

rule does not impose unfunded mandates or requirements that will have any effect on the quality of the human environment. A summary of the regulatory analyses of the rules whose effective date is being extended here was published at 64 FR 12850-12851 and 12859, March 15, 1999. Also published there were discussions of the rules' effects on small businesses and their Federalism and Paperwork Reduction Act implications. Apart from the Y2K implications recently brought to light and addressed above and in the July 9 proposal, the determinations made previously are not significantly affected by the limited extensions of the effective date made here.

List of Subjects in 14 CFR Parts 257 and 258

Air carriers, Foreign air carriers, Ticket agents, and Consumer protection.

For the reasons set forth in the preamble, the Department amends Title 14, Chapter II, Subchapter A, Parts 257 and 258 as follows:

PART 257—DISCLOSURE OF CODE-SHARING ARRANGEMENTS AND LONG-TERM WET LEASES

1. The authority citation for Part 257 continues to read as follows:

Authority: 49 U.S.C. 40113(a) and 41712.

2. Section 257.6 is added to read as follows:

§ 257.6 Effective and compliance dates.

(a) This Part is effective as of August 25, 1999.

(b) Compliance with the following sections is mandatory as of August 25, 1999:

(1) § 257.1, § 257.2, § 257.3, § 257.4, § 257.5(d), and § 257.6.

(2) § 257.5(b) to the extent that it requires sellers of air transportation to give consumers oral notice before booking transportation involving a code-share arrangement

(i) Of the fact that the selling carrier is not the transporting carrier and

(ii) Of the transporting carrier's identity (as shown by its two-letter designator code in CRS displays).

(c) Compliance with the following sections is mandatory as of March 15, 2000:

(1) § 257.5(a) and § 257.5(c) in their entirety.

(2) § 257.5(b) insofar as it requires sellers of air transportation to give consumers

(i) Oral notice before booking transportation involving a code-share arrangement of the transporting carrier's corporate name and any other name

under which the service is held out to the public and

(ii) The same disclosures for long-term wet leases as for code-sharing arrangements.

PART 258—DISCLOSURE OF CHANGE-OF-GAUGE SERVICES

3. The authority citation for Part 258 continues to read:

Authority: 49 U.S.C. 40113(a) and 41712.

4. Section 258.6 is added to read as follows:

§ 258.6 Effective and compliance dates.

(a) This Part is effective as of August 25, 1999.

(b) Compliance with the following sections is mandatory as of August 25, 1999: § 258.1, § 258.2, § 258.3, § 258.4, § 258.5(a), § 258.5(b), and § 258.6.

(c) Compliance with § 258.5(c) is mandatory as of March 15, 2000.

Issued in Washington, DC on August 18, 1999, under authority delegated by 49 CFR 1.56a(h)2.

A. Bradley Mims,

Acting Assistant Secretary for Aviation and International Affairs.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 270, 274 and 275

[Release Nos. 33-7728, IC-23958, IA-1815; File No. S7-25-95]

RIN 3235-AG27

Personal Investment Activities of Investment Company Personnel

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting amendments to the rule under the Investment Company Act that addresses conflicts of interest that arise from personal trading activities of investment company personnel. The amendments will increase the oversight role of an investment company's board of directors with respect to codes of ethics, improve the manner in which investment company personnel report their personal securities holdings, and require prior approval of investments in initial public offerings and certain limited offerings by certain investment company personnel (including portfolio managers). Related amendments to disclosure forms will require investment

companies to provide information about their policies concerning personal investment activities in their registration statements. The rule amendments are designed to enhance the board of directors' oversight of the policies governing personal transactions in securities by investment company personnel, help compliance personnel and the Commission's examinations staff in monitoring potential conflicts of interest and detecting potentially abusive activities, and make information about personal investment policies available to the public.

DATES: *Effective Date:* The rule amendments will become effective October 29, 1999. *Compliance Date:* Section IV of this release contains information on compliance dates.

FOR FURTHER INFORMATION CONTACT: Penelope W. Saltzman, Senior Counsel, or C. Hunter Jones, Assistant Director, Office of Regulatory Policy, Division of Investment Management, at (202) 942-0690, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549-0506.

SUPPLEMENTARY INFORMATION: The Commission is adopting amendments to rule 17j-1 [17 CFR 270.17j-1] under the Investment Company Act of 1940 [15 U.S.C. 80a] (the "Investment Company Act" or the "Act"), rule 204-2 [17 CFR 275.204-2] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] (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-77aa] (the "Securities Act"), and Form N-8B-2 [17 CFR 274.12] under the Investment Company Act.¹

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¹ Unless otherwise noted, all references to "amended rule 17j-1," "rule 17j-1, as amended," or any paragraph of the rule will be to 17 CFR 270.17j-1, as amended by this release, and all references to "amended rule 204-2," "rule 204-2, as amended," or any paragraph of the rule will be to 17 CFR 275.204-2, as amended by this release.

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I. Executive Summary

The Commission is adopting amendments to rule 17j-1 under the Investment Company Act. Rule 17j-1 addresses conflicts of interest between registered investment company ("fund") personnel (such as portfolio managers) and their funds that may arise when these persons buy or sell securities for their own accounts ("personal investment activities").

Rule 17j-1 prohibits fraudulent, deceptive or manipulative acts by fund personnel in connection with their personal transactions in securities held or to be acquired by the fund. The rule also contains requirements that are designed to prevent fraud, including (i) requiring funds and their investment advisers and principal underwriters (collectively, "rule 17j-1 organizations") to adopt a code of ethics ("code") containing provisions reasonably necessary to prevent fraudulent, deceptive or manipulative acts and (ii) requiring certain persons to report their personal securities transactions to their rule 17j-1 organization.

The amendments to rule 17j-1 are designed to improve the regulation of personal investment activities in two respects. First, the amendments enhance fund directors' oversight of personal investment activities by requiring that a fund's board, including a majority of independent directors on the board, approve the fund's code and the code of any investment adviser or principal underwriter of the fund. Second, the amendments assist the management of rule 17j-1 organizations in monitoring compliance with the rule. The amendments require initial and annual holdings reports from access persons, as well as review of reports on personal trading by compliance personnel. The amendments also require the fund or its investment adviser to review and pre-approve any investment in an initial public offering ("IPO") or a limited offering (such as a private placement) by personnel who participate in managing the fund's portfolio ("investment personnel"). In addition, amendments to the disclosure forms under the

Securities Act of 1933 and the Investment Company Act will make information about a rule 17j-1 organization's policies concerning personal investment activities available to the public in the fund's registration statement.

II. Background

Section 17(j) of the Investment Company Act prohibits any affiliated person of a rule 17j-1 organization from engaging in fraudulent trading activities that violate rules adopted by the Commission.² Section 17(j) authorizes the Commission to adopt rules to define or prevent fraudulent activities. Under this authority, the Commission adopted rule 17j-1 in 1980.³ Rule 17j-1 prohibits fund personnel from engaging in fraud in connection with personal transactions in securities held or to be acquired by the fund.⁴ In addition, the rule requires every rule 17j-1 organization to adopt a code of ethics designed to prevent "access persons" from engaging in fraud,⁵ and requires that the organization use reasonable diligence and institute procedures reasonably necessary to prevent violations of its code of ethics.⁷ The rule also requires an access person to report personal securities transactions to his or

her rule 17j-1 organization at least quarterly.⁸

The Commission issued a release in 1995 proposing amendments to rule 17j-1 ("Proposing Release").⁹ The proposed amendments were designed to: (i) increase the oversight role of a fund's board of directors with respect to the codes of ethics adopted by the fund, its investment adviser, and principal underwriter; (ii) require that rule 17j-1 organizations receive information about the personal securities holdings of their employees; and (iii) improve disclosure to investors concerning policies on personal investment activities.

We received fourteen comment letters, which generally expressed strong support for the proposed amendments to rule 17j-1.¹⁰ In addition, one commenter urged us to impose minimum guidelines that all codes of ethics must contain in order to address conflicts of interest. Two commenters stated that the current rule should not be revised. A number of commenters addressed particular issues raised by the proposals but did not express an overall view on the amendments. The comment letters have been very helpful to us in formulating the final rule amendments, which are described below.¹¹

⁸ Amended rule 17j-1(d)(1)(ii). The rule 17j-1 organization also must keep records of violations of its code of ethics and certain other records. See amended rule 17j-1(f).

⁹ Personal Investment Activities of Investment Company Personnel and Codes of Ethics of Investment Companies and their Investment Advisers and Principal Underwriters, Investment Company Act Release No. 21341 (Sept. 8, 1995) [60 FR 47844 (Sept. 14, 1995)]. The Proposing Release was preceded by a Commission staff study of rule 17j-1 and an industry advisory group report. Division of Investment Management, SEC, Personal Investment Activities of Investment Company Personnel (1994) ("PIA Report"); Investment Company Institute, Report of the Advisory Group on Personal Investing (1994) ("ICI Advisory Group Report"). The Investment Company Institute is an association of funds representing approximately 95 percent of total fund assets under management in the United States.

¹⁰ The comment letters and a summary of the comments prepared by Commission staff are available to the public in File No. S7-25-95. The Commission received additional comments on the rule proposal after the summary of comments was completed on September 11, 1997. These comments also are available to the public in File No. S7-25-95.

¹¹ In addition to the amendments described below, the amendments reorganize and add headings to the text of rule 17j-1 and replace the term "security" with "covered security" to make the rule easier to understand and use. The Commission also has changed the title of the rule from "Certain unlawful acts, practices, or courses of business and requirements relating to codes of ethics with respect to registered investment companies" to "Personal investment activities of investment company personnel" to reflect more clearly the substance of the rule.

² 15 U.S.C. 80a-17(j). An "affiliated person" of a rule 17j-1 organization includes: (i) any officer, director, partner, copartner, or employee of the rule 17j-1 organization; (ii) any person directly or indirectly controlling, controlled by, or under common control with the rule 17j-1 organization; (iii) any person owning five percent of the rule 17j-1 organization's voting securities; and (iv) any person in which the rule 17j-1 organization owns five percent or more of the voting securities. See Investment Company Act section 2(a)(3) [15 U.S.C. 80a-2(a)(3)].

³ Prevention of Certain Unlawful Activities With Respect To Registered Investment Companies, Investment Company Act Release No. 11421 (Oct. 31, 1980) [45 FR 73915 (Nov. 7, 1980)] ("1980 Adopting Release").

⁴ Amended rule 17j-1(b).

⁵ Rule 17j-1 defines "access person" to include: (i) any director, officer, or general partner of a fund or of a fund's investment adviser, or any employee of a fund or of a fund's investment adviser who, in connection with his or her regular functions or duties, participates in the selection of a fund's portfolio securities or who has access to information regarding a fund's future purchases or sales of portfolio securities; or (ii) any director, officer, or general partner of a principal underwriter who, in the ordinary course of business, makes, participates in or obtains information regarding, the purchase or sale of securities for the fund for which the principal underwriter acts, or whose functions or duties in the ordinary course of business relate to the making of any recommendation to the fund regarding the purchase or sale of securities. Amended rule 17j-1(a)(1). The term "principal underwriter" is defined in section 2(a)(29) of the Act [15 U.S.C. 80a-2(a)(29)].

