SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 270, 274 and 275

[Release No. 33–7212, IC–21341, IA–1518, File No. S7–25–95]

RIN 3235–AG27

Personal Investment Activities of Investment Company Personnel and Codes of Ethics of Investment Companies and Their Investment Advisers and Principal Underwriters

AGENCY: Securities and Exchange Commission.

ACTION: Proposed amendments to rules and forms.

SUMMARY: The Commission is proposing amendments to the rule under the Investment Company Act of 1940 that prohibits investment company personnel from engaging in fraudulent acts in connection with their personal transactions in securities held or to be acquired by the investment company, and requires an investment company and its investment adviser and principal underwriter to adopt codes of ethics reasonably designed to prevent such acts. The amendments would increase the oversight role of an investment company's board of directors with respect to the codes of ethics applicable to the investment company, improve the manner in which investment company personnel report their personal securities transactions to their employers, and clarify certain provisions of the rule (including the scope of its anti-fraud provision). Related proposed amendments would require an investment company to provide information about its policies concerning personal investment activities in its prospectus. The Commission also is proposing conforming changes to the rule under the Investment Advisers Act of 1940 that requires an investment adviser to maintain records of its advisory representatives' personal transactions in securities. The proposed amendments are intended to enhance board of director oversight of the policies governing personal transactions in securities by investment company personnel and to make available to the public additional information about these policies.

DATES: Comments must be received on or before November 13, 1995.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Stop 6–9, Washington, DC 20549. All comment letters should refer to File No. S7–25–95. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.

FOR FURTHER INFORMATION CONTACT: David M. Goldenberg, Senior Counsel, or Kenneth J. Berman, Assistant Director, at (202) 942–0690, Office of Regulatory Policy, Division of Investment Management, 450 Fifth Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission today is requesting public comment on proposed amendments to rule 17j-1 (17 CFR 270.17j-1) under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et. seq.*) (the ''Investment Company Act''), rule 204–2 (17 CFR 275.204–2) under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 *et. seq.*) (the ''Advisers Act''), Forms N–1A (17 CFR 239.15A, 274.11A), N–2 (17 CFR 239.14, 274.11a-1), N–3 (17 CFR 239.17a, 274.11b) and N–5 (17 CFR 239.24, 274.5) under the Investment Company Act and the Securities Act of 1933 (15 U.S.C. 77a-77aaa) (the ''Securities Act'') and Form N–8B–2 (17 CFR 274.12) under the Investment Company Act.

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Executive Summary

Conflicts of interest between investment company (''fund'') personnel (such as portfolio managers) and their funds can arise when these persons buy or sell securities for their own accounts (''personal investment activities''). These conflicts arise because fund personnel have the opportunity to profit from information about fund transactions, often to the detriment of fund investors. Rule 17j–1 under the Investment Company Act addresses these conflicts of interest by: (i) Prohibiting fraudulent, deceptive or manipulative acts by fund affiliates and certain other persons in connection with their personal transactions in securities held or to be acquired by the fund; (ii) requiring funds and their investment advisers and principal underwriters (collectively, ''rule 17j–1 organizations'') to adopt codes of ethics containing provisions reasonably necessary to prevent their ''access persons'' (generally, those fund personnel involved in the portfolio management process) from engaging in conduct prohibited by the rule; and (iii) requiring access persons to report their personal securities transactions to the appropriate rule 17j–1 organization. The rule also imposes certain recordkeeping requirements.

The Commission's Division of Investment Management (''Division'') recently completed its first detailed study of fund policies concerning personal investment activities since rule 17j–1 was adopted in 1980.[1] In the report on its study, the Division recommended several of the amendments to rule 17j–1 that the Commission is proposing today.

The proposed amendments are designed to improve the regulation of personal investment activities in three respects. First, the proposals would enhance the oversight of personal investment activities by (i) requiring management of a fund and of its investment adviser and principal underwriter, at least annually, to provide the fund's board of directors with a report describing issues arising during the previous year under the codes of ethics applicable to the fund and (ii) requiring access persons to provide the appropriate rule 17j–1 organization with information about securities owned by them at the time they become access persons.

Second, the proposed amendments are designed to provide the public with additional information about fund policies concerning personal investment activities. The Commission is proposing to require that a fund's prospectus disclose whether or not the fund permits its personnel to invest in securities, including securities that may be purchased or held by the fund. In

[1] Division of Investment Management, SEC, Personal Investment Activities of Investment Company Personnel (1994) (''PIA Report'').

addition, a fund would have to file with the Commission copies of all codes of ethics applicable to the fund as exhibits to its registration statement.

Third, the proposed amendments would tailor rule 17j–1 to make its scope more consistent with its purpose. The proposed amendments would (i) clarify that transactions involving certain securities related to securities in which a fund invests (such as debt securities convertible into stock in which the fund invests) are subject to the rule's anti-fraud provision, (ii) specify that money market funds and money market instruments are not subject to the rule's requirements concerning codes of ethics and transaction reporting, and (iii) clarify the meaning of the term ''beneficial ownership'' for purposes of the rule's reporting requirements for access persons. The Commission also is proposing certain conforming changes to the recordkeeping provisions applicable to investment advisers in rule 204–2 under the Advisers Act.

I. Background

When fund personnel buy or sell securities for their personal accounts, conflicts of interest with fund investors may arise. For example, in performing their day-to-day responsibilities, fund personnel may have access to information about impending fund transactions that they could use for their own benefit. A fund manager also could profit if the manager causes a fund to purchase or hold portfolio securities in order to protect or strengthen the manager's personal investments in these securities.

Beginning in the early 1960s, Congress and the Commission sought to devise a regulatory scheme to effectively address these potential conflicts.[2] These efforts culminated in the enactment of section 17(j) of the Investment Company Act in 1970 and the adoption by the Commission of rule 17j–1 under the Investment Company Act in 1980.[3]

A. Section 17(j) and Rule 17j–1

Section 17(j) of the Investment Company Act makes it unlawful for persons affiliated with a rule 17j–1 organization (*i.e.*, a fund or its investment adviser or principal underwriter), in connection with the purchase or sale of securities held or to be acquired by the fund, to engage in any fraudulent, deceptive or manipulative act or practice in contravention of rules and regulations adopted by the Commission. Section 17(j) authorizes the Commission to adopt rules to address the conflicts of interest presented by personal securities trading by these persons, including rules requiring the adoption of codes of ethics by funds and their investment advisers and principal underwriters.

In 1980, the Commission adopted rule 17j–1.[4] The rule, which has not been amended since its adoption, prohibits fraudulent, deceptive or manipulative acts by persons affiliated with a fund or its investment adviser or principal underwriter in connection with their personal transactions in securities held or to be acquired by the fund.[5] The rule also (i) requires rule 17j–1 organizations to adopt codes of ethics containing provisions reasonably necessary to prevent ''access persons'' [6] from engaging in such fraudulent, deceptive or manipulative acts, (ii) requires access persons to report their personal securities transactions to the rule 17j–1 organizations of which they are access persons at least quarterly, and (iii) requires rule 17j–1 organizations to maintain certain records and to make those records available for inspection by the Commission.

Congress gave the Commission the authority to mandate that codes of ethics restrict or prohibit certain activities of access persons and other employees. The Commission recognized when adopting rule 17j–1, however, that no single set of guidelines would be appropriate for all funds. The Commission stated in the release adopting the rule that ''as a matter of policy the Commission believes the introduction and tailoring of ethical restraints on the behavior of persons associated with an investment company can best be left in the first instance to the directors of the investment company.'' [7] The rule therefore does not require that codes of ethics contain any specific restrictions or prohibitions. Additionally, while the rule does require access persons to report their personal securities transactions, it does not place restrictions on the timing or nature of those transactions, other than the general restrictions of the rule's anti-fraud provision.

B. Recent Developments Concerning Personal Investment Activities

The personal investment activities of fund personnel received renewed attention early in 1994 after an investment adviser to several funds dismissed a well-known portfolio manager, alleging that he had failed to report a number of his personal securities transactions as required under both the Investment Company Act and the Advisers Act.[8] At about the same time, the media reported that the country's largest fund complex had amended its rules on personal investment activities in response to certain trading practices.[9] These developments drew further media and congressional attention to the ethical

[2] *See, e.g.*, Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 200 (1966) (''PPI Report''). In the PPI Report, the Commission expressed its concern about the ''ever present danger'' of conflicts of interest that arises when fund personnel engage in personal trading. *Id.* at 195. The Commission noted a 1963 report that had found ''widespread'' insider trading of fund portfolio securities by fund personnel. *Id.* at 196.

[3] Abusive personal investment activities by fund access persons are prohibited not only by section 17(j) and rule 17j–1, but also by other provisions of the federal securities laws. For example, a fund manager who buys or sells securities for his or her own account ahead of the fund (''front running'') or makes investment decisions for the fund with the intent to benefit personally may violate the anti-fraud provisions of section 17(a) of the Securities Act and section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a *et. seq.*) (''Exchange Act'') and rule 10b–5 thereunder. The manager also may violate section 17(d) of the Investment Company Act and rule 17d–1 thereunder if the manager purchases or sells the same securities as the fund he or she manages in a joint transaction or arrangement. The manager also could violate section 206 of the Advisers Act if the manager's personal trading defrauds or operates as a fraud on the fund.

[4] Prevention of Certain Unlawful Activities With Respect To Registered Investment Companies, Investment Company Act Release No. 11421 (Oct. 31, 1980), 45 FR 73915 (''Adopting Release'').

[5] Rule 17j–1(a).

