

August 13, 2002

### **The Sarbanes-Oxley Act: Application to Registered Investment Companies**

This memorandum briefly addresses application of the Sarbanes-Oxley Act of 2002 (the "Act") to registered investment companies, as discussed at an American Bar Association meeting yesterday that included members of the investment company industry and members of the staff of the Securities and Exchange Commission ("SEC"). Please note that the language in the Act can be subject to multiple interpretations, and that SEC rulemaking may change the current analysis. Although the SEC staff was not at liberty to confirm the views expressed at the meeting, the following represents a consensus of views expressed by the industry.

#### **Section 302 Certification**

Very basically speaking, Section 302 of the Act, which requires the SEC to issue implementing rules by August 29, 2002 to require the principal executive officer and principal financial officer of an "issuer" to certify to certain representations in certain periodic reports, appears to apply to registered investment companies under a broad reading of the definition of "issuer".

A number of interpretive issues arise for application of Section 302 in this context, including questions related to the respective roles of fund boards, audit committees and service providers as well as the functions of a principal executive officer and principal financial officer, that require SEC clarification. The SEC has issued a release that presumes application of Section 302 to registered investment companies and requests comments by August 19, 2002.

Given the short deadline imposed by the Act on the SEC rulemaking, it has been suggested that the SEC defer rulemaking under Section 302 with regard to registered investment companies – which have recently benefited from extensive overhaul of SEC regulation in the governance area – pending the development of carefully considered regulations.

The Act's implementation is a hotly charged political issue for which deferring deadlines may not be easily accomplished, although that could be a possibility in this case. Absent that, registered investment companies should be prepared to comply with any applicable SEC regulations adopted under Section 302 by the August 29, 2002 statutory deadline.

### Section 906 Certification

A separate but similar certification requirement is imposed by Section 906, which imposes criminal penalties for fraudulent certification of financial reports. The language of Section 906 differs from Section 302 in a number of respects and requires that “[e]ach periodic report containing financial statements filed by an issuer” with the SEC pursuant to Section 13(a) or 15(d) “shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.”

Registered investment company periodic reports under Section 15(d) are filed on the Form N-SAR and currently do not contain financial statements. Because Section 906 is a criminal provision, it is to be interpreted narrowly. Unless and until the SEC amends the Form N-SAR or otherwise adopts regulations to draw the fund financial statements under Section 15(d), Section 906 would appear not to apply to registered investment companies. The SEC is currently taking the position that authority to interpret criminal provisions such as Section 906 rests with the Justice Department and not with the SEC. The Justice Department has not addressed the issue.

If you have any questions, please contact Diane E. Ambler at 202-778-9886 or via email to [dambler@kl.com](mailto:dambler@kl.com).

# eBulletin

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