⁶ Amended rule 17j-1(c)(1)(i).

⁷ Amended rule 17j-1(c)(2)(i).

III. Discussion

A. Codes of Ethics

Codes of ethics are an important part of a rule 17j-1 organization's efforts to prevent fraud resulting from personal trading in securities by its employees. When the Commission adopted rule 17j-1 in 1980, it stated that 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."¹² Comments on the rule proposals confirmed that a "one-size-fits-all" approach to these codes would not be more effective in preventing fraudulent personal trading practices, and would be unnecessarily burdensome, particularly for smaller rule 17j-1 organizations.

Although rule 17j-1 does not specify the provisions that a code of ethics must contain, funds can take several steps to anticipate and avoid problems resulting from conflicts of interest. A 1994 report by an advisory group of the Investment Company Institute ("ICI Advisory Group Report") recommended, among other things, that every code of ethics: (i) prohibit investment personnel from participating in IPOs; (ii) prohibit securities transactions during certain "blackout periods";¹³ and (iii) prohibit short-term trading profits.¹⁴ A 1994 Commission staff report noted that the recommendations in the ICI Advisory Committee Report provide important guidance for a rule 17j-1 organization in preparing its own code of ethics.¹⁵ The Commission believes that a rule 17j-1 organization should review the recommendations in the ICI Advisory Group Report and determine whether the specific restrictions and prohibitions recommended by the report are

appropriate for inclusion in its code of ethics.

B. Role of Fund Boards

1. Approval of Code of Ethics

Rule 17j-1 requires each rule 17j-1 organization to adopt a code of ethics, but does not currently specify a role for a fund's board of directors with respect to the codes.¹⁶ We proposed that a majority of a fund's board, including a majority of independent directors,¹⁷ be required to approve the fund's code and review the codes of any investment adviser or principal underwriter to the fund.

Commenters generally supported increasing board oversight of codes of ethics, and we are adopting the provision, with certain modifications.¹⁸ As suggested by one commenter, the amended rule requires that instead of reviewing the code of an investment adviser and principal underwriter, the board must approve the code and any material changes.¹⁹ In addition, the Commission is clarifying that the board must approve the code when the fund initially engages the investment adviser or principal underwriter (rather than upon each contract renewal). If an investment adviser or principal underwriter makes a material change to its code of ethics, the board has six months in which to approve the material change.²⁰

Under amended rule 17j-1, a fund's board must base its approval of a code of ethics, or a material change to a code of ethics, upon a determination that the code contains provisions reasonably necessary to prevent access persons

from violating the anti-fraud provision of the rule.²¹ The Commission is not, as suggested by one commenter, adopting specific detailed standards for board approval of a code of ethics. We believe that the relevant factors used to approve a code of ethics will vary from fund to fund. Nevertheless, we continue to believe that a basic issue for each board of directors is whether the code should permit personal trading by personnel of a rule 17j-1 organization.²² This issue is relevant for each organization covered by the rule and is too important for a board to ignore.

2. Annual Issues and Certification Report

The board's involvement in the personal investment policies applicable to the fund should not end after the board's initial approval of a code. 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.²³ Therefore, we are adopting, as proposed, amendments that require each rule 17j-1 organization to report periodically to the board on issues raised under its code of ethics. Under the amended rule, the management of a rule 17j-1 organization, at least once a year, must provide the fund's board a written report²⁴ that (i) describes issues that arose during the previous year under the code of ethics or procedures applicable to the rule 17j-1 organization, including, but not limited to,

²¹ The codes of ethics of some rule 17j-1 organizations only recite general principles, and the procedures (rather than the codes) of these organizations contain the specific restrictions, prohibitions, or requirements concerning an access person's personal investment activities. Under amended rule 17j-1, the board must approve a code based on its determination that the code contains provisions reasonably necessary to prevent access persons from violating the anti-fraud provisions of the rule. If a board can make this determination only if it takes into consideration the procedures, then the code must incorporate, or the board must explicitly approve, those procedures, as well as any subsequent material changes to those procedures.

²² See Proposing Release, *supra* note 9, at text preceding n.18.

²³ See Division of Investment Management, SEC, Protecting Investors: A Half Century of Investment Company Regulation 253, 255-56 (1992); PIA Report, *supra* note 9, at 47.

²⁴ The proposed amendments did not specify the method by which the management of a rule 17j-1 organization should provide the report to the fund's board. Two commenters questioned whether the reports could be made orally. The Commission believes that the issues and certification report is important to board oversight of personal investment policies and will best serve the board in written form. We have therefore clarified in the amended rule that the management of each rule 17j-1 organization must furnish a written report to the fund board. See amended rule 17j-1(c)(2)(ii).

¹² See 1980 Adopting Release, *supra* note 3, at text following n.2.

¹³ Blackout period restrictions generally prohibit transactions by fund personnel in a security during a certain period of time before and after the fund trades in that security.

¹⁴ ICI Advisory Group Report, *supra* note 9, at 31-42. The report also recommended that every code of ethics require prior approval of any acquisition of securities by investment personnel in a private placement and prohibit investment personnel from serving on the boards of publicly traded companies without prior authorization. *Id.* In order to implement these restrictions effectively, the report recommended that fund codes of ethics, among other things, require all access persons to: (i) "preclear" personal securities investments; (ii) direct their brokers to provide copies of confirmations of all personal securities transactions and periodic statements of all securities accounts; and (iii) certify annually that they have read and understand the code of ethics, and that they have complied with the requirements of the code. *Id.* at 42-49.

¹⁵ See PIA Report, *supra* note 9, at 31-32.

¹⁶ All references in this release to boards of directors include boards of trustees for funds organized as business trusts. See Investment Company Act section 2(a)(12) [15 U.S.C. 80a-2(a)(12)] (definition of "director" for purposes of the Investment Company Act).

¹⁷ As used in this release, the term "independent directors" means directors who are not "interested persons" of the fund under the Investment Company Act. See Investment Company Act section 2(a)(19) [15 U.S.C. 80a-2(a)(19)] (definition of "interested person" for purposes of the Investment Company Act).

¹⁸ Amended rule 17j-1(c)(1)(ii).

¹⁹ *Id.* This change should not affect the substance of board action because, under the proposal, the same analysis would have been required by the board when it reviewed the code of an investment adviser or principal underwriter. See Proposing Release, *supra* note 9, at n.17 and accompanying text.

²⁰ Amended rule 17j-1(c)(1)(ii). Funds in a fund complex often have different fiscal year periods and, as a result, different schedules for meetings of their boards. The amendments to rule 17j-1 permit fund boards six months in which to approve material changes to codes in order to avoid requiring all funds in a fund complex to approve simultaneously a material change in their investment adviser's or principal underwriter's code of ethics. *Id.*

information about material code or procedure violations and sanctions imposed in response to those material violations²⁵ and (ii) certifies to the fund's board that the rule 17j-1 organization has adopted procedures reasonably necessary to prevent its access persons from violating its code of ethics.²⁶

The issues and certification report is designed to give the board an opportunity to evaluate the effectiveness of codes of ethics and procedures and the manner in which they have been implemented. We expect a fund's board to examine the report carefully, and thus the amended rule requires that the board "consider" the report.²⁷ Upon receipt and consideration of a report, a fund board may determine that it is necessary to amend the fund's code or procedures, or to suggest to an investment adviser or principal underwriter that it consider amending its code or procedures.²⁸

3. Unit Investment Trusts

Rule 17j-1 currently applies to unit investment trusts ("UITs") and requires a UIT and its principal underwriter to adopt codes of ethics.²⁹ Because UITs do

not have boards of directors, the Commission proposed to require that the principal underwriter or depositor for a UIT approve the codes of ethics of the UIT and its principal underwriter or depositor, and be responsible for ensuring that the code of ethics applicable to the UIT contains procedures reasonably necessary to prevent an access person from violating rule 17j-1 and the code.³⁰

Commenters generally accepted the proposed changes for UITs, which the Commission is adopting substantially as proposed.³¹ If a UIT has more than one principal underwriter or depositor, the principal underwriters and depositors may designate a single principal underwriter or depositor to be responsible for approving the UIT's code of ethics and any material changes to the code. The designated principal underwriter or depositor, however, would have to consent in writing to this arrangement.³²

C. Reports by Access Persons

1. Initial Holdings Report

Rule 17j-1 currently requires an access person to report personal securities transactions to his or her rule 17j-1 organization at least quarterly ("quarterly transaction reports") but does not require a complete report of all securities holdings that could create a conflict of interest with the fund. In the Proposing Release, the Commission expressed concern that a rule 17j-1 organization may not be able to monitor effectively potential conflicts of interest unless the rule 17j-1 organization knows the identity of *all* securities held by the access person that could present a conflict, including securities acquired before the person became an access person.³³ Without knowledge of all those securities, for example, it would be difficult for a fund to monitor whether the access person is making trading decisions for the fund based on the securities that the access person holds in his or her own portfolio.

To improve the information that a rule 17j-1 organization currently receives under the rule, the Commission proposed to require that each access person provide an initial holdings report to its rule 17j-1 organization listing all securities beneficially owned by the access person no later than 10

days after he or she becomes an access person. We are adopting this provision substantially as proposed.³⁴

Commenters generally supported the addition of an initial holdings report requirement, although some urged that it be limited to persons who participate in fund portfolio management.³⁵ The Commission has decided not to narrow the initial holdings report requirement as suggested by these commenters. These reports are not burdensome to file, and other access persons may be called upon from time to time to participate in fund investment decision-making that may give rise to a conflict because of these persons' securities holdings. The initial holdings report (updated by transaction reports and annual holdings reports described below) will allow a rule 17j-1 organization to better monitor and address these conflicts.³⁶

2. Annual Holdings Report

In addition to the initial holdings report and quarterly transaction reports, the Commission is amending rule 17j-1 to require each access person to file with his or her rule 17j-1 organization an annual holdings report.³⁷ In the Proposing Release, the Commission asked for comment on (but did not propose) an annual holdings report.³⁸ Commenters differed on the issue. We have decided to require the additional report because of our concern that, without the report, neither the Commission's examinations staff nor a rule 17j-1 organization would be able to understand the full nature of an access person's current securities holdings without sorting through, in some cases,

²⁵ Amended rule 17j-1(c)(2)(ii)(A). As suggested by two commenters, we are limiting the scope of the annual issues and certification report to *material* violations or matters. Nevertheless, even immaterial individual violations (such as late filings of transaction reports) may collectively suggest material problems with an organization's compliance systems. We therefore would expect the report to include any violations that are material in the aggregate. In addition, the requirement to report on issues under the code of ethics or procedures means that a report also should include significant conflicts of interest that arose involving the personal investment policies of the organization, even if the conflicts have not resulted in a violation of the code. For example, a fund would be required to report to the board if a fund portfolio manager is a director of a company whose securities are held by the fund.