[6] As defined in rule 17j–1(e), ''access persons'' generally include officers, directors and any employees who participate in the selection of a fund's portfolio securities or who have access to information regarding a fund's impending purchases or sales of portfolio securities.

[7] Adopting Release, *supra* note 4, at 73916. The need for flexibility was explicitly recognized by Congress. The House and Senate Reports that accompanied section 17(j) noted that:

The ability to deal with (personal securities) transactions by rule is intended to permit the Commission to draw flexible guidelines to prohibit persons affiliated with investment companies, their advisers and principal underwriters, from engaging in securities transactions for their personal accounts when such transactions are likely to conflict with the investment programs of their companies.

H.R. Rep. No. 1382, 91st Cong., 2d Sess. 28 (1970) (''House Report''); S. Rep. No. 184, 91st Cong., 1st Sess. 29 (1969) (''Senate Report'').

[8] *See, e.g.*, Robert McGough and Sara Calian, *Invesco Funds Fires Kaweske, A Star Manager*, Wall St. J., Jan. 6, 1994, at C1; Chris Wloszczyna, *Invesco Funds Fires Portfolio Manager*, USA Today, Jan. 6, 1994, at 2B; Jay Mathews, *Invesco Fires Manager Over Trade Reports*, Wash. Post, Jan. 7, 1994, at G2. The Commission instituted an enforcement action in federal district court against the portfolio manager in February 1995, alleging, among other things, violations of rule 17j–1(c) under the Investment Company Act. SEC v. John J. Kaweske, Civil Action No. 95–N–296 (D. Colo. filed Feb. 6, 1995).

[9] *See, e.g.*, Brett D. Fromson, *Fund Managers' Own Trades Termed a Potential Conflict; Biggest Mutual Fund Firm Tightens Rules*, Wash. Post, Jan. 11, 1994, at A1.

standards in the fund industry.[10] In response to the concerns raised, the Division initiated a study of rule 17j–1 and the personal investment activities of portfolio managers and other fund employees. The Division released a report on its study (the ''PIA Report'') in September 1994.[11]

The Division studied the personal investment activities of 622 fund managers employed by thirty companies that, in the aggregate, managed 1,053 mutual funds with total assets of $521 billion. The Division concluded that the existing regulatory framework governing the personal investment activities of fund personnel generally has worked well, but can be improved in certain respects. The Division recommended that the Commission amend rule 17j–1 to further protect fund shareholders by (i) enhancing the oversight of personal investment policies by fund boards, (ii) making it easier for funds to monitor the personal securities transactions of fund personnel, and (iii) making available to the public additional information about fund policies on personal investment. The Commission agrees with the conclusions contained in the PIA Report and is proposing amendments that will effect these recommendations.[12]

II. Discussion

A. Role of Fund Boards

1. Initial Reviews and Annual Reports

The board of directors or trustees of a fund has a significant oversight role with respect to the personal investment activities of fund personnel.[13] The board is responsible for ensuring that the fund establishes a code of ethics that satisfies the requirements of rule 17j–1.[14] The Commission is proposing two amendments to rule 17j–1 that would facilitate ongoing board oversight of codes of ethics. First, the proposed amendments would require a fund's board to affirmatively approve the fund's code and review the codes of any investment adviser or principal underwriter whose services it seeks to retain for the fund.[15] Second, the proposed amendments would require management of a fund and of its investment adviser and its principal underwriter to provide the board, at least annually, with reports describing issues arising during the previous year under the codes of ethics applicable to the fund.[16]

Although rule 17j–1 currently requires every fund to have a code of ethics, the rule does not explicitly require a fund's *board* to take any actions regarding the fund's code or other codes of ethics applicable to the fund. The Commission believes that the rule should be more explicit concerning the role of fund boards. The Commission has refrained from requiring by rule that codes of ethics contain specific restrictions, prohibitions or other provisions, preferring instead that each board establish an appropriate code for its fund. Additionally, a code of ethics that is tailored to the specific characteristics of a fund is fundamental to assuring that access persons do not engage in fraudulent or unethical conduct. It therefore is appropriate that the rule explicitly require a fund's board to have a continuing role in overseeing the application of these policies.

The standard for the board to apply when approving the fund's code or reviewing the code of an investment adviser or principal underwriter would be whether the code contains such provisions as are reasonably necessary to prevent access persons from violating rule 17j–1's anti-fraud provision.[17] The factors that the board should consider when making this determination will necessarily vary depending upon the investment objectives and policies of the fund, as well as the organization and activities of the fund's investment adviser and principal underwriter. Thus, the Commission is not proposing to include in the rule a list of the factors a board should consider in assessing a code of ethics. The Commission believes, however, that the consideration of certain basic issues may be particularly important for all funds.

As an initial matter, the board should consider whether personal investing by fund personnel is consistent with the interests of fund shareholders and should be permitted. Additionally, the board should determine whether the code establishes clear criteria for determining whether a security is ''being considered for purchase'' by the fund.[18] Such criteria may better enable

[10] *See, e.g.,* Tom Petruno, *When It Comes to Fund Industry, Public Trust Must Be A Mutual Issue,* L.A. Times, Jan. 12, 1994, at D1; Steve Bailey and Aaron Zitner, *Mutual Fund Managers Come Under Scrutiny,* Bost. Globe, Jan. 16, 1994, at A1; Susan Antilla, *Fund Managers Testing the Rules,* N.Y. Times, Jan. 23, 1994, § 3, at 15; Geoffrey Smith, *Mutual Funds: The Rules on Insider Trading, Please,* Bus. Wk., Jan. 31, 1994, at 60. *See also* Letter from Edward J. Markey, Chairman, Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce, to Arthur Levitt, Jr., Chairman, U.S. Securities and Exchange Commission (Jan. 11, 1994).

[11] *See supra* note 1. The fund industry also responded to the concerns. The Investment Company Institute (''ICI''), an association of funds representing 95% of total fund assets under management in the United States, organized an Advisory Group on Personal Investing (''ICI Advisory Group''). The ICI Advisory Group, which consisted of six industry representatives, conducted a review of practices and standards governing personal investing by fund personnel. *See* ICI, Report of the Advisory Group on Personal Investing (1994) (''ICI Report''). The ICI Report stated that most codes of ethics reviewed by the Advisory Group exceeded the requirements of rule 17j–1, but recommended that funds adopt additional measures regarding conflicts of interest and personal securities transactions in order to preserve the confidence of investors. *Id.* at iii, v. The ICI's board of governors recommended that all rule 17j–1 organizations adopt the recommendations contained in the ICI Report.

The ICI subsequently conducted a survey of its members to determine whether the fund industry had adopted the recommendations made in the ICI Report. Eighty-five percent of the ICI's member funds responded to the survey. ICI, Report to the Division of Investment Management, U.S. Securities and Exchange Commission: Implementation of the Institute's Recommendations on Personal Investing (1995) (''ICI Survey''). The ICI Survey indicated that more than a majority of the funds responding to the survey had adopted most of the ICI Advisory Group's recommendations, either in full or as adapted to meet each fund's unique business activities, structure and operations. As discussed below in Part II.A.3, the Commission is seeking comment whether to incorporate any of the ICI Advisory Group's recommendations into rule 17j–1.

[12] The Division made three additional recommendations in the PIA Report. First, the Division recommended that the National Association of Securities Dealers, Inc. (''NASD'') consider adopting a rule requiring its members (i) to notify a fund or investment adviser whenever an employee opens an account with the member, and (ii) upon request, to provide duplicate copies of the employee's trade confirmations and account statements to the fund or adviser. Second, the Division recommended that the NASD review the applicability of its ''free-riding'' rules (which prohibit NASD members from selling ''hot issue'' securities to their employees) to fund personnel. Finally, the Division recommended in the PIA Report that Congress amend section 17(j) to expand the Commission's rulemaking authority to define and proscribe fraud to include transactions that involve financial instruments that are not securities.

The NASD has advised the Division that its Investment Companies Committee has considered and decided not to act on the Division's recommendations to the NASD. The Committee concluded that the NASD does not have a mechanism to ensure compliance with a new rule requiring a member to notify a fund or investment adviser when an employee opens an account with the member. The Committee also concluded that, in the absence of a pattern of abuses involving personal investment activities, amendments to its ''free-riding'' rules would not be appropriate.

[13] All references in this Release to boards of directors include boards of trustees for funds organized as business trusts.

[14] As part of its oversight role, the board also is responsible for monitoring the operation of the code, including making amendments as may be necessary or appropriate in light of any violations of the code and changing circumstances generally. *See* PIA Report, *supra* note 1, at 34.

[15] Proposed amendment to rule 17j–1(b). The codes of ethics of a fund's investment adviser and principal underwriter may be of greater importance than those of the fund because the investment adviser and principal underwriter typically employ most of the personnel involved in fund management.

[16] Proposed rule 17j–1(b)(2).

[17] Proposed rule 17j–1(b)(1)(ii).

[18] Paragraph (e)(6) of rule 17j–1 defines ''security held or to be acquired'' by a fund to mean any

access persons and compliance personnel to determine whether certain personal securities transactions may violate the fund's code or rule 17j–1.[19] These criteria also may serve to remind fund managers of their duty to avoid taking advantage of investment opportunities that should be brought to the attention of the fund.[20] Finally, a board should consider the extent to which the code addresses the potential violations of rule 17j–1 that may occur when a fund access person purchases or sells securities held by another fund in the same complex.[21]

Under the proposed amendments, the board also likely will wish to determine whether the rule 17j–1 organizations have instituted such procedures as are reasonably necessary to prevent violations of their codes. The rule would not mandate any particular compliance procedures (other than the rule's existing transaction reporting requirements).[22] A fund board, however, should consider the necessity of procedures based on the circumstances of the fund and the other rule 17j–1 organizations. A board may want to consider, for example, whether the code and procedures should include a requirement that all access persons receive prior approval of their personal securities transactions (''pre-clearance''). The board may decide that pre-clearance is a necessary part of the code in order to prevent persons from violating the code and rule 17j–1's anti-fraud provision.[23] The board also may want to consider whether other types of reporting requirements, in addition to those required by rule 17j–1, are appropriate for the fund.

