# COMPLIANCE AND EXAMINATIONS; REPORTING AND RECORDKEEPING REQUIREMENTS

## I. COMPLIANCE

### A. Rule 38a-1

1. Rule 38a-1 under the 1940 Act requires funds to adopt a comprehensive compliance program and appoint a chief compliance officer ("CCO").

2. The Rule requires:

    a. Funds to adopt and implement written policies and procedures reasonably designed to prevent the fund from violating the federal securities laws

    b. Fund boards, including a majority of independent directors, to approve the fund's compliance program and the compliance programs of the fund's "service providers" (these include the fund's adviser(s), principal underwriter, administrator and transfer agent)

        (1) Board approval must be based on a finding that the compliance programs are reasonably designed to prevent violation of the federal securities laws by the fund and its service providers

    c. Fund boards to annually review the fund's compliance program as well as those of its service providers for adequacy and effectiveness

    d. Fund boards to appoint a CCO responsible for administering the fund's compliance program

    e. Independent Directors Council SEC No-Action Letter (October 12, 2018)

(1) The Staff stated it would not recommend enforcement action for violations of Sections 10(f), 17(a), or 17(e) of the 1940 Act if a fund board receives from the fund's CCO, no less frequently than quarterly, a written representation that any transactions effected in reliance on the related exemptive rules complied with procedures adopted by the board pursuant to the relevant exemptive rule, rather than the board itself making such compliance determinations on a quarterly basis.

(2) The Staff noted that this position is consistent with the SEC's approach in adopting Rule 38a-1 and would allow boards to avoid duplicating certain functions commonly performed by, or under the supervision of, the CCO.

(3) The Staff recognized the considerable responsibilities placed on directors as well as the prominent role of CCOs in handling the administrative aspects of a fund's compliance program.

(4) The Staff stated that allowing a board to rely on the written representation of the CCO rather than making its own determinations "would not change the board's oversight role with respect to a fund's overall compliance program."

3. Appointment of fund CCO

a. CCO's designation and compensation must be approved by the fund's board, including a majority of independent directors

b. CCO may be removed from his or her responsibilities only by action of the fund's board, including a majority of independent directors

c. CCO must prepare an annual written report to the fund's board

d. CCO must meet separately with the fund's independent directors at least annually

## B. Creating a Compliance Program

1. Conduct a Risk Assessment

    a. Identify "high risk" areas or practices

    b. Use risk assessment to develop compliance policies and procedures

    c. Regularly review risk assessment to incorporate new activities or products

2. Develop Policies and Procedures

    a. Coordinate policies and procedures with the fund's unique compliance risks, addressing and managing each risk

    b. Review, test, and assess each policy and procedure

3. Appoint Chief Compliance Officer

    a. Choice of either "inside" or "outside" CCO. Either can be legitimate, but must address issues associated with choice

4. Disclosures

    a. Ensure disclosures are consistent with actual practices

    b. Review regularly to ensure disclosures remain current

5. Recordkeeping

    a. Create, record, and retain all required information, including information in electronic format

    b. Be able to access needed information quickly

    c. Safeguard information from unauthorized access

6. Conduct Annual Review

## C. Written Policies and Procedures

1. Rule 38a-1 does not specify the areas to be covered by the compliance programs of the fund or its service providers.

2. Compliance policies and procedures for a particular fund need only encompass areas relevant to that fund.

3. The SEC set forth in the adopting release for Rule 38a-1 the following suggested areas in which the compliance programs of a fund and its adviser should address, to the extent they are relevant:

    a. Portfolio management

        (1) Style drift - chasing returns

        (2) Violation of investment restrictions

        (3) Window dressing and portfolio pumping

        (4) Unfair allocation of securities, including initial public offerings

        (5) Use of 17a-7 and 10f-3 transactions to "dump" unfavorable securities

        (6) Cherry picking

    b. Trading activities and practices

        (1) Failure to obtain best execution

        (2) Failure to periodically and systematically review execution quality and to route and re-route orders accordingly

        (3) Use of commissions to obtain goods/services outside the Section 28(e) safe harbor, and without adequate disclosure to clients/shareholders

        (4) Interpositioning of an affiliated broker-dealer

(5) Use of commissions outside of a 12b-1 plan to pay for distribution; or use of commissions to pay for client referrals without disclosure

(6) Failure to clearly disclose to clients the use of their commission dollars

c. Proprietary trading of the adviser and personal trading by employees

(1) Market timing, insider trading, front-running or other abusive personal or proprietary trading