²⁶ Amended rule 17j-1(c)(2)(ii)(B). Although the amendments require an issues and certification report to be provided to the board only once a year, more frequent reports by the management of a rule 17j-1 organization may be appropriate in certain circumstances, such as when there have been significant violations of a code or procedures, or significant conflicts of interest arising under the code or procedures. The report also may be used as an opportunity to propose changes to the code or to the procedures that must be approved by the board.

²⁷ Amended rule 17j-1(c)(2)(ii). In considering the report, the board should determine whether any action is required in response to the report.

²⁸ The board also may determine that the fund, investment adviser or principal underwriter is not appropriately implementing its code and procedures, as required by rule 17j-1, to prevent violations of the organization's code of ethics. See amended rule 17j-1(c)(2)(i).

²⁹ See amended rule 17j-1(a)(5) (defining the term "Fund" to include any registered investment company). Unlike other types of funds, a UIT typically does not employ an investment adviser or have a board of directors and has a relatively fixed

portfolio of investments. See Investment Company Act section 4(2) [15 U.S.C. 80a-4(2)] (definition of "unit investment trust").

³⁰ See Proposing Release, *supra* note 9, at nn.30-31 and accompanying text.

³¹ Amended rule 17j-1(c)(1)(iii).

³² *Id.*

³³ Proposing Release, *supra* note 9, at n.38 and accompanying text.

³⁴ Amended rule 17j-1(d)(1)(i). In some cases, persons may have been reporting their securities holdings and brokerage accounts to their rule 17j-1 organizations before they become access persons. In such cases, we believe that an access person would satisfy the initial holdings report requirement, *i.e.*, would not have to submit a report, if his or her rule 17j-1 organization maintains a record of the information required to be disclosed in the initial report and the access person confirms in writing (which writing may be electronic) the accuracy of the record within 10 days after becoming an access person.

³⁵ These commenters suggested limiting an initial holdings report to "investment personnel," as defined in the ICI Advisory Group Report. See *infra* note 48.

³⁶ Persons who currently are or who become access persons before the effective date of the amendments to rule 17j-1 are not required to file initial holdings reports. See *infra* note 98.

³⁷ Amended rule 17j-1(d)(1)(iii).

³⁸ Proposing Release, *supra* note 9, at n.42 and accompanying text. The Commission noted that the ICI Advisory Group Report recommended that access persons file reports listing all of their securities holdings upon commencement of employment and *annually thereafter*. See ICI Advisory Group Report, *supra* note 9, at 46.

many years of transaction reports.³⁹ Thus, requiring an annual holdings report should improve the ability of fund compliance personnel and Commission examiners to detect illegal trading activity by fund personnel.

3. Information Required in Reports

The Commission proposed that an access person be required to report in an initial holdings report every security (as defined in rule 17j-1) that the access person beneficially owns, regardless of whether the fund owns, or intends or proposes to acquire, the security.⁴⁰ The proposed amendments also would have required an initial holdings report to include the title of the security, the number of shares held, the principal amount of the security and its CUSIP number, and a quarterly transaction report to include the CUSIP number for each security for which a transaction occurred and the date that the access person submitted the report.

We are adopting these requirements with some modifications.⁴¹ The amended rule does not require disclosure of the security's CUSIP number. Commenters asserted that CUSIP numbers often are not readily available to access persons, and that requiring them could present an obstacle to timely filing of reports. The reports do, however, require disclosure of any securities account the access

person maintains with a broker, dealer or bank.⁴² This information will assist the rule 17j-1 organization and the Commission's compliance staff in evaluating compliance with the rule's reporting requirements.⁴³

4. Time for Providing Reports

The Commission proposed that the initial holdings report would be required to be filed within ten days after the individual becomes an access person. Some commenters recommended lengthening this period to twenty or thirty days, arguing that a ten-day period may not allow sufficient time for access persons to gather and provide the required information to their rule 17j-1 organization. One commenter suggested that the ten-day period could be *shortened* for an initial holdings report by a portfolio manager.

The Commission notes that quarterly transaction reports under existing rule 17j-1 are required to be submitted no later than ten days after the end of the calendar quarter. This time period does not appear to be unreasonable, and commenters did not argue that it has been burdensome. We are adopting this provision as proposed.⁴⁴

5. Review of Reports

Rule 17j-1 currently includes no specific requirement that the quarterly transaction reports required by the rule be reviewed by anyone in the rule 17j-1 organization. In the Proposing Release, the Commission explained that the purposes of the rule will be served only if the reports are reviewed to detect conflicts of interest and abusive practices.⁴⁵ The Commission therefore proposed to require that the procedures instituted by each rule 17j-1 organization include procedures to review all securities transaction and holdings reports required by rule 17j-1.

The Commission is amending rule 17j-1 to require the review of all securities transaction and holdings reports. Under the amended rule, the procedures instituted by a rule 17j-1 organization to prevent a violation of a code must include procedures requiring that: (i) appropriate management or compliance personnel of the rule 17j-1 organization review transaction and

holdings reports (both initial and annual reports) submitted by access persons; and (ii) the rule 17j-1 organization maintain the names of the persons responsible for reviewing these reports.⁴⁶

D. Preapproval of Investments in IPOs and Private Placements

As discussed above, the Commission did not propose specific restrictions on personal investment activities of fund personnel, but we did ask for comment on the issue.⁴⁷ We noted that the ICI Advisory Group Report recommended that all funds prohibit investment personnel from investing in IPOs, require pre-clearance of investments in private placements, and restrict certain other trading practices.⁴⁸ Many fund complexes have followed this advice and revised their codes of ethics accordingly.⁴⁹ Not all have adopted these ethical restrictions, however, which caused us to consider procedures that would further assist funds and advisers in monitoring conflicts of interest that arise from these particular investment activities.

Most individuals rarely have a chance to invest in IPOs, particularly "hot issue" IPOs,⁵⁰ shares of which usually

⁴⁶ Amended rule 17j-1(d)(3) and (f)(1)(D).

⁴⁷ Proposing Release, *supra* note 9, at nn.32-34 and accompanying text. Five commenters emphasized that all funds should be given flexibility to determine their own policies and procedures governing personal investment activities. One of these commenters, however, supported specific basic requirements in codes, including restrictions on trading in IPOs and private placement offerings.

⁴⁸ *Id.* The report did not define the term "private placement." See *supra* notes 13-14 and accompanying text for a discussion of the additional restrictions recommended in the report. The report defined "investment personnel" to include portfolio managers and employees who provide information and advice to a portfolio manager or who help execute a portfolio manager's decisions, such as securities analysts and traders. ICI Advisory Group Report, *supra* note 9, at 29-30.

⁴⁹ ICI, Report to the Division of Investment Management, U.S. Securities and Exchange Commission: Implementation of the Institute's Recommendations on Personal Investing 15-18 (1995) ("ICI Survey"). Approximately 66 percent of the fund complexes with funds that are ICI members (representing approximately 97 percent of ICI member assets under management) responded to the survey. Seventy-two percent of those fund complexes adopted the ban on investment personnel acquiring securities in an IPO. Sixty-nine percent adopted the ban on purchasing securities in private placements without prior approval. Fourteen percent of the fund complexes that responded to the survey adopted recommendations based on their particular circumstances, which in some cases provided for more stringent restrictions than those recommended by the ICI Advisory Group Report. *Id.*

⁵⁰ A "hot issue" IPO typically means an IPO in which the securities trade in the aftermarket at a premium over the offering price. See Rule IM-2110-1(a)(1) of the NASD Conduct Rules, NASD

³⁹ Using an annual holdings report, a rule 17j-1 organization should better be able to determine the securities holdings of all access persons each year and would not need, for example, to keep a "running count" of the holdings based on the initial holdings report and subsequent quarterly transaction reports. If holdings information were needed, for example, five years after a person becomes an access person, the Commission's examinations staff or a rule 17j-1 organization might have to piece together information from the initial holdings report and as many as 20 quarterly reports. Some rule 17j-1 organizations do, however, maintain a "running count" of their employees' current securities holdings and brokerage accounts. We believe that access persons at these organizations would satisfy their annual holdings report requirement by confirming annually, in writing (which may be electronic), the accuracy of the organization's record of information required to be disclosed in the annual holdings report, and recording the date of the confirmation.

⁴⁰ Proposing Release, *supra* note 9, at nn.43-46 and accompanying text. Under current rule 17j-1, the term "security" excludes certain securities, such as U.S. government securities and shares of open-end funds, that do not appear to present the same opportunities for fraudulent trading activities that rule 17j-1 was designed to prevent. See current rule 17j-1(e)(5). The amendments to rule 17j-1 change the term to "covered security" and expand the types of securities excluded from the definition. See amended rule 17j-1(a)(4) (discussed *infra* in section III.H of this release). The Commission has revised the term in order to avoid any confusion with the term "security" as defined under the Act. See Investment Company Act section 2(a)(36) [15 U.S.C. 80a-2(a)(36)].

⁴¹ Amended rule 17j-1(d)(1).

⁴² Amended rule 17j-1(d)(1)(i)(B), (ii)(B) and (iii)(B).

⁴³ This requirement is similar to a recommendation of the ICI Advisory Group Report that the National Association of Securities Dealers ("NASD") adopt a rule to require all broker-dealers to notify a fund when any of the fund's employees open a brokerage account. ICI Advisory Group Report, *supra* note 9, at 44-45.

⁴⁴ Amended rule 17j-1(d)(1)(i).

⁴⁵ Proposing Release, *supra* note 9, at text following n.47.

are reserved for institutional investors, or wealthy individual customers with large brokerage accounts.⁵¹ As the ICI Advisory Group Report commented, the opportunity for investment personnel to purchase IPO shares presents a "clear potential for conflict between the interests of the individual and the fund."⁵² The purchase of IPO shares by investment personnel may raise questions as to whether the investment is an undisclosed reward for directing fund business to the underwriter or issuer,⁵³ whether the individual is misappropriating an opportunity that should have been offered to the fund,⁵⁴ and whether the individual's future investment decisions for the fund will be based solely on the best interests of the fund's shareholders.⁵⁵

Purchases by investment personnel of securities in private placements or other limited offerings ("private placements") may raise similar conflicts because the opportunity to invest in the private placement may be a reward for past business deals.⁵⁶ In some cases, the conflict may occur later when the issuer of the privately placed security is considering making a public offering.⁵⁷

To ensure that the potential conflicts associated with these investments can

be addressed before they arise, the amendments we are adopting require that investment personnel obtain approval from their fund or adviser before directly or indirectly acquiring any beneficial ownership in securities in an IPO or private placement.⁵⁸ The amendments *do not* prohibit these investments because we recognize that there may be situations in which investment in these offerings does not raise the types of conflicts that the rule is designed to address. In some circumstances, an investment opportunity clearly may be available to investment personnel for reasons *other than* the individual's position with the fund. The fund or adviser therefore could determine that, based on the particular nature of the offering⁵⁹ or the particular facts of the purchase,⁶⁰ the investment would create no material conflict. In other circumstances, the investment may raise only potential conflicts from which the fund and its

investors can be protected.⁶¹ Because the portfolio manager's fund or investment adviser is in the best position to evaluate whether an investment in an IPO or limited offering creates or may create a conflict of interest, the amendments permit that organization to protect the fund by determining whether to approve the proposed investment.