The determinations required by the proposed amendments would need to be made by a majority of the fund's directors, including a majority of the independent directors (*i.e.*, directors who are not ''interested persons'' of the fund).[24] The role of independent fund directors in policing conflicts of interest is central to the Investment Company Act.[25] The codes of ethics applicable to a fund, and the manner in which these codes are implemented, should be designed to address the fundamental conflict of interest that results when fund access persons are in a position to take personal advantage of the knowledge and opportunities presented because of their positions. Thus, it is appropriate for independent directors to have a primary role in establishing and overseeing the implementation of the policies that address this conflict.

The board's involvement in the personal investment policies applicable to the fund should not cease after the board's initial approval or review of a code of ethics. Continued oversight of the personal investment policies applicable to the fund is in the interest of shareholders because it subjects these policies to independent, objective analysis by the ''watchdog'' for fund shareholders.[26] The proposed amendments would require the management of each rule 17j–1 organization to provide the board with a report, no less frequently than annually, describing issues arising during the previous year under the codes of ethics applicable to the fund. The report would include, but need not be limited to, details about code violations, sanctions imposed in response to those violations, procedures initiated or changed since the last report, and, in the case of the codes of the investment adviser or principal underwriter, changes to the code itself.[27] The proposed amendments also would require the management of each rule 17j–1 organization to certify to the fund board, no less frequently than annually, that the organization has adopted such procedures as are reasonably necessary to prevent access persons from violating the organization's code of ethics.[28] The report and certification requirements are designed to give the board an opportunity to evaluate and ask questions about the codes applicable to the fund, the manner in which they have been implemented, and their continued effectiveness.[29]

The Commission requests comment on the proposed board review, annual report and certification requirements. Are there other effective means of ensuring that boards are giving enough attention to the personal investment activities of fund personnel? Should the rule explicitly require board review when there have been material changes to a code or procedures, or when there have been significant or frequent violations of a code?

2. Unit Investment Trusts

Like other funds, unit investment trusts (''UITs'') and their principal underwriters currently are required by rule 17j–1 to adopt codes of ethics.[30] Because UITs do not have boards of directors, however, it would be difficult for them to comply with the proposed

security which, within the most recent 15 days, (i) is or has been held by the fund, or (ii) is being or has been considered by the fund or its investment adviser for purchase. When adopting rule 17j–1, the Commission indicated that ''the mechanics of setting parameters for determining when a transaction is 'being considered' by a particular investment company can best be resolved by the investment company, investment adviser or principal underwriter in the codes of ethics required to be adopted under the Rule.'' Adopting Release, *supra* note 4, at 73919.

[19] The board may conclude, for example, that it is appropriate to notify a fund's access persons that all securities that could be purchased by the fund are deemed ''being considered'' by the fund. Alternatively, the board may determine that a security is ''being considered'' by the fund once a research report relating to that security is prepared by, or received by, the fund's investment adviser.

[20] *See, e.g.*, In the Matter of Kemper Financial Services, Inc., *et. al.*, Investment Advisers Act Release No. 1494 (June 6, 1995) (investment adviser and portfolio manager found to have violated rule 17j–1(a)(3) under the Investment Company Act and the anti-fraud provision of the Advisers Act by diverting investment opportunities belonging to mutual fund clients to a profit-sharing plan established for the benefit of the adviser's employees); In the Matter of Joan Conan, Investment Advisers Act Release No. 1446 (Sept. 30, 1994) (portfolio manager found to have violated the anti-fraud provision of the Advisers Act by misappropriating an investment opportunity of clients that were unregistered investment funds).

[21] *See infra* note and accompanying text.

[22] *See* Part II. B for a description of, and proposed amendments to, these reporting requirements.

[23] Although the rule does not require that funds adopt pre-clearance procedures, the Commission notes that the ICI Advisory Group recommended that funds adopt these measures. ICI Report, *supra* note 11, at 42. The ICI Survey indicated that 69% of the funds responding to the survey had adopted the ICI Advisory Group's recommendation, and an additional 14% had modified the recommendation to reflect their own circumstances. ICI Survey, *supra* note 11, at 26.

[24] *See* 15 U.S.C. 80a–2(a)(19) (definition of ''interested person'' for purposes of the Investment Company Act).

[25] *See, e.g.*, Division of Investment Management, SEC, Protecting Investors: A Half Century of Investment Company Regulation 266 (1992).

[26] *See id.* at 255–56; PIA Report *supra* note 1, at 34.

[27] Upon receipt and consideration of a report, a fund board may in some cases determine that it is necessary to amend the fund's code, or to suggest to an investment adviser or principal underwriter that it consider amending its code. Reports prepared for, and submitted to, fund boards would be required to be maintained with the other records required by rule 17j–1.

[28] Although the proposed amendments would require a report and certification to be delivered to the board only annually, more frequent reports may be warranted in certain instances, such as when there have been particularly significant violations of a code or when there have been material changes to a code. In some instances, it may be determined that a particular violation or change should be reported to the board at its next meeting.

[29] In the ICI Report, the ICI Advisory Group made a recommendation similar to that proposed by the Commission today. ICI Report, *supra* note 11, at 47.

[30] A UIT is a type of fund that issues redeemable securities representing an undivided interest in a portfolio of specified securities. 15 U.S.C. 80a–4(2). Typically, UITs are created by a sponsor or ''depositor'' that accumulates a portfolio of securities and deposits them with a trustee under the terms of a trust indenture. The UIT portfolio is generally unmanaged; thus, UITs do not have investment advisers. The UIT's operations are subject to the terms of the trust indenture, which specifies the ongoing responsibilities of the trustee, the depositor and other third-party service providers. Thus, a UIT does not have a corporate-type management structure. *See generally* Form N–7 for Registration of Unit Investment Trusts Under the Securities Act of 1933 and Investment Company Act of 1940, Securities Act Release No. 6580 (May 14, 1985), 50 FR 21282.

amendments in the same manner as other funds. The principal underwriter or depositor of a UIT typically employs most of the persons having access to information concerning the UIT's securities. Under the proposed amendments, the initial approval and review requirement for a UIT would be fulfilled by either the principal underwriter or depositor for the UIT. The principal underwriter or the depositor would review all of the codes of ethics applicable to the UIT (i.e., the codes of the principal underwriter and the UIT) and determine whether the codes meet the standards described above.[31] Because they do not have boards of directors, UITs would be exempt from the proposed annual report and certification requirements. The principal underwriter or depositor would still be responsible, however, for ensuring that the codes of ethics applicable to the UIT and the related procedures contain provisions reasonably necessary to prevent access persons from violating rule 17j–1 and the codes.

The Commission recognizes that the absence of board review places the oversight of the operation of codes applicable to the UIT in the hands of the very people who may face the conflicts of interest that the rule is designed to address. The Commission requests comment whether an independent person or committee within the organization of the principal underwriter or depositor should review these codes. Should, for example, the underwriter be required to appoint a committee of persons who are not access persons to approve or review the codes? In addition, the Commission requests comment whether there are other investment companies that, like UITs, should be exempt from the annual report and certification provisions.

3. Alternative Approaches

As noted above, rule 17j–1 is based on the premise that rule 17j–1 organizations should be primarily responsible for tailoring specific restrictions and prohibitions on the personal investment activities of their access persons. The Division's PIA Report concluded that this premise continues to be correct.[32] Nevertheless, comment is requested whether rule 17j–1 should set more detailed standards for codes of ethics.

In its report on personal investment activities, the Investment Company Institute's Advisory Group on Personal Investing (''ICI Advisory Group'') suggested that codes of ethics should contain certain minimum substantive restrictions on the activities of access persons and other investment personnel. The ICI Advisory Group recommended, among other things, that codes of ethics prohibit investment personnel from participating in initial public offerings, receiving short-term trading profits, receiving gifts from persons with whom the fund has a business relationship, and purchasing securities during certain ''black-out periods.[33] The ICI Advisory Group did not recommend that the Commission amend rule 17j–1 to incorporate these recommendations. Should the Commission impose any specific restrictions on the personal investment policies of rule 17j–1 organizations and their access persons?[34]

B. Reports by Access Persons

1. Initial Reports

The Commission is proposing that rule 17j–1 require that every access person[35] provide a listing (an ''initial report'') of all securities directly or indirectly beneficially owned by the access person at the time that he or she becomes an access person.[36] Paragraph (c) of the rule currently requires every access person to report to the appropriate rule 17j–1 organization, at least quarterly, all transactions in which the access person has, or by reason of the transaction acquires, any direct or indirect beneficial ownership in any security (''quarterly reports'').[37] A fund, however, may not be able to monitor effectively the potential conflicts of interest that arise when an access person invests for his or her own account unless fund management knows the identity of *all* securities held by the access person, including securities acquired before the person became an access person.[38] For example, without knowledge of securities owned by an access person, the fund cannot adequately monitor if, and the extent to which, the access person may be making trading decisions on behalf of the fund regarding securities that the access person holds in his or her own portfolio.[39]

It appears to be common practice in the fund industry to require personnel to disclose personal securities holdings upon the commencement of employment.[40] Therefore, the initial report requirement should not create an additional burden for most rule 17j–1 organizations. To prevent duplicative reporting, the amended rule would provide that if an access person has previously provided information equivalent to that which would be in an initial report (whether in a single report or over time in transactional reports), the access person would not be required to submit an initial report.[41]

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[31] Last sentence of proposed rule 17j–1(b)(1)(ii).

