



**NASAA**

**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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February 5, 2004

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

Via e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

**Re: File No. S7-03-03; Release Nos. IA-2204; IC-26299  
Compliance Programs of Investment Companies and Investment Advisers**

Dear Mr. Katz:

The North American Securities Administrators Association, Inc. (NASAA)<sup>1</sup> is pleased to submit additional comments regarding the above-referenced rulemaking. We appreciate the opportunity to comment on the Commission's request for ideas on other measures or refinements to Rule 38a-1 of the Investment Company Act of 1940 that may further enhance the independence and effectiveness of chief compliance officers under the rule.

NASAA commends the Commission for adopting 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 to aid in the prevention of federal securities law violations. Through ambitious undertakings such as this, investor confidence in the mutual fund industry will be fully restored and investor protection will be enhanced.

The Commission acknowledges that a fund's chief compliance officer will often be employed by the fund's investment adviser, creating an actual or perceived conflict of interest. The investment adviser's business interests may discourage the employee of the investment adviser, acting as chief compliance officer for the fund, from making complete and forthright disclosure of the fund's compliance failures to the fund's

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

directors. NASAA does not object to a single individual acting in both capacities. For practical purposes, a compliance officer looking at the activities of a mutual fund must also have oversight of the advisory personnel implementing the fund's activities.

However, we do place paramount importance on the disclosures that should be made when this situation occurs. When a fund's chief compliance officer is an employee of the fund's investment adviser, it is essential that the investment adviser disclose the affiliation to its clients. We believe that Part II of Form ADV provides an appropriate vehicle for disclosure of all the compliance officer's affiliations and allegiances. NASAA supports amending Part II to require the investment adviser to outline the fact that the compliance officer has dual allegiances to the fund and the adviser.

NASAA and Commission staff presently are working on revising Part II of Form ADV and facilitating its filing and public disclosure through the Investment Adviser Registration Depository (IARD) and Investment Adviser Public Disclosure system (IAPD). These much-needed revisions and the electronic filing of Part II are priorities for NASAA. As part of the revisions, the Division of Investment Management, which is taking the lead for the Commission in this effort, should assure that full disclosure of the chief compliance officer's potential conflict is included in Part II.

It is equally essential that an open-end investment company disclose the compliance officer's dual allegiances to investors in the investment company's securities. NASAA urges the Commission to require specifically that open-end investment companies make public disclosure of the compliance officer's dual affiliation, and assure that actual and potential clients be given that disclosure.

The Commission also requested comment on whether the definition of "material compliance matters" that must be reported to fund boards by chief compliance officers adequately addresses the concern that fund boards receive compliance information they reasonably need to know in order to oversee fund compliance. NASAA urges the Commission to expand the definition to include a broader range of regulatory violations.

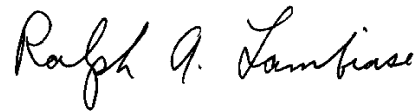
The text of Rule 38a-1(e)(2) defines the term "material compliance matter" to mean "those compliance matters – including violations of the federal securities laws or compliance policies and procedures by the fund or its service providers, as well as weaknesses in the design or implementation of those policies and procedures – about which the fund's board reasonably needs to know in order to oversee fund compliance." See Footnote 100 to Final Rule: Compliance Programs of Investment Companies and Investment Advisers, 17 CFR Parts 270, 275, and 279, Release Nos. IA-2204; IC-26299; File No. S7-03-03, 68 Fed. Reg. at 74723 (Dec. 24, 2003).

NASAA suggests that the definition be modified to include violations of state securities laws as well as violations of SRO rules. Expanding the definition will ensure that the board is advised of all significant securities violations. In addition, NASAA urges the Commission to expand the definition of "material compliance matter" to include pending investigations by federal and state regulators, as well as investigations by

self-regulatory organizations. NASAA believes that early notice of potential compliance problems, including those still under investigation, will enable boards to address such issues promptly and minimize their impact.

Should you have questions about NASAA's comments, please feel free to contact Patricia Struck, Chair of the NASAA Investment Adviser Section and Director of the Wisconsin Division of Securities, or Kristina Kneip, Chair of NASAA's Investment Adviser Regulatory Policy and Review Project Group and Senior Examination Attorney with the Washington State Securities Division. NASAA also wishes to recognize the contributions of Paul Schwartz and Lynn Naefach of the Pennsylvania Securities Commission.

Sincerely,

A handwritten signature in cursive script that reads "Ralph A. Lambiase".

Ralph A. Lambiase  
NASAA President and  
Director, Connecticut Division of Securities