(2) Untimely or failure to report personal securities transactions

(3) Codes of ethics violations

(4) Failure to properly identify and monitor trading by all access persons

d. The accuracy of disclosures made to investors, clients and regulators, including account statements and advertisements

(1) Inaccurate or misleading performance numbers

(2) Inadequate supporting documentation for performance claims

(3) Misleading advertisements

(4) Inadequate disclosure of revenue sharing arrangements

(5) Misleading statements in Form ADV, Part II, prospectuses or other documents

e. Safeguarding of client assets from conversion or misuse

(1) Improper or inadvertent access to client assets

(2) Unauthorized trading in client accounts

(3) Improper disclosure of client account information

(4) Discrepancies between the records of the adviser and the custodian

f. Creating and maintaining accurate books and records

(1) Failure to maintain and have accessible all required books and records, including emails

(2) Failure to protect records and information from unauthorized access and manipulation

(3) Maintaining inaccurate books and records— e.g., failure to accurately or timely post revenue or expense numbers

(4) Failure to produce business records required by OCIE

g. Marketing advisory services, including the use of solicitors

(1) Failure to disclose or inadequate disclosure of solicitation arrangements

(2) Failure of solicitor to deliver the adviser's Form ADV, Part 2A

(3) Failure to disclose payments to employees for referrals

(4) Failure to have written contracts with solicitors

h. Valuing client holdings and assessing fees

(1) Illiquid or fair valued assets not valued appropriately, or values not back tested

(2) Inaccurate computation of fees, or fees based on inaccurate valuation of client assets

i. Creating and protecting the privacy of client records and information

(1) Lack of verification that client data is compiled accurately

(2) Integrity of client data is not protected from unauthorized changes

(3) Failure to safeguard the privacy of client information

(4) Failure to notify clients of policies on safeguarding their information

j. Business continuity plans

(1) Failure to prepare for and test operations during human or natural emergencies

(2) Failure to provide for availability of critical personnel and systems

(3) Failure to verify continuity plans of third party providers

(4) Failure to protect records from unplanned destruction

## D. Chief Compliance Officer

1. Each fund must designate a CCO to administer its compliance program.

   a. The CCO should be competent and knowledgeable regarding the Investment Company Act and other applicable federal securities laws

   b. The CCO should be empowered with full responsibility and authority to develop and enforce an appropriate compliance program for the fund

   c. The CCO must have a position of seniority and authority sufficient to compel others to adhere to the compliance program

2. CCO's annual written report is required to include information about:

   a. Operation of the policies and procedures of the fund and its principal service providers

   b. Material changes made to those policies and procedures since the date of the last report

   c. Material changes to the policies and procedures recommended as a result of the annual review

d. "Material Compliance Matters" that occurred since the date of the last report

3. CCO's annual written report also may include information about

a. Management cooperation

b. Risk assessment methods, analysis and conclusions

c. Industry best practices

d. Back testing results

e. Violations

f. Remedial actions

g. Prior concerns

h. Compliance certifications

i. Compliance personnel assessment

j. Self-evaluation

k. Compliance budget, resources, staffing

l. Training and education

m. Changes/updates to program

n. Overall assessment

o. Goals for the coming year

4. CCO's annual meeting with independent directors

a. Include counsel to the independent directors but not management and adviser personnel or interested directors

b. Discuss sensitive compliance concerns

## E. Annual Reviews

1. Rule 38a-1 requires fund boards to review the fund's compliance program and the compliance programs of its service providers annually for adequacy and effectiveness.

2. The Rule does not provide specific guidance as to how to conduct an annual review. However, SEC staff has discussed specific issues that have been raised, while also noting that each fund's review process should be tailored to its unique circumstances.

3. While funds have flexibility to determine the specific structure and content of an annual review, the goal across funds is the same: to discover if the compliance program is working properly to prevent, detect, mitigate, and correct compliance issues.