[32] PIA Report, *supra* note 1, at 31.

[33] *See* ICI Report, *supra* note 11.

[34] Some commentators have advocated more comprehensive restrictions, such as banning all personal trading by fund personnel. *See, e.g.,* Stan Hinden, *Avoiding Conflicts—Real and Perceived,* Wash. Post, May 22, 1994, at H3; *Mutual Funds Need Tighter Rules,* Bus. Wk., Feb. 14, 1994, at 134; Susan Antilla, *Fund Managers Testing the Rules,* N.Y. Times, Jan. 23, 1994, § 3, at 15. In the PIA Report, the Division concluded that a total prohibition on personal investment activities by fund personnel is not warranted. PIA Report, *supra* note 1, at 29.

[35] *See supra* note 6.

[36] Proposed amendments to rule 17j–1(c)(1). The report would be required to be filed within 10 days of the event that causes the employee to become an access person (*e.g.,* hiring, promotion, change of position). The initial report would list the title of the security, its CUSIP number (if any), the number of shares held and the principal amount of the security. The Commission also is proposing to amend paragraph (c)(2) of the rule to require quarterly reports to include the CUSIP number (if any) for each security for which a transaction occurs and the date that the report is submitted by the access person. These amendments would assist fund compliance personnel and the Commission's inspections staff in evaluating compliance with the rule's reporting requirements. *See infra* note 38.

[37] *See supra* note 5. In many cases, an employee of an investment adviser or principal underwriter may technically be an access person of both his or her employer and the fund. The staff of the Division has taken the position that if in such a case the employer is required by rule 17j–1 to have a code of ethics, the employee need only be considered an access person of the employer and not of the fund. *See* Investment Company Institute (pub. avail. Mar. 31, 1981).

[38] *See* PIA Report, supra note 1, at 34. Not only are the reports required by rule 17j–1 important to fund management, but they also are important to the Commission's inspections staff, which reviews these reports and codes of ethics during inspections of rule 17j–1 organizations.

[39] Although rule 17j–1 does not explicitly prohibit an access person from making decisions on behalf of a fund regarding securities personally owned by the access person, the Commission would expect that codes of ethics would address this potential conflict of interest, and that boards of directors would wish to have the ability to track such decisions by access persons in order to determine whether these decisions are being inappropriately made. *See* PIA Report, *supra* note 1, at 24 n.74, 35 n.118. *See also* In re ML-Lee Acquisition Fund II, L.P., 848 F. Supp. 527 (D. Del. 1994) (rule 17j–1 may be violated if an access person causes a fund to purchase or sell securities owned by that person, particularly when the access person expects to personally benefit by the transaction).

[40] The ICI found that 77% of the fund complexes responding to its survey require some form of reporting similar to that proposed today. *See* ICI Survey, *supra* note 11, at 31.

[41] Proposed paragraph (c)(3)(v) of rule 17j–1. The proposed exception is intended to give rule 17j–1 organizations flexibility with respect to the initial report requirement. To comply with the exception, the applicable rule 17j–1 organization would have to retain all of the previously submitted information so that the organization could reconstruct the access person's securities holdings on the day that he or she became an access person. Additionally, all of the information used to reconstruct the access person's holdings would have to be maintained for five years from the date that the person becomes an

The ICI Advisory Group recommended that access persons file reports listing all of their securities holdings upon commencement of employment and thereafter annually.[42] The Commission requests comment whether an annual reporting requirement by access persons would be helpful to funds. To what extent would such a requirement be an undue burden on the persons required to file the reports? The Commission also requests comment whether ten days is the appropriate amount of time for a new access person to provide an initial report. Should new access persons be given additional time (*e.g.*, 15 or 20 days) to file these reports?

2. Scope of Reporting Requirements

The proposed amendments would require an access person to list in an initial report *every* security (as defined in rule 17j–1) beneficially owned by the access person, regardless of whether the security is connected to a security that the fund owns or intends or proposes to acquire at the time that the access person files the initial report. This approach departs from an earlier Division position.[43]

In response to inquiries made shortly after the adoption of rule 17j–1, the staff of the Division took the position that reports required to be made pursuant to paragraph (c) of the rule need be made only with respect to transactions in securities that may be connected to securities that the fund holds or intends or proposes to acquire.[44] These requests involved specific funds with investment objectives that permitted them to invest only in limited types of securities, such as municipal bonds.

The Commission believes that limiting the scope of the rule's reporting requirement may result in gaps in a rule 17j–1 organization's oversight of personal investment activities. For example, an employee of an investment adviser may violate the anti-fraud provision of rule 17j–1 by purchasing a security intended to be acquired by another fund in the same fund complex, even if the employee was not involved in the decision to purchase the security on behalf of the fund. If the employee did not have to report the transaction because the fund of which the employee was an access person did not own, and was not intending or proposing to acquire, the security, the transaction would escape the attention of fund compliance personnel. Comprehensive reporting requirements for both initial and quarterly reports would enable fund directors to determine whether access persons are inappropriately benefitting from their relationship with a fund, investment adviser or principal underwriter.[45] Thus, if the proposed amendments are adopted, the rule will be interpreted as requiring quarterly reports to be filed with respect to transactions in *all* securities. The Commission seeks comment on the effect that these reporting requirements would have on access persons and funds.[46]

3. Review of Reports

Rule 17j–1 currently requires that rule 17j–1 organizations inform access persons of their duty to make quarterly reports and to retain these reports in their records. The Commission is proposing to amend rule 17j–1 to specify that the procedures instituted by rule 17j–1 organizations to prevent violations of the code must include procedures for the review by appropriate managerial or compliance personnel of reports submitted by access persons.[47]

The transaction reporting requirements of rule 17j–1 are intended to keep rule 17j–1 organizations informed of the personal investment activities of access persons in order for these organizations to detect potential conflicts of interest and abusive practices. This purpose will be served only if the reports are reviewed. Procedures that specify not only that reports will be reviewed but that also assign the responsibility for review to specified personnel will increase the likelihood that the purposes of the reporting requirement will be met.

4. Duplicate Broker Reports

It appears to be increasingly common in the fund industry to require access persons of funds to direct their brokers to provide their employers with copies of confirmations of their personal securities transactions and periodic account statements (collectively, ''duplicate broker reports'').[48] The Commission believes that duplicate broker reports can be an appropriate substitute for quarterly reporting. The proposed amendments would provide that, at the option of the appropriate rule 17j–1 organization, access persons may provide duplicate broker reports in lieu of the quarterly reports.[49]

C. Disclosure of Personal Investing Policies

The Commission is proposing that each fund disclose in its prospectus that the fund and its investment adviser and principal underwriter have adopted codes of ethics relating to personal investment activities and whether or not these codes permit fund personnel to invest in securities (including securities that may be purchased or held by the

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access person, in accordance with the recordkeeping requirements of paragraph (d) of the rule. Because the proposed exception could require an organization relying on the exception to maintain some records for a longer period of time than it otherwise would, rule 17j–1 organizations may choose to require new access persons to submit new initial reports rather than rely on the exception.

[42] *See* ICI Report, *supra* note , at 46.

[43] *See* Alterman Investment Fund, Inc. (pub. avail. Sept. 17, 1981); Minbanc Capital Corp. (pub. avail. Sept. 17, 1981); MI Fund, Inc. (pub. avail. Sept. 17, 1981).

[44] *Id.*

[45] *See* PIA Report, *supra* note 1, at 34 n.116. A list of all securities owned, purchased and sold by an access person also may be a necessary element of the written policies that a registered investment adviser must establish, maintain and enforce, in accordance with section 204A of the Advisers Act, to prevent the misuse of material, non-public information by the adviser and its personnel.

[46] The facts of some recent enforcement actions brought by the Commission have demonstrated that the opportunity for abusive practices may exist where a portfolio manager or other fund insider receives personal investing opportunities in connection with his or her recommendation that the fund purchase a specific security. *See, e.g., United States* v. *Ostrander*, 999 F.2d 27 (2nd Cir. 1993) *aff'g* 792 F. Supp. 241 (S.D.N.Y. 1992); *SEC* v. *Talton R. Embry*, Litigation Release No. 13777 (Sept. 9, 1993); *SEC* v. *Benalder Bayse, Jr.*, Litigation Release No. 13145 (Jan. 24, 1992). The Division staff expressed a similar concern in response to no-action requests regarding rule 204–2(a)(12) under the Advisers Act of 1940, which requires records to be kept of the securities transactions of investment adviser personnel similar to the reports required under paragraph (c) of rule 17j–1. *See* American Syndicate Advisors (pub. avail. Oct. 29, 1986); Financial Independence Advisers, Inc. (pub. avail. Oct. 28, 1985). The change in the Division's interpretation would make it easier for fund compliance personnel and the Commission's inspections staff to identify cases in which fund insiders receive special opportunities in connection with their investing on behalf of a fund.

[47] Proposed rule 17j–1(b)(1)(i). The name of the person or persons responsible for reviewing these reports would be required to be maintained in an easily accessible place for five years under proposed amendments to paragraph (d)(4) of the rule.

[48] The ICI Advisory Group recommended that funds adopt these measures. ICI Report, *supra* note 11, at 44. The ICI Survey indicated that 70% of fund complexes responding to the survey had adopted the ICI Advisory Group's recommendations, and that an additional 14% of fund complexes responding to the survey had adapted these recommendations to their particular circumstances. ICI Survey, *supra* note , at 27.