The Commission expects that a fund or investment adviser, in fulfilling its pre-clearance responsibilities, will assign appropriate compliance personnel to carefully review each request for approval.⁶² We also expect that the fund or adviser will use its judgment to distinguish between serious conflicts that must be avoided and those less serious conflicts that the organization can monitor and manage consistent with the protection of the fund and its investors.⁶³ In addition, in order to further encourage careful monitoring of potential conflicts, amended rule 17j-1 requires funds and advisers to retain a record of the approval of, and rationale supporting, any direct or indirect acquisition by investment personnel of a beneficial interest in securities in an IPO or private placement.⁶⁴ These records also should assist compliance personnel and Commission staff in detecting illegal trading activities by fund personnel.

The application of the pre-clearance provision is limited to certain "investment personnel."⁶⁵ The term is

Manual (CCH) 4112 (1999) (introduction to rules on "free-riding" and "withholding").

⁵¹ See Kathleen Weiss Hanley, William J. Wilhelm, Jr., *Evidence on the Strategic Allocation of Initial Public Offerings*, 37 Journal of Financial Economics 239 (1995) (suggesting that approximately 67 percent of shares in IPOs are allocated to institutional investors). See also Michael Siconolfi, *Underwriters Set Aside IPO Stock for Officials of Potential Customers*, Wall St. J., Nov. 12, 1997, at A1 ("It is no news that underwriters make most of the shares in hot IPOs available not to the little-guy investor but to institutions, such as mutual fund companies and pension funds that provide a lot of trading commissions and other business.").

⁵² ICI Advisory Group Report, *supra* note 9, at 32.

⁵³ See, e.g., *U.S. v. Ostrander*, 999 F.2d 27 (2d Cir. 1993) (affirming conviction of portfolio manager, who purchased privately offered warrants of company whose securities she acquired for the fund, for accepting unlawful compensation for fund's purchase of property in violation of the Investment Company Act).

⁵⁴ See, e.g., In the Matter of Ronald V. Speaker and Janus Capital Corporation, Investment Company Act Release No. 22461 (Jan. 13, 1997) (investment adviser made \$16,000 profit on same day purchase and sale of debentures in which fund could have invested, and failed to disclose transactions to the fund or obtain prior consent of the fund (or a disinterested employee authorized to waive the opportunity on the fund's behalf)).

⁵⁵ See ICI Advisory Group Report, *supra* note 9, at 32.

⁵⁶ See *Ostrander*, *supra* note 53.

⁵⁷ A fund portfolio manager who has invested in the private placement may have an opportunity to increase the value of his or her investment by causing the fund to invest in the public offering and contribute to its success. See ICI Advisory Group Report, *supra* note 9, at 33-34 (citing John Accola, *Firms, Fund Exec Ties "Normal," Rocky Mountain News*, Jan. 18, 1994, at 38A).

⁵⁸ Amended rule 17j-1(e). The rule is not limited to purchases of "covered securities" sold in an IPO or limited offering, but rather applies to purchases of all securities sold in an IPO or limited offering. See 15 U.S.C. 80a-2(a)(36) (definition of "security"). The rule generally defines an IPO to include an offering of securities registered with the Commission, the issuer of which, immediately before the registration, was not required to file reports with the Commission. Rule 17j-1(a)(6). This is the same definition used in section 12(f)(1)(G)(i) of the Securities Exchange Act of 1934 (the "Securities Exchange Act") [15 U.S.C. 78j(f)(G)(i)]. The definition of "limited offering" under the rule includes private placement offerings that are exempt from registration under section 4(6) of the Securities Act [15 U.S.C. 77d(6)] or under Regulation D [17 CFR 230.501-508], as well as offerings that are not public under section 4(2) of the Securities Act [15 U.S.C. 77d(2)]. Amended rule 17j-1(a)(8).

⁵⁹ A portfolio manager, for example, may have an opportunity to invest in an IPO of the fund adviser as a result of his or her service as an employee of the adviser, in an IPO of a mutual insurance company as a result of his or her ownership of a life insurance policy, or in an IPO of a spinoff company as a result of his or her ownership of stock in the company that spins off the issuer. In each case (and other similar cases), a fund or adviser could determine that the portfolio manager's access to the IPO did not result from his or her position with the fund.

⁶⁰ For example, a portfolio manager's purchase of privately offered securities issued by a small family business that is unlikely to make a public offering in the future would likely not raise a material conflict if the portfolio manager's fund is prohibited from investing in private placements. Similarly, an investment in an IPO in which all shares are allocated to investors on a non-discriminatory basis may not raise a material conflict. See Elizabeth Cochran, *Taking a Seat at the IPO Table*, Wash. Post, Jan. 7, 1999, at E1 (some online firms allocate IPO shares on a "first-come, first-served" basis or on a pro-rata basis to all interested investors); Lisa Branstetter and Nick Wingfield, *New Company Aims to Shift IPO Playing Field*, Wall St. J., Feb. 8, 1999, at C1 (one online firm selling IPO shares will use a "Dutch auction" process to set the offering price and to allocate IPO stock to the highest bidding investors).

⁶¹ For example, if a portfolio manager sought approval to invest in a private placement of securities of a business that might make a public offering in the future, the fund or adviser could decide to approve the investment subject to conditions designed to protect investors from potential conflicts. These conditions might require that the portfolio manager disclose his or her investment if the fund subsequently considers investing in the business, and that other investment personnel who have no personal interest in the issuer review any decision the portfolio manager may make regarding the fund's investment in the business. See ICI Advisory Group Report, *supra* note 9, at 33.

⁶² We expect that funds and advisers will review these proposed investments on a case-by-case basis, except for those circumstances in which advance general approval may be appropriate because it is clear that conflicts are very unlikely to arise due to the nature of the opportunity for investing in the IPO or private placement. See *supra* text accompanying notes 59-60. The fund's inability to invest in the securities would not be a basis for concluding generally that the conflicts are unlikely to arise. See text accompanying note 53 *supra*.

⁶³ Some conflicts of interest must be reported to the fund's board of directors under rule 17j-1. See *supra* note 25; amended rule 17j-1(c)(2)(ii) (annual issues and certification report requirement).

⁶⁴ Amended rule 17j-1(f)(2).

⁶⁵ In deciding whether to approve securities transactions by investment personnel, the adviser should consider all conflicts that may cause the adviser and its investment personnel to violate their fiduciary obligations to the fund, other funds

defined in rule 17j-1 to include portfolio managers and other employees of the fund or its investment adviser who participate in making investment recommendations to the fund, and persons in a control relationship to the fund who obtain information about investment recommendations made to the fund.⁶⁶ These persons are involved in investment decisions for the fund and thus have significant opportunities to influence fund decisions that may benefit them personally.

E. Disclosure of Policies Concerning Personal Investment Activities

Rule 17j-1 currently does not require funds to disclose publicly any information about their codes of ethics. The Commission proposed to require that a fund disclose in its registration statement (i) that the fund and its investment adviser and principal underwriter have adopted codes of ethics, (ii) whether these codes permit personnel to invest in securities for their own accounts, and (iii) that the codes are on public file with, and are available from, the Commission.⁶⁷ We also proposed to require a fund to file with the Commission all codes of ethics applicable to the fund as an exhibit to its registration statement. Commenters generally did not raise significant objections to these proposals, although some commenters questioned whether the proposed disclosure would be meaningful to investors.⁶⁸

The Commission is adopting the disclosure requirements substantially as

advised by the adviser, and other clients of the adviser. In the case of a proposed transaction in a security of limited availability, the adviser should consider whether the fund or other clients can invest in the security before approving the transaction. See Speaker, *supra* note 54; In the Matter of Kemper Financial Services, Inc. et al., Investment Advisers Act Release No. 1494 (June 6, 1995); In the Matter of Joan Conan, Investment Advisers Act Release No. 1446 (Sept. 30, 1994).

⁶⁶ Amended rule 17j-1(a)(7) defines "investment personnel" as: (i) any employee of a fund or its investment adviser (or any company in a control relationship with either) who, in connection with his or her regular functions or duties, makes or participates in making any recommendations regarding the purchase or sale of securities by the fund and (ii) any natural person in a control relationship to the fund or its investment adviser who obtains information concerning recommendations made to the fund regarding the purchase or sale of securities by the fund.

⁶⁷ See Proposing Release, *supra* note 9, at nn.50-51 and accompanying text.

⁶⁸ Two commenters opposed the requirement that a fund disclose whether fund personnel may invest in "securities, including securities that may be purchased or held by the fund" and noted that this phrase could imply that investment by fund personnel in these securities is inherently suspect. We believe this information is important for investors, and, as discussed below, we are adopting this requirement as proposed. Funds are free to provide additional disclosure that personal trading by fund personnel is not inherently unlawful.

proposed, except that the disclosure may be in the Statement of Additional Information ("SAI") rather than in the prospectus.⁶⁹ This approach is more consistent with other disclosure rules that govern the type of information that appears in the SAI.⁷⁰ We also are requiring that the codes of ethics be filed through the Commission's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system as an exhibit to the fund's registration statement.⁷¹ Electronic filing will facilitate public access to the codes and permit investors, market professionals and the financial media to obtain information about a fund's policies concerning personal investment activities.

F. Beneficial Ownership

Rule 17j-1 currently states that, for purposes of the rule 17j-1 reporting requirement, beneficial ownership should be interpreted in a manner that is consistent with section 16 of the Exchange Act.⁷² In 1991, the Commission adopted revised rule 16a-1 under the Exchange Act, which clarified the meaning of beneficial

⁶⁹ The SAI is the second part of Form N-1A, the form used to register open-end funds, of Form N-2, the form used to register closed-end funds, and of Form N-3, the form used to register separate accounts offering variable annuity contracts. The recent amendments to Form N-1A require a fund to send an SAI to requesting investors within three business days of a request. See Registration Form Used by Open-End Management Investment Companies, Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916 (Mar. 23, 1998)], at text accompanying n.189 ("Amendments to Form N-1A"); Form N-1A [17 CFR 274.11A], Instruction 3 to Item 1(b)(1).

⁷⁰ See Amendments to Form N-1A, *supra* note 69, at text accompanying n.23 (stating that prospectus disclosure requirements are designed to include "essential information" about the fundamental characteristics and risks of investing in a fund, and to be limited to information "necessary for an average or typical investor to make an investment decision").