4. Some issues the SEC staff identified in its inspections:

    a. Risk identification

        (1) Failing to assess unique risk exposures that do not appear on generic checklists

        (2) Failing to coordinate the risks identified with compliance policies and procedures

    b. Policies and procedures

        (1) Overlooking the need for separate written policies for one of multiple registered entities within a complex

        (2) Lacking written policies in a particular area such as:

            (i) market timing

            (ii) conflicts of interest when voting proxies

            (iii) supervision of sub-advisers

            (iv) insider trading

        (3) Failing to enforce policies and procedures

c. Written report to the fund board

(1) Overwhelming a board with too much information

(2) Not giving a board enough information

d. Testing

(1) Failing to perform any tests when tests could have been useful

(2) Failing to perform appropriate tests that could have resolved specific problems

e. The CCO

(1) Addressing conflict of interest issues of an “inside” CCO

(2) Providing a CCO with the authority and influence needed to do the job

(3) Ensuring an “outside” CCO is involved, experienced, and has enough access to do the job

f. Implementing Recommendations

(1) Ensuring that findings from the annual review are analyzed and applied

(2) Obtaining support from executives and management

5. Other lessons learned and advice in preparation for the next annual compliance program review

a. Do not put off preparing for the next annual review.

(1) Develop a compliance calendar. Use the information from the last annual review to help anticipate which areas had the most issues and what took the longest.

(2) Provide ongoing training to compliance staff.

(3) Schedule tests year-round, follow up on tests to ensure they have been completed, and allow time to analyze the results.

b. Keep compliance policies dynamic.

(1) Identify changes in practices, affiliates, products, or services. Re-examine risk assessment and keep it updated as potential risks evolve.

(2) Keep updated on regulatory changes and update policies accordingly.

c. Form compliance contacts to discuss industry practices. Keep in mind that industry practice does not necessarily equal best practice.

d. Follow through on issues raised during the last annual review.

### F. Required Records

1. Funds must maintain copies of all compliance programs in effect at any time during the last five years (with the most recent two years in an easily accessible place), including

a. Materials provided to the board in connection with its approval of the fund's and service providers' compliance programs

b. Any annual written reports by the fund's CCO

2. Funds are required to keep any records documenting their annual reviews for at least five years after the end of the fiscal year in which the annual review was conducted (with the most recent two years in an easily accessible place).

3. Records may be maintained electronically, and must be provided in electronic format to the SEC upon request.

a. No attorney-client privilege, work-product doctrine, or similar protections.

## II. EXAMINATIONS

### A. Preparation and Management of the Regulatory Exam Process

1. Regulatory environment has changed dramatically

2. SEC Response: Changes to OCIE exam program including:

    a. Expertise of exam teams

    b. Enhanced scrutiny for compliance with the federal securities laws

    c. Enhanced scrutiny for the detection of fraud

    d. More aggressive enforcement actions

3. More important than ever that advisers are well prepared to handle examinations

    a. Most enforcement actions originate from examinations

    b. Enforcement actions can have serious consequences

    c. More frequent and intensive face-to-face interactions with SEC staff

    d. Clients, insurers and business partners asking to review deficiency letters

4. OCIE has a centralized unit for risk assessment

5. Regulatory Exam Preparation

    a. Designate a contact person - CCO

    b. Review prior examination records

    c. Arrange for examiner work area and resources

    d. Notify senior management and personnel of the exam

    e. Organize files prior to arrival of examiners

    f. Walk through the office

    g. Prepare opening presentation

6. Regulatory Exam Management

    a. Present a professional appearance

b. Do not keep the examiners waiting

c. Ask the examiners for their business cards

d. Documents should be ready

e. Confirm the schedule of meetings with specific individuals and let the examiners know CCO will be present for all interviews

f. Examiners should not make copies themselves – retain duplicates

g. Address deficiencies identified during the course of the exam

h. Request an exit interview

7. The Relationship Between the Annual Review and Examinations

a. SEC examiners are looking for effective control and compliance systems

b. Demonstrate documentary evidence showing:

(1) Risks are identified, managed and mitigated

(2) Problems are found as they occur

(3) Problems are resolved promptly

8. Addressing Exam Deficiencies and Identifying Hot Topics

a. Possible exam results

(1) No findings or violations

(2) Deficiency letter

(3) Enforcement referral

b. Deficiency letter arrives

(1) Requires prompt written response

(2) Possible corrective action:

(i) revising compliance policies or procedures

(ii) implementing new exception or surveillance reports

(iii) changing the level or frequency of reviews

(3) Request confidentiality

## III. PERIODIC REPORTING

### A. Reports to the SEC

1. Section 30(a) of the 1940 Act provides that every registered investment company shall annually file with the SEC such information, documents, and reports as investment companies that have securities registered on a national securities exchange must file annually under Section 13(a) of the Exchange Act. However, pursuant to Rule 30d-1, a registered investment company that is required to file annual and quarterly reports pursuant to Section 13(a) of the Exchange Act shall satisfy its requirements by filing reports on Form N-CSR and Form N-Q (to be rescinded and replaced by Form N-PORT).

