for Section 302 certifications to apply in a meaningful way to registered investment companies, the Commission would have to undertake a careful review of the types of reports that registered investment companies file under Sections 13(a) and 15(d), and determine

¹ See Certification of Disclosure in Companies' Quarterly and Annual Reports, Release No. 34-46079 (June 14, 2002) [67 FR 41877] ("June 2002 Release").

how they should be modified to make the certifications meaningful. Therefore, if the Commission concludes, based on the comments it receives in response to the Release, that registered investment companies should not be exempted from the certification requirement, we believe that investment companies should be temporarily exempt from the requirement in order that the Commission may conduct such a review, with specific rule proposals possibly under the ICA as well as the Securities and Exchange Act of 1934 (the "Exchange Act"), and a meaningful opportunity for comment.

Statutory and Regulatory Context

Section 302 provides that the Commission "shall, by rule, require for each company filing periodic reports under Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, that the principal executive officer or officers and the principal financial officer or officers . . . [make certain certifications] in each annual or quarterly report filed or submitted under either such section of such Act . . ."

Most registered investment companies are required to file periodic reports under Section 15(d) of the Exchange Act, and some, for example, closed-end management investment companies whose securities are listed on a national securities exchange, are required to file such reports under Section 13(a) of the Exchange Act. Pursuant to Rule 30a-1 under the Investment Company Act of 1940 (the "ICA"), an investment company required to file reports under Section 13(a) or Section 15(d) of the Exchange Act is deemed to have satisfied its requirement to make such filings by filing semiannual reports on Form N-SAR. Form N-SAR does not contain financial statements and is rarely if ever sought or reviewed by investors. Form N-SAR does require, annually, the filing, as an exhibit, of the independent accountants' report on the investment company's internal controls.

General Comments

The Committee believes that the Commission has the authority under the Act to exempt registered investment companies from the certification requirement of Section 302, that such an exemption is in the best interests of investors and consistent with the policies and purposes of the Act and the ICA, and that certifications of the periodic reports required to be filed by registered investment companies under Sections 13(a) or Section 15(d) of the Exchange Act would serve no substantive purpose.

The Committee also believes that, in light of the structural approach taken in the ICA to address substantively the conflicts of interests and opportunities for self-dealing between investment companies and their employees, advisers and principal underwriters, the corporate governance structure of registered investment companies required by the ICA and the rules thereunder and the limited range of accounting principles that are available in the preparation of investment company financial statements, it is not necessary in the best interests of investors and would serve no useful purpose to amend rules under the ICA simply to require certifications under Section 302 covering annual and semiannual reports to shareholders filed with the Commission under Section 30(b) of the ICA.

Specific Comments

Authority. The Commission has the authority to except registered investment companies from Section 302 of the Act. Section 3(a) of the Act provides the Commission plenary authority to promulgate rules and regulations that are necessary for the protection of investors and in furtherance of the Act. Such plenary authority carries with it the authority to distinguish between persons as to which the applicability of particular rules is appropriate and those as to which it is not. In addition, we believe that the Commission could adopt such an exemptive rule without providing any additional notice. It was clear from the June 2002 Release that registered investment companies would not be subject to a certification requirement. Thus, adequate notice and opportunity for comment for such an exemption has been provided.

Investment companies should not be covered by Section 302 of the Act. Investment company operations, their contract management relationships and the structure of investment company governance, and the substantive remedial statutory and regulatory provisions to which investment companies are subject distinguish them dramatically from those of substantially all other public companies. Although technically subject to the periodic filing requirements of Section 13(a) or 15(d) of the Exchange Act, their unique character and the substantially different disclosure regime to which investment companies have been subject for many years should render inapplicable a certification requirement arising from completely different and readily distinguishable public companies and the disclosure regime applicable to them.

Mutual funds continuously offer securities registered under the Securities Act of 1933, (the "1933 Act"). Registered open-end investment companies, constituting the predominant form of registered investment company per capita and by assets under management, continuously offer shares registered under the 1933 Act on the basis of an effective registration statement thereunder.² This contrasts with most public corporations, for which public offerings are reasonably rare events. In addition, under rules of the Commission, registered open-end investment companies amend such registration statements annually by post-effective amendment with the effect that the statute of limitations for claims under Section 11 of the 1933 Act for material misstatements and omissions never expires. Accordingly, the liability of registrants, individuals, including the chief executive officer and chief financial officer and the directors of investment companies, and their independent auditors which file a consent are at all times already subject to the highest disclosure standard established in the federal securities laws, indeed a higher one than provided in Section 302.