⁷¹ Information in the EDGAR system is available through our Internet web site at <http://www.sec.gov>. Registration statements also can be reviewed and copied at the Commission's Public Reference Room in Washington, D.C.

A fund that is not required to have a code of ethics because, for example, it does not invest in covered securities as defined in amended rule 17j-1(a)(4), would not be required to file any code as an exhibit to its registration statement, but should indicate on its exhibit list the reason that it is not filing a code of ethics. See Form N-1A, Item 23(p). A fund that invests only in the securities of one other fund (such as a feeder fund in a "master-feeder" fund arrangement) would be required to file the codes of ethics applicable to the fund in which it invests because the feeder fund is a vehicle for investment in the underlying fund. *Id.* A management investment company that invests in the securities of other funds and exercises discretion regarding the funds in which it invests (such as a "fund of funds") would not, however, be required to file the codes of ethics of those other funds.

⁷² Current rule 17j-1(c)(1); 15 U.S.C. 78p.

ownership for purposes of section 16.⁷³ The Commission is amending rule 17j-1 to incorporate this interpretation.⁷⁴ The Commission is making a parallel amendment to rule 204-2 under the Advisers Act to incorporate this interpretation.⁷⁵

G. "Security Held or To Be Acquired" by a Fund

Rule 17j-1 prohibits fraud by certain fund personnel⁷⁶ in connection with their purchase or sale of a "security held or to be acquired" by the fund.⁷⁷ The Commission proposed to amend the definition of a "security held or to be

⁷³ 17 CFR 240.16a-1(a)(2). See Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Securities Exchange Act Release No. 28869 (Feb. 8, 1991) [56 FR 7242 (Feb. 21, 1991)]. The rule provides that, for purposes of determining whether a person is the beneficial owner of more than 10 percent of a registered class of equity securities under section 16 of the Securities Exchange Act [15 U.S.C. 78p], ownership should be calculated according to standards of beneficial ownership outlined under section 13(d) of the Securities Exchange Act [15 U.S.C. 78m(d)] and the rules under section 13(d), subject to certain exclusions. 17 CFR 240.16a-1(a)(1). For all other purposes under section 16, beneficial ownership should be based on whether the person has a pecuniary interest in the equity security. 17 CFR 240.16a-1(a)(2).

⁷⁴ Amended rule 17j-1(d)(5). The amended rule also clarifies that the definition of beneficial ownership applies to any "covered security" the access person owns or acquires. *Id.* To the extent that the clarification differs from any previous guidance that the staff has given, that guidance is withdrawn. See MI Fund, Inc., SEC No-Action Letter (Aug. 18, 1981).

⁷⁵ Amended rule 204-2(a)(12)(iii)(B), (13)(iii)(B).

⁷⁶ These personnel are "affiliated persons" of a fund or of its investment adviser or principal underwriter. An "affiliated person" of an organization includes any officer, director, partner, copartner, or employee of the organization. See *supra* note 2.

⁷⁷ Amended rule 17j-1(b); see also section 17(j) [15 U.S.C. 80a-17(j)] (prohibiting violation of Commission rules in connection with purchase or sale of a "security held or to be acquired" by a fund). Under rule 17j-1, a "security held or to be acquired" by a fund includes a security that (i) is held or is being considered for purchase by the fund or its investment adviser for the fund at the time of the transaction, or (ii) was held or was considered for purchase by the fund or its investment adviser for the fund at any time during the 15 days before the transaction. Amended rule 17j-1(a)(10). The effect of this provision is to include a transaction in such a security within the scope of the rule's anti-fraud provision. Rule 17j-1 does not prohibit fund personnel from purchasing or selling these securities unless the transaction would defraud the fund (although codes of ethics may prohibit or limit such transactions). In addition, rule 17j-1 does not limit a fund's ability to purchase or sell a security as a result of transactions by fund personnel. While a transaction by fund personnel in a security that is outside the scope of the rule will not violate section 17(j) or rule 17j-1, such a transaction may nonetheless violate other anti-fraud provisions of the federal securities laws. See, e.g., section 17(a) of the Securities Act [15 U.S.C. 77q(a)], section 10(b) of the Securities Exchange Act [15 U.S.C. 78j(b)], rule 10b-5 [17 CFR 240.10b-5] thereunder, and section 206 of the Advisers Act [15 U.S.C. 80b-6].

acquired" by a fund, to clarify that the securities that are subject to the rule's anti-fraud provision include any option to purchase or sell, and any security that is exchangeable for or convertible into, any security that is held or to be acquired by a fund. As explained in the Proposing Release, a fund insider who purchases or sells an option or convertible security could improperly benefit from that transaction to the same extent as a fund insider who purchases or sells the underlying security.⁷⁸ The only two commenters on this issue supported the proposed clarification, and we are adopting it as proposed.⁷⁹

H. Excepted Securities and Funds

Because certain types of securities do not present the opportunity for the type of improper trading activities that rule 17j-1 is designed to prevent, the rule has excepted from its coverage transactions in certain money market fund instruments, certain U.S. Government securities,⁸⁰ and securities issued by mutual funds. The Commission proposed to expand the exceptions to cover a broader array of money market instruments, and to exclude from the rule's coverage all money market funds (which are generally limited to investing in money market instruments), as well as their investment advisers and principal underwriters. Commenters supported the amendments, which the Commission is adopting as proposed.⁸¹

As a result of these exceptions, all funds that are money market funds, or that limit their investments to certain money market instruments, certain U.S. Government securities and securities of other mutual funds, do not need to

adopt codes of ethics under rule 17j-1.⁸² Access persons of these organizations also would not be required to make holdings or transaction reports to their organization.⁸³ In addition, access persons of rule 17j-1 organizations that are required to adopt codes of ethics under the rule do not have to file transaction reports concerning transactions in these instruments or report them in their initial or annual holdings reports.⁸⁴

I. Conforming Amendments to Advisers Act Rules

Rule 204-2(a) under the Advisers Act requires each investment adviser to keep records of the personal securities transactions of the adviser and its "advisory representatives."⁸⁵ Although the purpose of this requirement is substantially the same as the quarterly transaction reporting requirements of rule 17j-1, the two rules except transactions in different securities from their respective reporting and recordkeeping requirements.⁸⁶ The Commission is revising rule 204-2(a), as proposed, to conform its exceptions to those of rule 17j-1.⁸⁷ The Commission also is adding an exception to the recordkeeping requirements under rule 204-2(a) to permit an investment adviser not to make certain records under the rule if the information required under rule 204-2(a) would

duplicate information contained in a broker trade confirmation or account statement received and kept by the investment adviser.⁸⁸

IV. Effective Date; Compliance Dates

A. Effective Date

The rule amendments the Commission is adopting today will become effective October 29, 1999.

B. Compliance Dates

To permit the individuals and entities that are subject to rule 17j-1 sufficient time to comply with the new provisions adopted today and to avoid conflicts with plans to address Y2K issues, the Commission is providing transition time for certain new requirements.

1. March 1, 2000

No later than March 1, 2000, rule 17j-1 organizations (*i.e.*, funds and their investment advisers and principal underwriters) and their personnel must meet the following requirements:⁸⁹

(i) Each rule 17j-1 organization must have identified access persons and notified them of their reporting obligations;⁹⁰

(ii) Each rule 17j-1 organization must have adopted procedures for management or compliance personnel to review transaction and holdings reports; and⁹¹

(iii) Each rule 17j-1 organization must have established a record of access persons who are required to make transaction and holdings reports, and of persons who are responsible for reviewing those reports.⁹²

2. September 1, 2000

No later than September 1, 2000:

(i) Each fund's board of directors must have approved codes of ethics of the fund, its investment advisers and principal underwriters (which codes may have been revised in response to the rule amendments adopted in this release);⁹³

(ii) Each rule 17j-1 organization must have provided the fund's board of

⁷⁸ Proposing Release, *supra* note 9, at nn.59-61 and accompanying text.

⁷⁹ Amended rule 17j-1(a)(10). A security that is exchangeable for or convertible into a security that is held or to be acquired by a fund would include warrants to purchase or sell the security.

⁸⁰ Rule 17j-1 currently excepts "securities issued by the Government of the United States" from the definition. The Commission is not changing the securities subject to this exception, but is amending the 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 rule 204-2(a)(12) and 204-2(a)(13) under the Advisers Act. Amended rule 17j-1(a)(4)(i).

⁸¹ Amended rule 17j-1(a)(4)(ii). As amended, rule 17j-1 excludes from the definition of "covered security" "bankers' acceptances, bank certificates of deposit, commercial paper, and high quality short-term debt instruments, including repurchase agreements." *Id.* We interpret "high quality short-term debt instrument" to mean any instrument that has a maturity at issuance of less than 366 days and that is rated in one of the two highest rating categories by a Nationally Recognized Statistical Rating Organization.

⁸² See amended rule 17j-1(c)(1)(i). Similarly, investment advisers and principal underwriters to these funds would not have to adopt codes of ethics unless the investment adviser or principal underwriter also provides services to a fund that must adopt a code of ethics under rule 17j-1. See also *supra* note 71.

⁸³ See amended rule 17j-1(d)(1). If, however, an access person is an access person of another organization that is covered by rule 17j-1, the access person would have to provide holdings and transaction reports to that organization.

⁸⁴ See amended rule 17j-1(d)(1)(i), (ii)(A) and (iii)(A) (reports limited to covered securities). The Proposing Release requested comment whether there are other types of securities that should be excepted from the scope of the rule. Commenters recommended several other types of securities that should be excepted, such as options and futures on broad-based market indices. The Commission does not believe that those recommended types of securities are insulated from the risks of market manipulation and the potential conflicts of interest that rule 17j-1 is intended to cover. The Commission therefore is not amending the rule's definition of "covered security" to exclude those securities.

⁸⁵ Amended rule 204-2(a)(12), (13).

⁸⁶ Rule 17j-1 currently excepts transactions in securities issued by the Government of the United States, bankers' acceptances, bank certificates of deposit, commercial paper and shares of registered open-end investment companies from its reporting requirements. Rule 204-2(a) currently excepts from its recordkeeping requirements only transactions in securities that are direct obligations of the United States.

⁸⁷ For a discussion of these exceptions, see *supra* section III.H of this release.

⁸⁸ Amended rule 204-2(a)(12), (13).

⁸⁹ Rule 17j-1 organizations that already are in compliance with these requirements do not have to satisfy the requirements of the rule again to meet these compliance dates. Thus, a rule 17j-1 organization that currently requires quarterly transaction, initial holdings and annual holdings reports containing the information required under amended rule 17j-1 and that already has identified and notified its access persons of those reporting obligations would not need to identify and notify the individuals again.

⁹⁰ See amended rule 17j-1(d)(4).

⁹¹ See amended rule 17j-1(d)(3).

⁹² See amended rule 17j-1(f)(4).