2. Rule 30b1-1, as amended, requires a registered management company to file an annual report on Form N-CEN within 75 days after the fund's fiscal year end.

3. Rule 30b1-4 requires a registered management investment company to file an annual report on Form N-PX not later than August 31 of each year, containing the fund's proxy voting record for the most recent 12-month period ended June 30.

4. Rule 30b1-5 requires a registered management investment company to file quarterly reports on Form N-Q not more than 60 days after the close of the first and third quarters of each fiscal year until the first N-PORT filing is due April 30, 2019 for larger funds and April 30, 2020 for smaller funds, reflecting data as of March 31 of that year.

5. Rule 30b1-7 requires a money market fund to file a monthly report on Form N-MFP not later than the fifth business day of each month.

6. Rule 30b1-9 requires a registered management investment company to file a monthly report of portfolio holdings on Form N-PORT, current as of the last business day, or last calendar day, of the month. Reports on Form N-PORT must be filed with the SEC no later than 30 days after the end of each month. Beginning June 2018, most fund groups must maintain in their records the information that is required to be included in Form N-PORT, but need not submit filings to the SEC until April 30, 2019 (larger fund groups) or April 30, 2020 (smaller fund groups).

7. Rule 30b2-1(a) requires a registered management investment company to file a report on Form N-CSR not later than 10 days after the transmission to shareholders of any report required pursuant to Rule 30e-1(a).

8. Rule 30b2-1(b) requires a registered management investment company to file a copy of any periodic or interim report or similar communication containing financial statements that are transmitted to shareholders but is not required to be filed under Rule 30b2-1(a) not later than 10 days after the transmission to shareholders.

**B. <u>Reports to Shareholders</u>**

1. Rule 30e-1(a) requires that an investment company transmit reports to shareholders at least semi-annually.

2. Rule 30e-3 permits “notice and access” delivery of an investment company’s shareholder reports via website posting, subject to certain conditions.

3. The reports must include the following

    a. The following information and financial statements, which, in the case of the annual report, must be audited:

        (1) Statement of net assets (or assets and liabilities)

        (2) Schedule of investments

        (3) Statement of operations

        (4) Statement of changes in net assets

        (5) Statement of aggregate dollars amounts of purchase and sales of investment securities

(6) Financial highlights

b. Statement of aggregate remuneration paid to directors, officers and others

c. The report of the accountants *(annual reports only).* Section 30(g) requires the audit report to state that the independent public accountants have verified securities owned either by actual examination or by confirmation from the custodian.

d. Information concerning changes in and disagreements with accountants

e. Biographical information for each director and officer required by Item 17 of Form N-1A *(annual reports only)*

f. Statement of availability of additional information about fund directors *(annual reports only)*

g. If any matter was submitted to a shareholder vote during the period covered by the report, or if shareholder consents were solicited, the date and type of meeting and a summary of the matter(s) and the results of the vote. For an election of directors, the report should contain the names of the directors who were elected and the names of any directors whose term is continuing.

h. Management's discussion of fund performance *(annual reports only). Money market funds are exempt from this requirement.* The presentation must include:

(1) A discussion of the factors that materially affected fund performance during the most recently completed fiscal year, including the relevant market conditions and the investment strategies and techniques used by the fund's adviser. Particular attention must be paid to text accompanying the financial statements, because it may be viewed as advertising or sales literature.

(2) A line graph showing the growth of $10,000 invested over the last 10 fiscal years (or period since the fund was first registered, if shorter), and the growth of $10,000 invested

in "an appropriate broad-based securities market index" for the same period

(3) A table showing the fund's average annual return for the one-, five-, and 10-year periods ending at the end of the most recently completed fiscal year, and a statement that past performance does not predict future performance and that the graph and table do not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares. Rule 34b-1, which governs the timeliness of performance information in sales literature, provides an exemption for annual and semi-annual reports to shareholders,

i. An expense example

j. Graphical representation of holdings

k. Statement regarding availability of quarterly portfolio schedule

l. Statement regarding availability of proxy voting policies and procedures

m. Statement regarding availability of proxy voting record

n. Statement regarding basis for approval of investment advisory contract

4. The report must be transmitted to shareholders within 60 days of the end of the fiscal period to which it relates. Reports must be filed with the SEC on Form N-CSR no later than 10 days after they are first sent or given to shareholders.