[49] Proposed rule 17j–1(c)(3)(vi). The duplicate broker report would be required to contain the same information that would appear on a quarterly report, and must be received by the rule 17j–1 organization within 10 days after the end of the quarter in which the transaction takes place. A duplicate broker report that does not contain all of the information required by paragraph (c)(2) would satisfy the rule if the missing information were contained in the records of the appropriate rule 17j–1 organization.

fund) for their own accounts.[50] The fund also would disclose that these codes are on public file with, and are available from, the Commission.[51]

As noted in the PIA Report, recent press accounts have suggested that fund shareholders may not fully understand the potential conflicts of interest faced by fund managers.[52] The ICI Advisory Group, in recommending prospectus disclosure concerning fund codes of ethics, stated that the most recent controversy over personal investing is ''in some significant part a product of insufficient information regarding current practices and standards.'' [53] There currently is no requirement that funds publicly disclose any information about their codes of ethics, and recent media accounts have suggested that it often is difficult to obtain this information.[54] The Commission believes that disclosure concerning the existence of fund personal investing policies to investors not only would provide investors with information they may want when making investment decisions, but also may encourage fund boards to exercise greater care in considering the contents of codes of ethics applicable to their funds.

The Commission believes that the proposed prospectus disclosure can be brief and clear, and thus it is consistent with the Commission's efforts to make prospectuses easier to read for investors.[55] The Commission requests comment whether a more detailed description should be provided in the Statement of Additional Information (''SAI'') or in the prospectus. If a fund's code of ethics conforms to a generally accepted industry norm, should a statement to that effect be sufficient to satisfy this requirement? [56] Commenters should indicate how an industry norm can be identified, and whether divergences from the norm that reflect the particular situations of the fund should be disclosed.

The Commission believes that the codes of ethics applicable to a fund should be available to the public. The Commission therefore is proposing that each fund file all codes of ethics applicable to it as an exhibit to its registration statement.[57] Making codes of ethics publicly available will permit the financial press and market professionals to obtain information about personal investment policies and to disseminate this information to the public.[58] The Commission requests comment whether funds should be required to send copies of their codes of ethics to investors upon request.

D. Applicability of Rule 17j–1 to Options and Convertible Securities

Paragraph (a) of rule 17j–1 prohibits fraudulent, deceptive or manipulative acts by fund affiliates and certain other fund insiders in connection with their personal transactions in securities held or to be acquired by the fund. The Commission is proposing to amend rule 17j–1 to clarify that this anti-fraud provision applies to any purchase or sale of an option for, or a security that is exchangeable for or convertible into, a security that is held or to be acquired by a fund (collectively, ''related securities'').[59]

Congress contemplated that the Commission's rules ''could apply to insider trading in the convertible securities, options and warrants of issuers whose underlying securities are owned by an investment company with which the insider is affiliated.'' [60] The value of a related security often is directly affected by the value of the underlying security. A fund insider who purchases or sells such a related security could improperly benefit from that transaction to the same extent as an insider who conducts a similar transaction in the underlying security.[61] The fact that the transaction involves a related security rather than the underlying security does not diminish its potential for providing an improper benefit to the insider at the expense of the fund and its shareholders.

The Commission requests comment whether this amendment would appropriately clarify the scope of the rule. Should paragraph (a) of rule 17j–1 incorporate other standards to define the types of related securities that fall within the scope of the rule, such as the standard used to determine whether an arrangement creates a ''pecuniary interest'' in an equity security for purposes of section 16 under the Securities Exchange Act of 1934 (''Exchange Act'') [62]

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[50] If a fund is not required to have a code of ethics, the proposed amendment would not require any prospectus disclosure of that fact. A fund that invests only in the securities of another fund (as is the case with ''master/feeder'' funds or variable annuities structured as unit investment trusts that invest in an underlying fund) would be required to disclose the requested information for the fund in which it invests and for such fund's investment adviser and principal underwriter. *See* Letter from Richard C. Breeden, Chairman, SEC, to John D. Dingell, Chairman, Committee House Committee on Energy and Commerce (Apr. 15, 1992), at Part III; Letter from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC, to Registrants (Feb. 22, 1993), at Comment II.H. The new disclosure would be required under proposed amendments to Item 5 of Form N–1A, Item 9 of Form N–2, Item 6 of Form N–3, Item 3 of Form N–5 and Item 41 of Form N–8B–2.

[51] The Commission also is proposing that a fund be required to file with the Commission all codes of ethics applicable to the fund as exhibits to the fund's registration statement. *See infra* text accompanying note 57.

[52] PIA Report, *supra* note 1, at 13, 33.

[53] ICI Report, *supra* note 11, at 49.

[54] *See, e.g.*, Christopher Phillips, *Keeping Your Fund Manager Honest*, Kiplinger's Pers. Fin. Mag., Apr. 1994, at 57, 58; John Accola, *Only 1 of Top 4 Mutual Fund Firms Reveals Ethics Codes*, Rocky Mountain News, Feb. 6, 1994, at 93A. *See also* John Accola, *Janus First to Announce Revised Code of Ethics*, Rocky Mountain News, Jan. 15, 1995, at 98A (describing how the fund group provided a general outline of its code after many investor requests but had been advised by its attorneys not to release the complete document).

[55] *See, e.g.*, Arthur Levitt, Chairman, SEC, Taking the Mystery Out of the Marketplace: The SEC's Consumer Education Campaign, Remarks before the National Press Club (Oct. 13, 1994); Jeffrey M. Laderman, *The Prospectus Tries Plain Speaking*, Bus. Wk., Aug. 14, 1995, at 72; Stan Hinden, *Investor Protection, Plain and Simple; The SEC Unveils a New Fund Prospectus Written in Basic, Understandable Language*, Wash. Post, July 30, 1995, at H3; Albert B. Crenshaw, *SEC Ponders How to Make Prospectuses Speak Plainly*, Wash. Post, Oct. 16, 1994, at H1, H12.

[56] The ICI Advisory Group recommended certain minimum standards for all codes of ethics, such as prohibiting fund personnel from investing in initial public offerings, receiving short-term trading profits, and receiving gifts. *See* ICI Report, *supra* note 11. The ICI Survey indicated that a majority of fund complexes that responded to the survey are in some manner adopting these standards. *See* ICI Survey, *supra* note 11.

[57] If a fund is not required to have a code of ethics because it is a money market fund or because its investment policies permit it to invest only in securities that are exempt from the definition of ''security'' in rule 17j–1(e)(5), the fund would not be required to file any code, but would indicate on its exhibit list the reason that no code of ethics is being filed. If the fund invests only in the securities of another fund (as is the case with ''master/feeder'' funds), the fund would be required to file the codes of ethics applicable to the fund in which it invests. The exhibits would be required under proposed amendments to Item 24 of Forms N–1A and N–2, Item 28 of Form N–3, the Instructions As To Exhibits of Form N–5 and Part IX of Form N–8B–2.

[58] Prior to the adoption of Form N–SAR (17 CFR 249.330, 274.101) in 1985, funds made periodic reports on Form N–1R. Funds were required to file a copy of any codes of ethics or other written conflicts policies as exhibits to the form. *See, e.g.* Prevention of Unlawful Activities with Respect to Registered Investment Companies, Investment Company Act Release No. 10162 (Mar. 20, 1978), 43 FR 12721. Form N–SAR does not include a similar requirement.

[59] Proposed amendment to rule 17j–1(e)(6).

[60] House Report, *supra* note 7, at 28; Senate Report, *supra* note 7, at 29.

[61] Similarly, a fund insider who purchases or sells an underlying security when the fund holds or intends to purchase the related security could, in some instances, improperly benefit from that transaction. A security that underlies an option, warrant or convertible security held by a fund generally would be a security that is being considered for purchase by the fund.

[62] *See* rule 16a–1(a)(2) (17 CFR 240.16a–1(a)(2)) under the Exchange Act, which provides that certain persons are deemed to beneficially own specified equity securities if they have a ''direct or indirect pecuniary interest'' in the securities. The rule defines a pecuniary interest in an equity security as ''the opportunity, directly or indirectly,

E. Other Amendments

1. Money Market Instruments

Money market instruments and shares of open-end funds would appear to present little opportunity for the type of improper trading that rule 17j–1 is intended to cover.[63] The Commission therefore excepted bankers' acceptances, bank certificates of deposit, commercial paper and shares of open-end funds from the definition of ''security'' for purposes of rule 17j–1.[64] Since the adoption of the rule, the Division has issued several no-action and interpretive letters generally restating the Commission's position that all money market instruments (and not only those specified by the rule) are excepted from the rule's definition of ''security.''[65] The Commission proposes to amend the definition of ''security'' in the rule to specifically provide that, in addition to the money market instruments currently listed, repurchase agreements and other high quality short-term debt instruments also are excepted from the definition.[66] The proposed amendments also provide that money market funds are not required to adopt codes of ethics.[67] The Commission requests comment whether there are other types of securities that, like money market instruments, would appear to present little opportunity for the type of improper trading that rule 17j–1 is intended to cover, and thus should be excepted from the definition of ''security'' for purposes of the rule.