Fund Structure. In contrast to U.S. public corporations generally and as a consequence of the ICA and rules thereunder, registered management investment companies

(a) have a corporate governance structure under which substantially all such

² Most closed-end management investment companies do not continuously offer their securities pursuant to an effective registration statement. For all of the other reasons discussed in this letter, however, we do not believe they should be covered under Section 302 or distinguished from open-end companies.

companies have a majority of independent directors;

(b) are prohibited from entering into principal and joint transactions with affiliated persons, including officers and directors;

(c) are prohibited from issuing options and warrants to directors, officers and employees; indeed, very few investment companies have officers or employees who are not provided by their investment advisers, managers or administrators;

(d) cannot make loans to affiliated persons, including directors, officers and employees; and

(e) are permitted to have only limited leverage and simple capital structures, so that special purpose entities are effectively prohibited.

Registered unit investment trusts are even more limited in their activities and structure. They are passive, unmanaged investment vehicles, without directors or officers, with assets held by a bank trustee subject to strict limitations on permitted activities.

Form N-SAR is not designed to provide disclosure to investors. As noted above, the filing of Form N-SAR is deemed to satisfy an investment company's requirement to file periodic reports under Section 13(a) or 15(d) of the Exchange Act. Form N-SAR was developed primarily to provide information to the Commission as to the compliance of an investment company with the Commission's rules and regulations and with the fund's own internal limitations, as well as to provide information to the Commission on the basis of which to design its compliance and inspection programs. Form N-SAR does not provide information about an investment company's investment objectives, policies, restrictions or methods of operations, all of which are necessary for an informed investment decision.³ As a result, it is not reasonable to require a certification that an investment company's Form N-SAR 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 . . ." — the information in Form N-SAR simply does not purport to make a full and fair presentation of the investment company's business and affairs.

³ Section 553(b) of the Administrative Procedures Act would require that notice of proposed amendments to these forms (to incorporate additional disclosure requirements) or related Investment Company Act rules (to specify that that annual reports to shareholders are filed under Section 15(d)) be published in the Federal Register. Section 553(d) under the Administrative Procedures Act would require that such amendments, if adopted, be published thirty days before their effective date. We do not believe that the Commission would have "good cause" under either Sections 553(b) and 553(d), respectively, to forego the comment process or the advance publication requirement. The content of the certification required by Section 302 clearly contemplates that the certification requirement applies only to periodic reports that contain financial statements; and Section 302 clearly does not promulgate periodic reports or financial statement filing requirements that do not currently exist. In addition, Congress must have been aware that investment company periodic reports do not contain financial statements. Thus, there are no factors suggesting that notice of such wholesale rule changes is "impracticable, unnecessary or contrary to the public interest" for purposes of Section 553.

Annual and Semiannual Reports. Registered investment companies are required pursuant to Section 30(e) of the ICA to provide annual and semiannual reports to shareholders, including financial statements ("Section 30(e) Reports"), and, under Section 30(b), to file such reports with the Commission. As a result, Section 30(e) Reports are not filed under Section 13(a) or 15(d) of the Exchange Act. Even if rules under the ICA were amended to provide that Section 30(e) Reports were filed or submitted under the Exchange Act, the content of such reports is in striking contrast to annual reports on Form 10-K and quarterly reports on Form 10-Q required of other issuers required to file periodic reports under Sections 13(a) or 15(d) of the Exchange Act. Section 30(e) reports do not contain information on the business, operations, investment restrictions or policies, or the distribution or redemption of a fund's shares; they are not even required to, and do not, as has been acknowledged by the Commission⁴, contain a Management's Discussion and Analysis of Financial Conditions and Results of Operations ("MD&A") of the sort found in form 10-K and Form 10-Q, which are among the most meaningful of all portions of reports on Form 10-K and Form 10-Q. The Committee does not believe that Management's Discussion of Fund Performance ("MDFP") (required by Item 5 of Form N-1A) is the substantive equivalent of the MD&A. Moreover, Section 30(e) Reports do not replicate the important information contained in mutual fund prospectuses; they merely report results and in the MDFP, provide some insights (often prepared by the portfolio manager and not by the chief executive officer or the chief financial officer) in the reasons for a fund's comparative performance. Accordingly, it would also be unreasonable to mandate the certification required by Section 302 in respect of documents clearly not, and not required to be, crafted to include all information on the basis of which investors may make informed investment decisions.