5. Rule 30e-1(d) permits an open-end investment company to send a copy of its currently effective prospectus or statement of additional information, or both, to shareholders in satisfaction of the annual or semi-annual report requirement if it includes all the information that would otherwise be required to be contained in the report. A prospectus or statement of additional information, or both, mailed instead of an annual or semi-annual report must be mailed within 60 days after the close of the relevant period. Thus, in order to make this a usable option, the fund must carefully observe the 60-80 day effectiveness provision of Rule 485(a) for post-effective amendments to ensure that all reviews and submissions

will be made in a timely manner so that the new prospectus will become effective within the 60-day period for mailing the annual report.

## C. Proxy Voting Requirements Applicable to Registered Investment Companies

1. Registered management investment companies are required to disclose in their registration statements (and, in the case of closed-end funds, Form N-CSR) the policies and procedures that they use to determine how to vote proxies relating to portfolio securities. See Instruction 17(f) to Form N-1A.

2. Registered management investment companies are required to file with the SEC and to make available to their shareholders, either on their websites or upon request, their records of how they voted proxies relating to portfolio securities. Funds are required to disclose in their annual and semi-annual reports to shareholders and in their registration statements the methods by which shareholders may obtain information about proxy voting.

3. The following are examples of general policies and procedures that some funds include in their proxy voting policies and procedures and with respect to which the SEC has indicated that disclosure would be appropriate:

    a. The extent to which the fund delegates its proxy voting decisions to its investment adviser or another third party, or relies on the recommendations of a third party

    b. Policies and procedures relating to matters that may affect substantially the rights or privileges of the holders of securities to be voted

    c. Policies regarding the extent to which the fund will support or give weight to the views of management of a portfolio company

4. Form N-PX requires disclosure of the following information for each matter relating to a portfolio security considered at any shareholder meeting held during the period covered by the report and with respect to which the fund was entitled to vote:

    a. The name of the issuer of the portfolio security

    b. The exchange ticker symbol of the portfolio security

c. The Council on Uniform Securities Identification Procedures ("CUSIP") number for the portfolio security

d. The shareholder meeting date

e. A brief identification of the matter voted on

f. Whether the matter was proposed by the issuer or by a security holder

g. Whether the fund cast its vote on the matter

h. How the fund cast its vote (e.g., for or against proposal, or abstain; for or withhold regarding election of directors)

i. Whether the fund cast its vote for or against management

## IV. RECORDKEEPING REQUIREMENTS

### A. Books and Records of the Investment Company

1. Section 31 of the 1940 Act sets out the requirements pertaining to the books and records of registered investment companies. It requires the company, and its underwriters, brokers, dealers or investment advisers to maintain and preserve the books and other documents that constitute the basis of the financial statements. In addition, investment advisers that are not majority-owned subsidiaries, depositors and principal underwriters must maintain records of their transactions with the fund. These books and records are subject to examination by the SEC.

2. Rule 31a-1 requires an investment company to maintain and keep current:

   a. original entry journals containing an itemized detailed daily record of all securities purchases and sales (including its own securities), all receipts and deliveries of securities, and all receipts and disbursements of cash and all other debit and credits

   b. general and auxiliary ledgers reflecting all asset, liability, reserve, capital, income and expense accounts, including separate ledger accounts for specific activities as set forth in the rule

   c. corporate charters, certificates of incorporation or trust agreements, by-laws and minute books of meetings

d. specific records of each transaction and investment as set forth in the rule

e. a record identifying their persons or persons, committees or groups authorizing the purchase or sale of portfolio securities

f. files of all advisory material received from the investment adviser or any persons from whom the fund accepts investment advice

g. other records, as appropriate

3. Rule 31a-2 requires an investment company to retain records for the following time periods:

a. Journals, ledgers and corporate documents must be preserved permanently, the first two years in an easily accessible place

b. The other records described above must be preserved for six years, the first two years in an easily accessible place

c. The following records must also be preserved for six years, the first two years in an easily accessible place:

(1) Any advertisements, pamphlets, circulars, form letters or other sales literature addressed to or intended for distribution to prospective investors

(2) Any record of the initial determination that a director is not an interested person and each subsequent determination (including any questionnaire used to make such determination)

(3) Any materials used by the disinterested directors to determine that a person who is acting as their legal counsel is an independent legal counsel

(4) Any documents or other written information considered by the directors pursuant to Section 15(c) of the 1940 Act in approving the terms or renewal of a contract or agreement between the company and an investment adviser

4. Rule 38a-1 contains additional recordkeeping requirements with respect to fund compliance programs. See Section I. F for a discussion of these requirements.

5. Rule 2a-7, which governs money market funds, contains additional recordkeeping requirements that apply to those funds.