2. Beneficial Ownership

Rule 17j–1 currently provides that, for purposes of the reporting requirement of paragraph (c) of the rule, beneficial ownership should be interpreted in a manner that is consistent with the way that term is interpreted for purposes of section 16 of the Exchange Act. In 1991, the Commission adopted revised rule 16a–1 under the Exchange Act in part to clarify the meaning of beneficial ownership for purposes of section 16.[68] Shortly thereafter, the Division issued a letter stating that the definition of beneficial ownership provided in newly adopted rule 16a–1(a)(2) under the Exchange Act should be used when determining beneficial ownership for purposes of paragraph (c) of rule 17j–1.[69] The Commission proposes to amend rule 17j–1(c) to incorporate this interpretation.

3. Conforming Amendments to Advisers Act Rules

Under paragraphs (a)(12) and (a)(13) of rule 204–2 under the Advisers Act, every investment adviser is required to keep records of the personal securities transactions of the adviser and its ''advisory representatives'' (as defined in the rule). Although the purposes of these paragraphs are substantially the same as the purposes of paragraph (c) of rule 17j–1, the two rules except transactions in different securities from their respective reporting/recordkeeping requirements. Currently, the rule under the Advisers Act excepts from its recordkeeping requirements only transactions in government securities.[70] The Commission believes the reporting requirements for the two rules should cover the same securities. Therefore, the Commission is proposing to amend rules 204–2(a)(12) and 204–2(a)(13) to except from the recordkeeping requirement transactions in securities that are (i) direct obligations of the U.S. Government, (ii) high quality short-term instruments,[71] including but not limited to bankers' acceptances, bank certificates of deposit, commercial paper and repurchase agreements, and (iii) shares of registered open-end investment companies. The Commission also proposes to incorporate the definition of beneficial ownership in rule 16a–1(a)(2) under the Exchange Act into rule 204–2.[72]

III. General Request for Comments

Any interested persons wishing to submit written comments on the rule and form changes that are the subject of this Release, to suggest additional changes, or to submit comments on other matters that might have an effect on the proposals contained in this Release, are requested to do so.

IV. Cost/Benefit Analysis

Funds and the public would benefit from the proposed amendments because the amendments would help prevent fraudulent activity, the costs to the public and shareholders of which could far exceed the cost of compliance with the proposed amendments.

The proposed amendments would impose certain additional costs on rule 17j–1 organizations and their access persons to the extent that these organizations do not currently require their access persons to file initial reports listing all securities held by the access persons, and to the extent the currently required quarterly reports do not include all securities transactions by access persons. Because access persons already are required by rule 17j–1 to file quarterly reports, however, the cost to these entities of accommodating initial reports is estimated to be minimal. The costs to access persons of compiling such reports also is estimated to be minimal.

Funds would incur additional costs for the proposed initial review of the codes applicable to the funds, the annual report and certification from fund management, the additional prospectus disclosure and the filing of applicable exhibits under the proposed amendments. However, in certain cases, fund costs would decrease because the proposed amendments would expand the list of securities exempt from the recordkeeping requirements.

to profit or share in any profit derived from a transaction in the subject securit(y).'' The rule includes examples of ''indirect pecuniary interests,'' such as a general partner's proportionate interest in a portfolio of securities held by the partnership, certain performance-based fee arrangements, and a person's interest in securities held in a trust. As noted below, this definition is being incorporated into the rule's reporting provisions. *See infra* note 69 and accompanying text.

[63] *See* Adopting Release, *supra* note 4, at 73919.

[64] Rule 17j–1(e)(5). The rule also excepts ''securities issued by the Government of the United States'' from the definition. The proposed amendments would change this exception to read ''direct obligations of the Government of the United States'' in order to conform the exception to the exception for these securities listed in rules 204–2(a)(12) and 204–2(a)(13) under the Advisers Act. *See infra* part II.E.3. *See also*, ACM Government Income Fund, Inc. (pub. avail. Dec. 15, 1988) (Division staff interprets the reference to government securities in rule 17j–1(e)(5) to refer only to direct obligations of the United States, and not to obligations of instrumentalities).

[65] *See, e.g.,* The Mexico Fund, Inc. (pub. avail. Aug. 23, 1982); The Securities Groups Money Fund, Inc. (pub. avail. May 6, 1982); Institutional Liquid Assets (pub. avail. July 6, 1981).

[66] Proposed amendment to rule 17j–1(e)(5). The Commission interprets ''high quality short-term debt instrument'' to mean any instrument having a maturity at issuance of less than 366 days and which is rated in one of the highest two rating categories by a Nationally Recognized Statistical Rating Organization, or which is unrated but is of comparable quality.

[67] Proposed amendment to rule 17j–1(b). This is consistent with an interpretive position taken by the Division staff that funds that invest only in securities that are excepted from the definition of ''security'' in rule 17j–1, and their investment advisers and principal underwriters, are not required to adopt codes of ethics. Investment Company Institute (pub. avail. Mar. 31, 1981).

[68] *See* Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Securities Exchange Act Release No. 28869 (Feb. 8, 1991), 56 FR 7242. *See also supra* note 62.

[69] *See* Investment Company Institute (pub. avail. July 31, 1991).

[70] The Division staff has issued several no-action letters stating that transactions in shares of funds unaffiliated with the investment adviser are exempt from the recordkeeping requirements of paragraphs (a)(12) and (a)(13) of rule 204–2. *See, e.g.,* Massachusetts Financial Services Co. (pub. avail. Oct. 6, 1992). The Division staff also currently takes the position that transactions in shares of affiliated open-end funds are exempt from the recordkeeping requirements.

[71] *See supra* note 66.

[72] *See supra* note 69 and accompanying text.

V. Summary of Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603 regarding amendments to rule 17j–1 under the Investment Company Act and rule 204–2 under the Advisers Act, and amendments to fund registration forms under the Investment Company Act and the Securities Act. The analysis notes that the amendments are designed to improve the regulation of personal investment activities by enhancing the oversight of these activities by rule 17j–1 organizations, providing the public with additional information about fund personal investment policies and making the scope of rule 17j–1 more consistent with its purpose. Cost-benefit information reflected in the ''Cost/Benefit Analysis'' section of this Release also is reflected in the analysis. A copy of the Initial Regulatory Flexibility Analysis may be obtained by contacting David M. Goldenberg, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 10–2, Washington, DC 20549.

VI. Statutory Authority

The Commission is proposing to amend rule 17j–1 pursuant to the authority set forth in sections 17(j) and 38(a) of the Investment Company Act (15 U.S.C. 80a–17(j) and 80a–37(a)). The amendments to registration forms are proposed pursuant to the authority set forth in sections 6, 7(a), 10 and 19(a) of the Securities Act (15 U.S.C. 77f, 77g(a), 77j, 77s(a)), and sections 8(b), 24(a) and 38(a) of the Investment Company Act (15 U.S.C. 80a–8(b), 80a–24(a) and 80a–37(a)). The amendments to rule 204–2 under the Advisers Act are proposed pursuant to the authority set forth in sections 204, 206(4) and 211(a) of the Advisers Act (15 U.S.C. 80b–4, 80b–6(4) and 80b–11(a).)

Text of Proposed Rule and Form Amendments

List of Subjects in 17 CFR Parts 239, 270, 274 and 275

Investment companies, Reporting and recordkeeping requirements, Securities.

For the reasons set out 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:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–37, 80a–39 unless otherwise noted;

* * * * *

2. Section 270.17j–1 is revised to read as follows:

§ 270.17j–1 Certain unlawful acts, practices, or courses of business and requirements relating to codes of ethics with respect to registered investment companies.

(a) It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company, or any affiliated person of an investment adviser of or principal underwriter for a registered investment company in connection with the purchase or sale, directly or indirectly, by such person of a security held or to be acquired, as defined in this section, by such registered investment company:

(1) To employ any device, scheme or artifice to defraud such registered investment company;

(2) To make to such registered investment company any untrue statement of a material fact or omit to state to such registered investment company a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading;

(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any such registered investment company; or

(4) To engage in any manipulative practice with respect to such registered investment company.

(b)(1)(i) Every registered investment company, other than a money market fund, and each investment adviser of and principal underwriter for such investment company, shall have a written code of ethics containing provisions reasonably necessary to prevent its access persons from engaging in any act, practice, or course of business prohibited by paragraph (a) of this section and shall use reasonable diligence, and institute procedures reasonably necessary, including procedures by which the reports required by paragraph (c) of this section are reviewed by appropriate management or compliance personnel, to prevent violations of such code.

(ii) The board of directors of the investment company shall approve the code of the investment company. Prior to retaining the services of an investment adviser or principal underwriter, the board of directors shall review the codes of ethics adopted pursuant to paragraph (b)(1)(i) of this section by such investment adviser or principal underwriter, and shall receive a certification from such investment adviser or principal underwriter that it has adopted such procedures as are reasonably necessary to prevent access persons from violating such code. When approving or reviewing a code of ethics pursuant to this paragraph (b)(1)(ii), a majority of the directors of the investment company, including a majority of the directors who are not interested persons thereof, shall determine whether the code contains such provisions as are reasonably necessary to prevent access persons from engaging in any act, practice, or course of business prohibited by paragraph (a) of this section. In the case of a unit investment trust, the approval and review required by this paragraph (b)(1)(ii) shall be conducted by the principal underwriter or depositor of such unit investment trust.

(2) No less frequently than annually, the management of every investment company (other than a unit investment trust) and of its investment adviser and principal underwriter shall furnish to the directors of the investment company a report:

(i) Describing issues arising under the applicable code of ethics since the last report to the board, including, but not limited to, information about violations of the code, sanctions imposed in response to such violations, changes made to the code or procedures, and any proposed or recommended changes to the code or procedures; and

(ii) Certifying that the investment company, investment adviser or principal underwriter, as applicable, has adopted such procedures as are reasonably necessary to prevent access persons from violating the code.