⁹³ See amended rule 17j-1(c)(1)(iii).

directors with the first of its annual issues and certification reports;⁹⁴ and

(iii) Each access person must have provided the first of his or her annual holdings reports to his or her rule 17j-1 organization.⁹⁵

3. April 10, 2000

Each quarterly transaction report filed for the calendar quarter ending March 31, 2000 (due April 10, 2000), and for subsequent quarters must include all information required under amended rule 17j-1(d)(1)(ii).⁹⁶

4. Other Compliance Dates

(i) After March 1, 2000, investment personnel may not directly or indirectly acquire any beneficial interest in securities in an IPO or in a private placement without prior approval from the fund or the fund's investment adviser, and the fund and adviser must retain records of the approval and reasons for granting the approval;⁹⁷

(ii) Each person who becomes an access person on or after March 1, 2000 must file his or her initial holdings report with his or her rule 17j-1 organization within 10 days after becoming an access person;⁹⁸ and

(iii) In the next post-effective amendment filed by a fund after March 1, 2000, the fund must file copies of codes of ethics of the rule 17j-1 organizations as an exhibit to the registration statement, and disclose certain information about those codes.⁹⁹

V. Cost-Benefit Analysis

A. Summary

The Commission is sensitive to the costs and benefits that result from its rules, and understands that complying

with the requirements of rule 17j-1 may impose costs on rule 17j-1 organizations and their personnel. The Commission requested data on the costs and benefits of rule 17j-1 in the Proposing Release, but none of the comment letters on the Proposing Release provided specific estimates of any costs or benefits of amending the rule. Nevertheless, as discussed below, the Commission believes that the amendments to rule 17j-1 will improve the regulation of personal investment activities and that the benefits to investors justify the costs of compliance with the rule. Investors also should benefit from the additional disclosure of information about policies of rule 17j-1 organizations concerning personal investment activities.

The amendments to rule 17j-1 require: (i) a fund's board, including a majority of independent directors on the board, to approve the fund's code and the code of any investment adviser or principal underwriter of the fund as well as any material changes to those codes; (ii) the management of a 17j-1 organization to provide the fund's board an annual report describing issues that arose under the code during the previous year; (iii) each access person to file with his or her rule 17j-1 organization an initial and annual holdings report; and (iv) all investment personnel to obtain approval from the fund or investment adviser before investing in an IPO or private placement. The amendments also clarify certain provisions of rule 17j-1. Amendments to disclosure forms under the Securities Act and the Investment Company Act require funds to make available to the public information about the policies of rule 17j-1 organizations regarding personal investment activities.

B. Benefits

The Commission believes that the rule amendments adopted today will yield important benefits for investors. The amendments to rule 17j-1 are designed to improve the oversight and monitoring of personal trading activities. In addition, the amendments to disclosure forms under the Securities Act and Investment Company Act will allow the public, including the financial media and market professionals, to obtain information on rule 17j-1 organizations' policies regarding personal investment activities.

These regulations will allow rule 17j-1 organizations more quickly to detect conflicts of interest that may arise from personal trading activities and help prevent subsequent conduct that could defraud the fund. Specifically, the rule's requirement that each fund board

approve the codes of ethics of the fund and its investment advisers and principal underwriters will allow fund directors to better oversee the personal investment activities of fund personnel. The requirement that management of a rule 17j-1 organization annually provide a written report to the board on issues raised under its code of ethics will give the board the opportunity to evaluate the effectiveness of the codes and procedures and the manner in which they have been implemented.

The requirement that each access person provide an initial and annual holdings report to his or her rule 17j-1 organization will allow the organization to better monitor the conflicts of interest that may arise when an access person participates in investment decisions for the fund that involve securities the access person holds in his or her portfolio. The annual holdings report requirement also will enable rule 17j-1 organizations to monitor whether access persons are filing accurate quarterly transaction reports. In addition, the annual report will allow the rule 17j-1 organization and the Commission's examination staff to view the full scope of an access person's current securities holdings without having to sort through multiple years of transaction reports. Finally, the requirement that investment personnel pre-clear their investments in IPOs and private placements will allow funds and advisers to review carefully the personal investment activities that create the greatest opportunities for fraud and to address any potential conflicts of interest that could result from these investments before they arise.

C. Costs

Several commenters who addressed the proposed amendments to rule 17j-1 suggested that the Commission modify the rule to simplify its application and reduce compliance burdens, in order to reduce costs for rule 17j-1 organizations. We have evaluated these comments and determined that it is appropriate to adopt the amendments to rule 17j-1 with a number of changes that simplify the rule for rule 17j-1 organizations. The adopted amendments, for example, simplify the compliance requirements of rule 17j-1 organizations by extending the exception from the requirement to have a code of ethics to cover any fund that does not invest in covered securities as defined in the rule.

We estimate that approximately 5,226 rule 17j-1 organizations would be required to comply with rule 17j-1. Those organizations include approximately: (i) 3,900 active

⁹⁴ See amended rule 17j-1(c)(2).

⁹⁵ See amended rule 17j-1(d)(1)(iii).

⁹⁶ The additional information required under this amendment is: (i) the date that the quarterly transaction report is filed; (ii) the name of any covered securities account established by the access person during that quarter; and (iii) the date the account was established. Amended rule 17j-1(d)(1)(ii)(A)(5), (B). Note that access persons need not file a quarterly transaction report if the information would duplicate information that their rule 17j-1 organization has received in a broker's confirmation or account statement. See amended rule 17j-1(d)(2)(v).

⁹⁷ See amended rule 17j-1(e), (f)(2).

⁹⁸ See amended rule 17j-1(d)(1)(i). Any person who has become an access person before March 1, 2000 need not file an initial holdings report, but must file the first of his or her annual holdings reports no later than the date specified above.

⁹⁹ See Amended Forms N-1A, N-2, N-3, N-5 and N-8B-2. A post-effective amendment made for the purpose of complying with these amendments may be made pursuant to rules 485(b) or 486(b) under the Securities Act [17 CFR 230.485(b), 486(b)], provided the post-effective amendment otherwise meets the conditions for immediate effectiveness under those rules.

registered investment companies; (ii) 901 investment advisers to funds; and (iii) 425 principal underwriters of funds.¹⁰⁰ The number of rule 17j-1 organizations is based on staff estimates of the number of entities that must comply with rule 17j-1 and data available for 1998.¹⁰¹ Other estimates are based on the staff's experience and discussions with mutual fund organizations.

Rule 17j-1 Organizations. Funds may incur additional expenses in the first year after the amendments become effective because the board of directors will have to approve the codes of the fund, its investment adviser and principal underwriter.¹⁰² The Commission believes these expenses will be minimal because all rule 17j-1 organizations already are required to have adopted codes of ethics.¹⁰³ In addition, we have allowed fund boards one year in which to comply with this requirement, which will allow boards to consider the codes during one of their regularly scheduled meetings.¹⁰⁴ After initial approval, fund boards will be required to approve only material changes to the codes.¹⁰⁵

Under the amendments, a rule 17j-1 organization also could incur additional costs in producing and filing the annual issues and certification report for the fund's board. We estimate that the report would take each rule 17j-1 organization approximately 3 hours to prepare, for an annual cost to the organization of approximately \$315 and a total annual cost to the industry of approximately \$1,646,190.¹⁰⁶

¹⁰⁰ The estimated number of respondents may overstate the number of entities actually required to comply with the rule's requirements because money market funds, funds that invest only in securities excluded from the definition of "covered security" in rule 17j-1, and some investment advisers, principal underwriters, and access persons to those funds, do not have to comply with the rule's requirements concerning codes of ethics and transactions and holdings reports. See amended rule 17j-1(c)(1); 17j-1(d)(2)(i).

¹⁰¹ Although the Proposing Release requested it, none of the comment letters provided data pertaining to the cost of complying with rule 17j-1.

¹⁰² Because the amendments to rule 17j-1 expand the types of funds that are exempt from rule 17j-1, in certain cases a rule 17j-1 organization's costs could decrease under the amended rule.

¹⁰³ See current rule 17j-1(b)(1).

¹⁰⁴ We understand that fund directors generally receive compensation on the basis of the number of meetings that they attend. Therefore, no additional payment would be required for work performed during a regularly scheduled meeting.

¹⁰⁵ See amended rule 17j-1(c)(1)(ii).

¹⁰⁶ The cost estimate is based on our estimate that the report would take 2 hours of professional time (at \$150 per hour) and 1 hour of support staff time (at \$15 per hour) to prepare.

The amendments also require the procedures instituted by rule 17j-1 organizations to require

The amendments also require the fund to disclose that the fund, its investment adviser and principal underwriter have adopted codes of ethics, and require each fund to file a copy of the applicable codes with the Commission. We estimate that the cost to funds of these requirements in the first year after the amendments are adopted would be \$1,263,600.¹⁰⁷ Funds would be required to file codes in subsequent years only to the extent that the codes had been materially amended.

Finally, funds and advisers will have to maintain a written record of any approvals permitting investment personnel to purchase securities in an IPO or private placement. Many funds and advisers currently prohibit investment personnel from IPO investments and require pre-clearance of investments in private placement offerings.¹⁰⁸ For those funds and advisers that would have to begin maintaining approval records, we estimate the review and documentation process would cost approximately \$750 per organization each year, for a total annual cost to the industry of \$900,000.¹⁰⁹

Access Persons. Rule 17j-1 currently requires access persons to file quarterly transaction reports. The amendments to the rule require access persons to file initial holdings reports when they become access persons and annual holdings reports thereafter.¹¹⁰

review of transaction and holdings reports. The Commission believes that most funds already have review procedures in place and the cost of implementing additional procedures to review transaction and holdings reports would not be significant.

¹⁰⁷ The cost of including this disclosure in a post-effective amendment and filing the codes of ethics would be minimal for funds that submit their own filings through EDGAR. Funds that use outside contractors to submit EDGAR filings would incur some additional cost in filing the codes as exhibits. We estimate that approximately 40 percent of funds submit their own EDGAR filings. Thus, approximately 2,340 funds use outside contractors. We estimate that funds using outside contractors would file an average of 36 pages of exhibits at an average cost of \$15 per page, for a total cost to funds of \$1,263,600 ($2,340 \times 36 \times \$15 = \$1,263,600$) in the first year after the amendments to rule 17j-1 become effective.

¹⁰⁸ See *infra* note 118.

¹⁰⁹ This estimate assumes that each fund and adviser will receive, on average, 10 applications for review each year, each of which will take, on average, approximately 0.5 hours of professional time (at \$150 per hour) to review (and, if necessary, document), for an annual cost of \$750 per organization ($5 \times \$150 = \750). These numbers may vary considerably depending on the fund or adviser and its personnel. The estimated annual cost of review and documentation is equal to the number of funds and advisers that must begin review multiplied by the number of hours per organization to review multiplied by the cost per hour to review, for a total of \$900,000 ($1,200 \times 5 \times \$150 = \$900,000$).