## B. Books and Records of Investment Advisers and Principal Underwriters

1. Investment advisers and principal underwriters are required to maintain and preserve the accounts, books and other documents that reflect their transactions with the fund.

2. Investment advisers are required by Rule 204-2 under the Advisers Act to make and keep current records of:

    a. Journals, ledgers, memoranda and other records detailing each transaction with the fund

    b. originals of all written communications received and copies of all written communications sent by such investment adviser relating to (i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, or (iii) the placing or execution of any order to purchase or sell any security

    c. a list or other record of all accounts in which the investment adviser is vested with any discretionary power with respect to the fund and all evidences of the granting of any discretionary authority by any client to the investment adviser

    d. all written agreements entered into by the investment adviser

    e. a copy of each notice, advertisement or other communication recommending the purchase or sale of a specific security, which the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons and the reasons for the recommendation

    f. a record of transactions in a security in which the investment adviser has a direct or indirect beneficial ownership

g. a copy of each written disclosure statement and each amendment or revision thereof; and all receipts from clients acknowledging receipt disclosure statements

h. a copy of the adviser's compliance program and any records documenting the adviser's annual review of its compliance program

3. The above records must be preserved for five years, the first two years of which must be in an appropriate office of the investment adviser, and are subject to routine or special examination by the SEC at any time.

4. Rule 204-2 also requires registered investment advisers that vote client proxies to maintain specified records with respect to those clients. These records must be maintained in the manner, and for the period of time, as other books and records under Rule 204-2(c). These records are:

a. A copy of the adviser's proxy voting policies and procedures

b. Proxy statements received regarding client securities

c. Records of the votes the adviser cast on behalf of clients

d. Records of client requests for proxy voting information

e. Any documents prepared by the adviser that were material to making a decision regarding how to vote, or that memorialized the basis for the decision

5. Principal underwriters must maintain books and records required of broker-dealers under the Exchange Act, if necessary to record the underwriter's transactions with the investment company.

## C. Records Maintained for the Fund by Others

1. Pursuant to Rule 31a-3, if the records required to be maintained and preserved under Rules 31a-1 and 31a-2 are actually prepared or maintained by others on behalf of the person required to keep them, the person required by the rules to keep the records musts obtain from the other person a written agreement that the records are the property of the person required by the rule to keep them and will be surrendered promptly on request.

2. Where a bank or a member of a national securities exchange acts as custodian, transfer agent or dividend disbursing agent for a fund, the requirements of Rule 31a-3 are considered to have been met if the bank or exchange member agrees in writing to make any records relating to such service available upon request and to preserve, for the periods specified in Rule 32a-2, any records that are required by Rule 32a-1 to be kept.

## V. CODE OF ETHICS

### A. Overview of Rule 17j-1 under the 1940 Act

1. Rule 17j-1 prohibits certain fraudulent practices by persons affiliated with registered funds, their investment advisers or their principal underwriters.

2. The SEC has not defined in specific terms the acts or transactions that would constitute fraudulent or manipulative practices. Instead, the SEC's original adopting release of the rule suggested that ongoing scrutiny should be applied to conflict of interest situations in which:

    a. "access persons are able to improperly gain personal benefit from their relationship with the fund;" and

    b. "access persons through their position of influence over the fund" have an incentive to influence the investment strategy of the company for their personal benefit.

3. Rule 17j-1 also requires every registered investment company, and each investment adviser of or principal underwriter for such fund, to "adopt a written code of ethics containing provisions reasonably necessary to prevent its access persons from engaging" in fraudulent practices.

### B. Rule 17j-1 Board Approval of Code

1. Rule 17j-1 imposes responsibilities on a fund's board with respect to code of ethics approval and oversight, reporting requirements on "access persons" and public disclosure requirements regarding codes of ethics and compliance procedures.

2. Rule 17j-1 requires that the board (including a majority of the disinterested directors) of a fund approve the code of ethics of the fund, and the codes of its investment adviser and affiliated principal underwriter.

3. The board must also approve any material change to the fund's, investment adviser's, or affiliated principal underwriter's code of ethics within six months of such change.

## C. Compliance and Certification Report

1. Under Rule 17j-1, each fund, investment adviser and affiliated principal underwriter must provide a written report "no less frequently than annually" to the board that (a) describes any issues and material violations arising under the code since the last report and (b) certifies the adoption of procedures reasonably designed to prevent violations of the code.

2. Written report as it relates to the funds is typically provided by the CCO.