(3) The requirements of paragraphs (b)(1) and (b)(2) of this section shall not apply to any underwriter:

(i) Which is not an affiliated person of the registered investment company or its investment adviser; and

(ii) None of whose officers, directors or general partners serves as an officer, director or general partner of such registered investment company or investment adviser.

(c)(1) Every access person of a registered investment company, other than a money market fund, or of an investment adviser of or principal underwriter for such investment company shall report to that investment company, investment adviser or principal underwriter:

(i) No later than 10 days after the date that such person becomes an access person, the title, CUSIP number (if any), number of shares and principal amount with respect to each security in which the access person had any direct or indirect beneficial ownership at the time such person became an access person; and

(ii) No later than 10 days after the end of a calendar quarter, the information described in paragraph (c)(2) of this section with respect to any transactions during that quarter in any security in which the access person had, or by reason of such transaction acquired, any direct or indirect beneficial ownership in the security.

(2) Reports required to be made pursuant to paragraph (c)(1)(ii) of this section shall contain the following information:

(i) The date of the transaction, the title, CUSIP number (if any) and number of shares, and the principal amount of each security involved;

(ii) The nature of the transaction (*i.e.*, purchase, sale or any other type of acquisition or disposition);

(iii) The price at which the transaction was effected;

(iv) The name of the broker, dealer or bank with or through which the transaction was effected; and

(v) The date that the report is being submitted by the access person.

(3) Notwithstanding paragraph (c)(1) of this section, no person shall be required to make a report:

(i) With respect to transactions effected for any account over which such person does not have any direct or indirect influence or control;

(ii) If such person is not an ''interested person'' of a registered investment company within the meaning of section 2(a)(19) of the Act (15 U.S.C. 80a–2(a)(19)), and would be required to make such a report solely by reason of being a director of such investment company, except where such director knew or, in the ordinary course of fulfilling his official duties as a director of the registered investment company, should have known that during the 15-day period immediately preceding or after the date of the transaction in a security by the director such security is or was purchased or sold by such investment company or such purchase or sale by such investment company is or was considered by the investment company or its investment adviser;

(iii) Where the principal underwriter, as to which such person is an access person:

(A) Is not an affiliated person of the registered investment company or any investment adviser of such investment company; and

(B) Has no officers, directors or general partners who serve as officers, directors or general partners of such investment company or any such investment adviser;

(iv) Where a report made to an investment adviser would duplicate information recorded pursuant to §§ 275.204–2(a)(12) or 275.204–2(a)(13) of this chapter;

(v) Where a report to be made under paragraph (c)(1)(i) of this section would duplicate information that:

(A) Already has been provided to the investment company, investment adviser or principal underwriter;

(B) Would enable the investment company, investment adviser or principal underwriter to reconstruct the person's securities holdings at the time that the person became an access person; and

(C) Will be maintained in accordance with the requirements of paragraph (d)(3) of this section from the date that such person becomes an access person; or

(vi) Where a report to be made under paragraph (c)(1)(ii) of this section would duplicate information contained in a broker trade confirmation or account statement received by the investment company, investment adviser or principal underwriter with respect to such person in the time period required by that paragraph, *provided* that all of the information required by paragraph (c)(2) of this section is contained in such broker trade confirmation or account statement or is noted in the records of such investment company, investment adviser or principal underwriter.

(4) Each registered investment company, investment adviser and principal underwriter to which reports are required to be made pursuant to this section shall identify all access persons who are under a duty to make such reports to it and shall inform such persons of such duty.

(5) Any report required by paragraph (c)(1) of this section may contain a statement that the report shall not be construed as an admission by the person making such report that he or she has any direct or indirect beneficial ownership in the security to which the report relates. For purposes of this section, beneficial ownership shall be interpreted in the same manner as it would be under § 240.16a–1(a)(2) of this chapter in determining whether a person has beneficial ownership of a security for purposes of section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) and the rules and regulations thereunder.

(d) Each registered investment company, investment adviser and principal underwriter which is required to adopt a code of ethics or to which reports are required to be made by access persons shall, at its principal place of business, maintain records in the manner and to the extent set forth in this paragraph (d), and make such records available to the Commission or any representative thereof at any time and from time to time for reasonable periodic, special or other examination:

(1) A copy of each such code of ethics which is, or at any time within the past five years has been, in effect shall be preserved in an easily accessible place.

(2) A record of any violation of such code of ethics, and of any action taken as a result of such violation, shall be preserved in an easily accessible place for a period of not less than five years following the end of the fiscal year in which the violation occurs.

(3) A copy of each report made by an access person pursuant to this section, including any information provided in lieu of such reports pursuant to paragraphs (c)(3)(v) and (c)(3)(vi) of this section, shall be preserved for a period of not less than five years from the end of the fiscal year in which it is made, the first two years in an easily accessible place.

(4) A list of all persons who are, or within the past five years have been, required to make reports pursuant to this section, and a list of all persons responsible for reviewing such reports, shall be maintained in an easily accessible place.

(5) A copy of each report required by paragraph (b)(2) of this section shall be maintained for a period of not less than five years from the date such report is made, the first two years in an easily accessible place.

(e) As used in this section:

(1) *Access person* means:

(i) With respect to a registered investment company or an investment adviser thereof, any director, officer, general partner, or advisory person, as defined in this section, of such investment company or investment adviser.

(ii) With respect to a principal underwriter, any director, officer, or general partner of such principal underwriter who in the ordinary course of his business makes, participates in or obtains information regarding the purchase or sale of securities for the registered investment company for which the principal underwriter so acts or whose functions or duties as part of the ordinary course of his business relate to the making of any recommendation to such investment company regarding the purchase or sale of securities.

(iii) Notwithstanding the provisions of paragraph (e)(1)(i) of this section, where the investment adviser is primarily engaged in a business or businesses other than advising registered investment companies or other advisory clients, the term *access person* shall mean any director, officer, general partner, or advisory person of the investment adviser who, with respect to any registered investment company, makes any recommendation, participates in the determination of which recommendation shall be made, or whose principal function or duties relate to the determination of which recommendation shall be made to any registered investment company; or who, in connection with his duties, obtains any information concerning securities recommendations being made by such investment adviser to any registered investment company.

(iv) An investment adviser is ''primarily engaged in a business or businesses other than advising registered investment companies or other advisory clients'' when, for each of its most recent three fiscal years or for the period of time since its organization, whichever is lesser, the investment adviser derived, on an unconsolidated basis, more than 50 percent of its total sales and revenues and more than 50 percent of its income (or loss) before income taxes and extraordinary items from such other business or businesses.

(2) *Advisory person* of a registered investment company or an investment adviser thereof means:

(i) Any employee of such company or investment adviser (or of any company in a control relationship to such investment company or investment adviser) who, in connection with his regular functions or duties, makes, participates in, or obtains information regarding the purchase or sale of a security by a registered investment company, or whose functions relate to the making of any recommendations with respect to such purchases or sales; and

(ii) Any natural person in a control relationship to such company or investment adviser who obtains information concerning recommendations made to such company with regard to the purchase or sale of a security.

(3) *Control* shall have the same meaning as that set forth in section 2(a)(9) of the Act (15 U.S.C. 80a–2(a)(9)).

(4) *Purchase or sale of a security* includes, *inter alia,* the writing of an option to purchase or sell a security.

(5) *Security* shall have the meaning set forth in section 2(a)(36) of the Act (15 U.S.C. 80a–2(a)(36)), except that it shall not include:

(i) Direct obligations of the Government of the United States;

(ii) High quality short-term debt instruments, including but not limited to bankers' acceptances, bank certificates of deposit, commercial paper and repurchase agreements; and

(iii) Shares of registered open-end investment companies.

(6) *Security held or to be acquired* by a registered investment company means:

(i) Any security as defined in this section which, within the most recent 15 days:

(A) Is or has been held by such company; or

(B) Is being or has been considered by such company or its investment adviser for purchase by such company; and

(ii) Any option to purchase or sell, and any security convertible into or exchangeable for, a security described in paragraph (e)(6)(i) of this section.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

3. The authority citation for Part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78*l*, 78m, 78n, 78o(d), 78w(a), 78*ll*(d), 79e, 79f, 79g, 79j, 79*l*, 79m, 79n, 79q, 79t, 80a–8, 80a–29, 80a–30 and 80a–37, unless otherwise noted.

*   *   *   *   *

4. The authority citation for Part 274 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, and 80a–29, unless otherwise noted.

5. Item 5 of Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by adding paragraph (h) and an instruction to read as follows:

Note: The text of Form N–1A does not, and the amendments to the form will not appear in the Code of Federal Regulations.

Form N–1A

*   *   *   *   *

Item 5. Management of the Fund

*   *   *   *   *

(h) A brief statement explaining (i) that the Registrant and its investment adviser and principal underwriter have adopted codes of ethics that have been filed with the Commission, (ii) whether or not these codes of ethics permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the Registrant, and (iii) that information about how the codes can be inspected or copied at the Commission's public reference rooms or obtained from the Commission's headquarters is available through the Commission's toll-free telephone number, 1–800–SEC–0330.

Instruction: A Registrant that is a money market fund or that otherwise is not required to adopt a code of ethics under Rule 17j–1 under the 1940 Act [17 CFR 270.17j–1] is not required to respond to this item.