¹¹⁰ We have assumed that a new access person who files an initial holdings report would not have

These amendments will impose additional costs on access persons only to the extent that their rule 17j-1 organization currently does not impose similar reporting requirements. A 1995 survey of members by the ICI found that a majority of fund complexes already require some form of reporting similar to that adopted in the amendments.¹¹¹ Based on the ICI Survey, we estimate that the rule amendments would require approximately 67,518 access persons at approximately 4,703 rule 17j-1 organizations to begin filing annual holdings reports.¹¹² We further estimate

to file an annual holdings report in the same year. An access person may, however, have to file an initial and annual holdings report in the same year if the rule 17j-1 organization requires all access persons to file reports by the same date each year.

¹¹¹ Sixty-six percent of member fund complexes responded to the ICI Survey. ICI Survey, *supra* note 49, at 1. The Survey indicated that 66 percent of the fund complexes responding adopted the ICI Advisory Group Report recommendation that investment personnel disclose all personal securities holdings when they begin employment and annually thereafter. *Id.* at 30-31. An additional 11 percent of the responding fund complexes stated that they had adapted the disclosure requirements to their circumstances. Some of these adaptations have imposed more frequent reporting requirements or extended reporting requirements to all access persons. *Id.*

¹¹² We estimate that 275 of the 5,226 rule 17j-1 organizations are new this year. Access persons at those organizations would file an initial holdings report in the first year rather than an annual holdings report. Of the remaining 4,951 existing rule 17j-1 organizations, we estimate that 66 percent already have implemented initial and annual holdings report requirements for *investment personnel*, see *supra* note 111, and that investment personnel represent half of the *access persons* at these organizations. Therefore, the amendments would impose new reporting requirements on only half of the access persons at 66 percent of existing organizations. Based on the ICI Survey, we estimate that 5 percent of existing organizations currently require all access persons to submit initial and annual holdings reports. Therefore, the amendments would not impose new reporting requirements on any of the access persons at those organizations. (We do not know the precise percentage of funds that impose reporting requirements on all access persons, see *supra* note 111, so we have estimated 5 percent as the approximate midpoint of the 11 percent range of funds that adapted the reporting recommendations of the ICI Advisory Group Report.) We estimate that the remaining 29 percent of organizations ($100 - (66 + 5) = 29$) currently do not require any access persons to make personal holdings disclosures comparable to those required by the amendments to rule 17j-1. Therefore, the amendments would impose new reporting requirements on all the access persons at those organizations.

We estimate that, on average, a rule 17j-1 organization will have approximately 24 access persons (22 of whom would file an annual holdings report, and 2 of whom are new and would file an initial holdings report). Therefore, we estimate that the number of access persons who would have to begin filing annual reports as a result of the amendments to rule 17j-1 equals the sum of: all continuing access persons at 29 percent of 4,951 existing rule 17j-1 organizations ($22 \times 1,435 = 31,570$) plus half of continuing access persons at 66 percent of existing rule 17j-1 organizations ($11 \times 3,268 = 35,948$); or a total of 67,518 access persons.

that it would take an access person, on average, 0.5 hours of professional time to complete an annual report, for an estimated total annual cost to the industry of \$5,063,850.¹¹³

Initial reports are required to be provided only by persons who become access persons after the effective date of the amendments.¹¹⁴ The Commission estimates that the amendments to rule 17j-1 will result in approximately 10,218 new access persons having to file initial holdings reports each year.¹¹⁵ Assuming the initial holdings report will take approximately 1 hour of professional time to prepare, we estimate an annual total cost to the industry of \$1,532,700.¹¹⁶

Investment Personnel. The requirement that investment personnel obtain approval before investing in an IPO or private placement should impose minimal costs on those individuals for at least three reasons. First, the requirement may result in restrictions on their purchases of two types of offerings, but the provision does not restrict them from participating in the vast majority of investment opportunities. Second, as discussed above, few individuals have access to IPOs and private placements unless they have substantial accounts with a broker or may be in a position to direct business to the broker or issuer.¹¹⁷ Therefore, few investment personnel

appear likely to be given an opportunity to purchase securities in an IPO or private placement that does not raise a serious conflict with the fund. Third, most fund complexes already prohibit these activities.¹¹⁸ Although the Commission cannot quantify the costs to investment personnel associated with the pre-clearance provision because we cannot verify the number of investment personnel who invest in IPOs and private placements, we believe that any costs of the provision to investment personnel will be minimal and will be greatly outweighed by the benefits to investors of restricting these potentially fraudulent opportunities.

Issuers. We also believe that the pre-approval provision will result in minimal, if any, costs to issuers selling securities in IPOs or private placements. These offerings are often oversubscribed, and we expect that other purchasers will replace investment personnel who might otherwise invest in the offerings.¹¹⁹

Based on the estimates discussed above, we estimate that in the first year after the effective date, the costs of complying with the amendments to rule 17j-1 will be \$10,406,340. In later years we anticipate these costs will decrease because funds will have to file codes again with the Commission only if the codes have been materially amended.

VI. Effects on Competition, Efficiency and Capital Formation

As discussed above, we anticipate that the amendments to rule 17j-1 will not result in a major increase in costs to funds or fund investors. We also have considered, in addition to the protection

of investors, whether the provisions adopted today will promote efficiency, competition, or capital formation.

VII. Paperwork Reduction Act

Certain provisions of the amendments to rule 17j-1 and the conforming amendments to rule 204-2 under the Advisers Act contain "collection of information" requirements within the meaning of the Paperwork Reduction Act ("PRA").¹²⁰ Because the Proposing Release was published in 1995, prior to the effective date of the 1995 amendments to the PRA, the Proposing Release did not contain a separate section requesting comment on the collection of information burdens imposed by the proposed amendments, as required by the PRA.¹²¹ The Proposing Release did, however, request comment regarding the specific reporting and recordkeeping requirements contained in the proposed amendments to rule 17j-1.

The collection of information requirements contained in the amendments were submitted to the Office of Management and Budget ("OMB") for review pursuant to section 3507(d) of the PRA. OMB approved the PRA submission with respect to these amendments and assigned OMB control numbers with respect to the rules and forms amended by this release.¹²² We received an extension of the OMB approval of the collection of information for rule 17j-1 last year.¹²³ The collection of information requirements are in accordance with section 3507 of the PRA. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the agency displays a valid OMB control number.

As described in more detail above and in the Proposing Release, the collections of information under the rule and form amendments are necessary for funds to monitor potential conflicts of interest, to

¹¹³ The estimated cost to the industry resulting from the rule's annual holdings report requirement equals the number of continuing access persons multiplied by the number of hours required to complete the report multiplied by the hourly cost of completing the report ($67,518 \times 0.5 \times \$150 = \$5,063,850$). The estimated cost of professional time (\$150) is an average and could be significantly higher or lower for individual rule 17j-1 organizations and their access persons.

¹¹⁴ See *supra* note 98.

¹¹⁵ The estimated number of new access persons who would file initial holdings reports as a result of the amendments to rule 17j-1 equals the number of new access persons each year at existing rule 17j-1 organizations that do not have an initial holdings report requirement plus the number of new access persons at new organizations that do not have an initial holdings report requirement. Based on the ICI Survey, see *supra* note 112, we estimate the number of access persons each year who would have to submit an initial holdings report as a result of amendments to rule 17j-1 equals the sum of: all new access persons at 29 percent of 4,951 existing rule 17j-1 organizations ($2 \times 1,435$); all access persons at 29 percent of 275 new rule 17j-1 organizations ($24 \times 79 = 1,896$); half of new access persons at 66 percent of 4,951 existing rule 17j-1 organizations ($1 \times 3,268 = 3,268$); and half of access persons at 66 percent of 275 new rule 17j-1 organizations (12×182); for a total of 10,218 access persons.

¹¹⁶ The estimated cost to the industry of filing initial holdings reports equals the number of access persons required to file reports multiplied by the number of hours required to complete the report multiplied by the hourly cost to complete the report ($10,218 \times 1 \times \$150 = \$1,532,700$).

¹¹⁷ See *supra* note 51 and accompanying text.

¹¹⁸ According to the ICI Survey, 72 percent of fund complexes that responded to the Survey prohibit investment personnel from acquiring any securities in an IPO. In addition, approximately 14 percent of responding fund complexes have adapted the prohibition to their circumstances, in some cases adopting broader prohibitions, such as prohibiting purchases of securities in secondary market transactions or extending the prohibition to all access persons or all employees. ICI Survey, *supra* note 49, at 15-16. Approximately 69 percent of fund complexes responding to the Survey stated that they require prior approval before investment personnel may purchase securities in a private placement. An additional 14 percent of responding fund complexes stated that they have adapted this requirement to their situations, in some cases making the restrictions broader, such as by applying it to all access persons or employees in certain cases. *Id.* at 17-18. We estimate that after the amendments to rule 17j-1 become effective, investment personnel in approximately 25 percent of fund complexes will be subject to the restrictions on purchases of IPOs and private placements for the first time.

¹¹⁹ See *supra* note 51 of this release. We are unable to quantify the number of investment persons who purchase securities in IPOs and private placements or the frequency of those purchases. The number may vary significantly among individual funds or advisers.

¹²⁰ 44 U.S.C. 3501-3520.

¹²¹ Prior to the revisions to the PRA in 1995, requiring disclosure of information to third parties was not a "collection of information" under the PRA. See 44 U.S.C. 3502(3)(A) (definition of "collection of information").

¹²² OMB control numbers are as follows: rule 17j-1 (3235-0224, expires Oct. 31, 2001); rule 204-2 (3235-0278, expires Apr. 30, 2000); Form N-1A (3235-0307, expires May 31, 2000); Form N-2 (3235-0026, expires Oct. 31, 2001); Form N-3 (3235-0316, expires Mar. 31, 2000); Form N-5 (3235-0169, expires Oct. 31, 2001); Form N-8B-2 (3235-0186, expires Oct. 31, 2001); and Form S-6 (3235-0184, expires Mar. 31, 2002).

¹²³ As required under any request for extension of approval, the Commission sought comment on the collection of information. See Existing Collection; Comment Request, OMB Control No. 3235-0224 [63 FR 37606 (July 13, 1998)]; and Submission for OMB Review; Comment Request, OMB Control No. 3235-0224 [63 FR 50608 (Sept. 22, 1998)].

facilitate the effective oversight of personal investment activities by a fund and our examinations staff, to provide the fund and the Commission with information regarding compliance with rule 17j-1, and to disclose information to investors about a fund's policies concerning personal investment activities. If the records required to be kept pursuant to the rule are requested by Commission examiners, they will be kept confidential to the extent permitted by relevant statutory and regulatory provisions. Information required by Form N-1A, Form N-2, Form N-3, Form N-5, Form N-8B-2, and Form S-6 and disclosed in a registration statement, is public, and we do not keep it confidential.