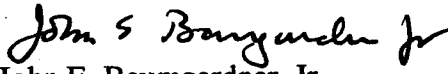
Temporary Exemption for Investment Companies. As noted above, the Committee believes that, if the Commission determines not to exempt investment companies from the certification requirement of Section 302, it should provide a temporary exemption to consider the specific circumstances of investment company governance and operations. Among the issues the Commission should consider in that context are (1) the fact that, in many cases, the investment company's chief executive officer and chief financial officer do not have the same primary employers, which may be and often are entirely unaffiliated persons; (2) the fact that retroactive restatements of investment company net asset values per share are reasonably common to reflect pricing and computational errors, such restatements being for the benefit of investors, redeemers and shareholders; (3) the pricing of portfolio securities for which market prices are unavailable is under the statutory authority of the board of directors, in which context the views of the chief financial officer may be and usually are taken into account, but as a statutory matter represent the determination of the board and not of the officers of the company; (4) the certification as to internal controls poses particular problems for investment companies because key services are provided and operations carried out under contract by one or more separate service providers (such as the adviser, administrator, custodian and transfer agent), whose activities must be coordinated to establish a reasonable basis for making the requisite certification; and (5) some funds, for example, unaffiliated feeders investing in master portfolios, have no authority or

⁴ Disclosure and Analysis of Mutual Fund Performance Information; Portfolio Manager Disclosure, Rel. No. 33-6850, IC-17294 (Jan. 8, 1990), p. 14.

responsibility for the financial statements of the master, on which those of the feeder are entirely dependent. Unit investment trusts pose similar issues, including identifying who, and in what capacity, can sign the certifications. In the context of the present rulemaking and the timing exigencies of the process, the Committee believes that these illustrations indicate by themselves the need for further thought by the Commission and the Division of Investment Management. As a result, the Committee suggests a temporary exemption so that an additional rulemaking process in which many more similar issues requiring appropriate differences between the certifications required by investment companies and other public companies can be usefully addressed.

As noted above, members of the Committee would be pleased to meet or discuss these comments further with the staff.

Very truly yours,


John E. Baumgardner, Jr.
Chair

Drafting Committee:

John E. Baumgardner, Jr.
Kenneth J. Berman
Stuart H. Coleman
Burton M. Leibert

**The Association of the Bar of The City of New York
Committee on Investment Management Regulation**

John E. Baumgardner, Jr. (Chair)	Sullivan & Cromwell
Marina Pearlman (Secretary)	Sullivan & Cromwell
Margaret A. Bancroft	Dechert
Edmund P. Bergan, Jr.	Alliance Capital Management L.P.
Kenneth J. Berman	Debevoise & Plimpton
Cynthia G. Cobden	Simpson Thacher & Bartlett
Stuart H. Coleman	Stroock & Stroock & Lavan
David Dickstein	Kirkpatrick & Lockhart LLP
Kenneth S. Gerstein	Schulte Roth & Zabel LLP
Frank W. Giordano	Adjunct Professor - St. John's Law School
Kenneth S. Gerstein	Schulte Roth & Zabel LLP
Joel H. Goldberg	Shearman & Sterling
William V. Healey	Prudential Investments Fund Management LLC
Daniel O. Hirsch	Deutsche Asset Management-Americas
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Lisa M. Hurley	BISYS
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Arthur Lev	FrontPoint Partners LLC
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John A. MacKinnon	Sidley Austin Brown & Wood LLP
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Frank J. Nasta	J. & W. Seligman & Co. Incorporated
Susan Penry-Williams	Kramer Levin Naftalis & Frankel LLP
Michael R. Rosella	Paul, Hastings, Janosky & Walker LLP
Michael Rosenbaum	Citigroup Asset Management
Victoria E. Schonfeld	Wilmer, Cutler & Pickering
Nina O. Shenker	JP Morgan Chase & Company
Stuart M. Strauss	Mayer, Brown, Rowe & Maw
Craig S. Tyle	Investment Company Institute
Robert M. Zakem	SunAmerica Asset Management