*   *   *   *   *

6. Item 24 of Form N–1A [referenced in §§ 239.15A and 274.11A] is amended by redesignating paragraph (b)(17) as paragraph (b)(18) and adding paragraph (b)(17) and an instruction to read as follows:

Form N–1A

*   *   *   *   *

Item 24. Financial Statements and Exhibits

*   *   *   *   *

(b) * * *

(17) a copy of all codes of ethics adopted pursuant to Rule 17j–1 under the 1940 Act [17 CFR 270.17j–1] and currently applicable to the Registrant (*i.e.*, the codes of the Registrant and its investment advisers and principal underwriters). If there are no codes of ethics applicable to the Registrant, state why (*e.g.*, that the Registrant is a money market fund).

Instruction: A Registrant that is a feeder fund must also file a copy of all codes of ethics applicable to the master fund.

*   *   *   *   *

7. Item 9 of Form N–2 (referenced in §§ 239.14 and 274.11a–1) is amended by removing the word ''and'' after the semicolon in paragraph 1.f., removing the period in the last line of paragraph 1.g. and replacing it with ''; and'' and adding paragraph 1.h. and an instruction to read as follows:

Note: The text of Form N–2 does not, and the amendments to the form will not, appear in the Code of Federal Regulations.

Form N–2

*   *   *   *   *

Item 9. Management

1. *General:* * * *

h. *Codes of Ethics:* a brief statement explaining (i) that the Registrant and its investment adviser and principal underwriter have adopted codes of ethics that have been filed with the Commission, (ii) whether or not these codes of ethics permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the Registrant, and (iii) that information about how the codes can be inspected or copied at the Commission's public reference rooms or obtained from the Commission's headquarters is available through the Commission's toll-free telephone number, 1–800–SEC–0330.

Instruction

A Registrant that is not required to adopt a code of ethics under Rule 17j–1 under the 1940 Act (17 CFR 270.17j–1) is not required to respond to this item.

*   *   *   *   *

8. Item 24 of Form N–2 (referenced in §§ 239.14 and 274.11a–1) is amended by redesignating paragraph 2.r. as

paragraph 2.s. and adding paragraph 2.r. to read as follows:

Form N–2

* * * * *

Item 24. Financial Statements and Exhibits

* * * * *

2. * * *

r. a copy of all codes of ethics adopted pursuant to Rule 17j–1 under the 1940 Act (17 CFR 270.17j–1) and currently applicable to the Registrant (*i.e.*, the codes of the Registrant and its investment advisers and principal underwriters). If there are no codes of ethics applicable to the Registrant, state why (*e.g.*, the Registrant invests only in direct obligations of the United States Government).

* * * * *

9. Item 6 of Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by adding paragraph (e) and an instruction to read as follows:

Note: The text of Form N–3 does not, and the amendments to the form will not, appear in the Code of Federal Regulations.

Form N–3

* * * * *

Item 6. Management

* * * * *

(e) A brief statement explaining (i) that the Registrant and its investment adviser and principal underwriter have adopted codes of ethics that have been filed with the Commission, (ii) whether or not these codes of ethics permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the Registrant, and (iii) that information about how the codes can be inspected or copied at the Commission's public reference rooms or obtained from the Commission's headquarters is available through the Commission's toll-free telephone number, 1–800–SEC–0330.

Instruction: A Registrant that is a money market fund or that otherwise is not required to adopt a code of ethics under Rule 17j–1 under the 1940 Act (17 CFR 270.17j–1) is not required to respond to this item.

* * * * *

10. Item 28 of Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by redesignating paragraph (b)(17) as paragraph (b)(18) and adding paragraph (b)(17) to read as follows:

Form N–3

* * * * *

Item 28. Financial Statements and Exhibits

* * * * *

(b) * * *

(17) a copy of all codes of ethics adopted pursuant to Rule 17j–1 (17 CFR 270.17j–1) and currently applicable to the Registrant (*i.e.*, the codes of the Registrant and its investment advisers and principal underwriters). If there are no codes of ethics applicable to the Registrant, state why (*e.g.*, the Registrant is a money market fund).

* * * * *

11. Item 3 of Form N–5 (referenced in §§ 239.24 and 274.5) is amended by removing the word ''investment'' both times that it appears in the introductory text and adding paragraph (i) after the instruction to read as follows:

Note: The text of Form N–5 does not, and the amendments to the form will not, appear in the Code of Federal Regulations.

Form N–5

* * * * *

Item 3. Policies With Respect to Security Investments

* * * * *

(i) Whether or not the codes of ethics of the registrant and its investment adviser and principal underwriter permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the registrant. Also state that the codes of ethics adopted by the registrant and its investment adviser and principal underwriter have been filed with the Commission and that information about how the codes can be inspected or copied at the Commission's public reference rooms or obtained from the Commission's headquarters is available through the Commission's toll-free telephone number, 1–800–SEC–0330.

* * * * *

12. The Instructions As To Exhibits of Form N–5 (referenced in §§ 239.24 and 274.5) are amended by redesignating paragraph 13 as paragraph 14 and adding paragraph 13 to read as follows:

Form N–5

* * * * *

Instructions as to Exhibits

* * * * *

13. A copy of all codes of ethics adopted pursuant to Rule 17j–1 under the 1940 Act (17 CFR 270.17j–1) and currently applicable to the registrant (*i.e.*, the codes of the registrant and its investment advisers and principal underwriters).

* * * * *

13. Item 41 of Form N–8B–2 (referenced in § 274.12) is amended by adding paragraph (d) to read as follows:

Note: The text of Form N–8B–2 does not, and the amendments to the form will not, appear in the Code of Federal Regulations.

Form N–8B–2

* * * * *

41. * * *

(d) Provide a brief statement explaining (i) that the trust and its principal underwriter have adopted codes of ethics that have been filed with the Commission, (ii) whether or not these codes of ethics permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the trust, and (iii) that information about how the codes can be inspected or copied at the Commission's public reference rooms or obtained from the Commission's headquarters is available through the Commission's toll-free telephone number, 1–800–SEC–0330.

* * * * *

14. Part IX of Form N–8B–2 (referenced in § 274.12) is amended by adding paragraph A.(11) to read as follows:

Form N–8B–2

* * * * *

IX

Exhibits

A. * * *

(11) a copy of all codes of ethics adopted pursuant to Rule 17j–1 under the 1940 Act (17 CFR 270.17j–1) and currently applicable to the trust (*i.e.*, the codes of the trust and its principal underwriters). If there are no codes of ethics applicable to the trust, state why (*e.g.*, the trust invests only in direct obligations of the United States Government).

* * * * *

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

15. The authority citation for part 275 continues to read, in part, as follows:

Authority: 15 U.S.C. 80b–3, 80b–4, 80b–6A, 80b–11, unless otherwise noted.

16. Section 275.204–2 is amended by revising the first sentence of paragraph (a)(12)(i), redesignating paragraphs (a)(12)(ii) and (a)(12)(iii) as (a)(12)(iii) and (a)(12)(iv), adding paragraph (a)(12)(ii), redesignating newly designated paragraph (a)(12)(iii)(B) as (a)(12)(iii)(C), adding paragraph (a)(12)(iii)(B), revising the first sentence of paragraph (a)(13)(i), redesignating paragraphs (a)(13)(ii) and (a)(13)(iii) as paragraphs (a)(13)(iii) and (a)(13)(iv), adding paragraph (a)(13)(ii), redesignating newly designated paragraphs (a)(13)(iii)(B) and (a)(13)(iii)(C) as (a)(13)(iii)(C) and (a)(13)(iii)(D) and adding new paragraph (a)(13)(iii)(B), to read as follows:

§ 275.204–2 Books and records to be maintained by investment advisers.

(a) * * *

(12)(i) A record of every transaction (other than transactions described in paragraph (a)(12)(ii) of this section) in a security in which the investment adviser or any advisory representative (as hereinafter defined) of such investment adviser has, or by reason of such transaction acquires, any direct or indirect beneficial ownership.* * *

(ii) Notwithstanding paragraph (a)(12)(i) of this section, no record need be kept of any transactions:

(A) Effected in any account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; or

(B) In securities which are:

(*1*) Direct obligations of the Government of the United States;

(*2*) High quality short-term debt instruments, including but not limited to bankers' acceptances, bank certificates of deposit, commercial paper and repurchase agreements; or

(*3*) Shares of registered open-end investment companies.

(iii) * * *

(B) The term *beneficial ownership* shall be interpreted in the same manner as it would be under § 240.16a–1(a)(2) of this chapter in determining whether a person has beneficial ownership of a security for purposes of section 16 of the Securities Exchange Act of 1934 [15 U.S.C. 78p] and the rules and regulations thereunder.

* * * * *

(13)(i) Notwithstanding the provisions of paragraph (a)(12) of this section, where the investment adviser is primarily engaged in a business or businesses other than advising registered investment companies or other advisory clients, a record must be maintained of every transaction (other than transactions described in paragraph (a)(13)(ii) of this section) in a security in which the investment adviser or any advisory representative (as hereinafter defined) of such investment adviser has, or by reason of such transaction acquires, any direct or indirect beneficial ownership.* * *

(ii) Notwithstanding paragraph (a)(13)(i) of this section, no record need be kept of any transactions:

(A) Effected in any account over which neither the investment adviser nor any advisory representative of the investment adviser has any direct or indirect influence or control; or

(B) In securities which are:

(*1*) Direct obligations of the Government of the United States;

(*2*) High quality short-term debt instruments, including but not limited to bankers' acceptances, bank certificates of deposit, commercial paper and repurchase agreements; or

(*3*) Shares of registered open-end investment companies.

(iii) * * *

(B) The term *beneficial ownership* shall be interpreted in the same manner as it would be under § 240.16a–1(a)(2) of this chapter in determining whether a person has beneficial ownership of a security for purposes of section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) and the rules and regulations thereunder.

* * * * *

Dated: September 8, 1995.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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