The amendments to rule 17j-1 as adopted contain two collection of information requirements in addition to those in the proposed amendments. The adopted amendments require each access person to provide an annual holdings report listing all covered securities the access person beneficially owned at the end of the previous calendar year and all accounts in which securities are held for the benefit of the access person.¹²⁴ The annual holdings report requirement imposes an additional paperwork burden on rule 17j-1 organizations and their access persons only to the extent that these organizations do not currently require their access persons to file this information.¹²⁵ If an access person already submits equivalent information to his or her rule 17j-1 organization, the access person will simply have to confirm in writing the accuracy of that information to satisfy the annual holdings report requirement under rule 17j-1.¹²⁶

The amendments to rule 17j-1 also require funds and their advisers to retain a written record of any decision to permit investment personnel to purchase securities in an IPO or private placement and the reasons supporting the approval.¹²⁷ This requirement

imposes additional burdens on funds and advisers only to the extent the fund or adviser does not currently prohibit investments in IPOs or require pre-clearance of investments in private placements.¹²⁸

We estimate that each year 275 new rule 17j-1 organizations each will expend 8 hours to formulate and provide codes of ethics for an annual total of 275 responses and 2,200 burden hours ($275 \times 8 = 2,200$). We also estimate that the managements of 5,226 rule 17j-1 organizations¹²⁹ each will expend 3 hours annually to provide the fund board with an annual issues and certification report for a total of 5,226 responses and 15,678 burden hours ($5,226 \times 3 = 15,678$). We estimate that in the first year after the amendments to rule 17j-1 become effective, each fund will require 0.25 hours to prepare the required disclosure regarding the appropriate codes of ethics, for a total of 3,900 responses and 975 burden hours ($3,900 \times 0.25 = 975$).¹³⁰

We estimate that 103,800 access persons¹³¹ each will spend 0.5 hours filing one quarterly transaction report per year, for a total of 103,800 responses and 51,900 burden hours ($103,800 \times 0.5 = 51,900$).¹³² We estimate that each year

investment activities, including prohibition on the purchase of securities in an IPO. See *supra* note 47.

¹²⁸ See *supra* note 118. Because this requirement and the requirement for access persons to provide an annual holdings report affect the paperwork burden estimate, the Commission has filed a "Paperwork Reduction Act Change Worksheet" with OMB to reflect the changes in the annual reporting burden.

¹²⁹ See *supra* note 100 and accompanying text for a discussion of the estimated number of funds, and investment advisers and principal underwriters to funds.

¹³⁰ As noted above, funds should have to prepare disclosures regarding codes of ethics after the initial disclosure only to the extent the codes are materially amended.

¹³¹ See *supra* note 112 for an estimate of the average number of access persons at each 17j-1 organization. Under amended rule 17j-1, access persons of investment advisers to funds are exempt from filing quarterly transaction reports if the reports would duplicate information provided under rule 204-2 of the Advisers Act. Amended rule 17j-1(d)(2)(v). Thus, we estimate that the number of access persons filing quarterly transaction reports is equal to the average number of access persons for each rule 17j-1 organization multiplied by the total number of funds and principal underwriters of funds ($24 \times (3900 + 425) = 103,800$).

¹³² The number of access persons who are required to file quarterly transaction reports will vary depending on the personal investment activities of each access person. In addition, amended rule 17j-1 contains several exceptions to filing quarterly transaction reports, including an exception if the report would duplicate information contained in broker trade confirmations or account statements received by the rule 17j-1 organization. Amended rule 17j-1(d)(2)(v). Although a number of access persons may, on average, have transactions to report during more than one quarter each year, many access persons may not have to provide a

16,502 new access persons each will expend 1 hour to file an initial holdings report for a total of 16,502 responses and 16,502 burden hours¹³³ and each of 108,922 existing access persons will expend 0.5 hours to file an annual holdings report, for a total of 108,922 responses and 54,461 burden hours ($108,922 \times 0.5 = 54,461$).¹³⁴

The Commission estimates that 5,226 rule 17j-1 organizations each will expend 2 hours to maintain records of codes of ethics, records of violations of codes of ethics, reports by access persons, and issues and certification reports, for a total of 5,226 responses and 10,452 burden hours ($5,226 \times 2 = 10,452$). We also estimate that each of the approximately 1,200 funds and advisers that currently do not prohibit investment personnel from purchasing securities in an IPO would take, on average, approximately 0.25 hours to complete each of 3 responses each year to document approvals of IPO purchases, for a total of 3,600 responses and 900 burden hours ($1,200 \times 0.25 \times 3 = 900$).¹³⁵ Finally, we estimate that 4,801 funds and advisers would make, on average, 3 responses each year to document approvals of investment in private placement offerings, for a total of 14,403 responses and 3,601 burden hours ($4,801 \times 0.25 \times 3 = 3,601$).

The Commission therefore estimates the total number of annual responses required by the rule is 261,854, and the total annual burden of the collection of information requirements in the first year is 156,669 hours. This estimate represents an increase of 82,099 hours from the current estimate of 74,570

quarterly transaction report because their rule 17j-1 organizations have received the information in a broker trade confirmation or account statement. Accordingly, we estimate that each access person, on average, would file one quarterly transaction report each year. Estimates concerning quarterly transaction reports are not included in the cost-benefit analysis because access persons currently are required to file quarterly transaction reports under rule 17j-1. See current rule 17j-1(c)(1), (2).

¹³³ We estimate that the number of access persons who would have to file initial holdings reports each year equals the average number of access persons at each new rule 17j-1 organization ($275 \times 24 = 6,600$) plus the average number of new access persons at existing rule 17j-1 organizations ($4,951 \times 2 = 9,902$), for a total of 16,502 ($6,600 + 9,902 = 16,502$). See *supra* note 112 and accompanying text.

¹³⁴ The number of access persons filing an annual report would not include new access persons. See *supra* note 110. Thus, we estimate that the number of access persons filing an annual report each year equals the number of existing rule 17j-1 organizations ($5,226 - 275 = 4,951$) multiplied by the average number of continuing access persons per organization ($24 - 2 = 22$), for a total of 108,922 ($4,951 \times 22 = 108,922$).

¹³⁵ This estimate assumes that 75 percent of funds and advisers currently prohibit investment personnel from investing in IPOs. See *supra* note 118.

¹²⁴ The Proposing Release requested comment on an annual holdings report and whether an annual holdings report would impose an undue burden on persons required to file the report. See Proposing Release, *supra* note 9, at n.42 and accompanying text.

¹²⁵ See *supra* notes 111-12 and accompanying text.

¹²⁶ The amendments also require access persons to disclose two new items of information in their quarterly transaction and initial holdings reports: the name of any broker, dealer or bank with whom they maintain a securities account, and the date the report is filed. Amended rule 17j-1(d)(1)(i)(B), (ii)(B). We believe this information will take little additional time to disclose.

¹²⁷ The Proposing Release sought comment regarding specific restrictions on personal

burden hours. The increase is attributable primarily to the annual holdings report requirement, the documentation of approvals for investments in IPOs and private placements, and adjustments due to an increase in rule 17j-1 organizations reflected in the updated number of organizations.¹³⁶

In addition to the annual hour burden, we estimate that some funds will incur costs to file the codes of the fund and its investment adviser and principal underwriter. As discussed above, a fund that submits its own EDGAR filings will incur costs associated with the annual hourly burden. Funds that use an outside contractor to submit filings will incur costs for that service. We have estimated that the cost of filing codes for firms that use outside contractors would be approximately \$1,263,600 in the first year after the amendments become effective.¹³⁷ Thereafter, the annual cost would decrease significantly because funds would only have to refile a code if the code had been materially amended.

VIII. Summary of Final Regulatory Flexibility Analysis

A summary of the Initial Regulatory Flexibility Analysis ("IRFA") regarding the proposed amendments, which was prepared in accordance with 5 U.S.C. 603, was published in the Proposing Release. No comments were received on the IRFA. We have prepared a Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. 604 relating to the adopted amendments.

The FRFA discusses the need for, and objectives of, the amendments to rule 17j-1. The FRFA states that rule 17j-1 currently prohibits fraud by fund affiliates and certain other persons in connection with their personal transactions in securities held or to be acquired by the fund, requires funds and their investment advisers and principal underwriters to adopt codes of ethics containing provisions reasonably

necessary to prevent fund personnel from engaging in conduct prohibited by the rule, and requires fund personnel to report their personal securities transactions to their employers. The FRFA further states that the amendments are designed to enhance the board of directors' oversight of the policies governing personal transactions in securities by investment company personnel, help fund compliance personnel and the Commission's examinations staff in monitoring potential conflicts of interest and detecting potentially abusive activities, and make available to the public additional information about these policies.

The FRFA estimates that out of approximately 3,900 funds registered with the Commission, a total of approximately 732 would be considered small entities.¹³⁸ The FRFA also states that investment advisers and principal underwriters of registered funds would be required to comply with certain amendments to rule 17j-1. The FRFA estimates that (i) out of approximately 901 investment advisers registered with the Commission that advise funds, a total of approximately 265 would be considered small entities¹³⁹ and (ii) out of approximately 425 principal underwriters to funds, a total of approximately 272 would be considered small entities.¹⁴⁰ The FRFA indicates that the amendments to rule 17j-1

¹³⁸ As defined in rules adopted under the Investment Company Act for purposes of the Regulatory Flexibility Act, a small entity is an investment company with net assets of \$50 million or less as of the end of its most recent fiscal year. 17 CFR 270.0-10 (1997). The Commission amended its definition of small entity under the Investment Company Act for purposes of the Regulatory Flexibility Act in 1998. See Definitions of "Small Business" or "Small Organization" Under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Exchange Act of 1934 and the Securities Act of 1933, Securities Act Release No. 7548 (June 24, 1998), [63 FR 35508 (June 30, 1998)]. Because the IRFA for this proposal relied on the earlier definition (which was broader), the FRFA also relies on the earlier definition.

¹³⁹ As defined in rules adopted under the Investment Advisers Act for purposes of the Regulatory Flexibility Act, a small entity is an investment adviser that manages assets with a total value of \$50 million or less, in discretionary or nondiscretionary accounts, as of the end of its most recent fiscal year and does not render other advisory services. 17 CFR 275.0-7 (1997). The FRFA relies on the definition of "small entity" under the Investment Advisers Act before it was amended in June 1998. See *supra* note 138.

¹⁴⁰ As defined in rules under the Securities Exchange Act for purposes of the Regulatory Flexibility Act, a small entity is a broker or dealer that had total capital of less than \$500,000 on the date of its prior fiscal year. 17 CFR 240.0-10 (1997). The FRFA relies on the definition of "small entity" under the Securities Exchange Act before it was amended in June 1998. See *supra* note 138.

would affect small entities in the same manner as other entities subject to the rule.

Finally, the FRFA states that in adopting the amendments to rule 17j-1, the Commission considered (a) the establishment of differing rule requirements that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of the rule's requirements for small entities; (c) the use of performance rather than design standards; and (d) an exemption from the rule for small entities. The FRFA states that the Commission concluded that different requirements for small entities would be inconsistent with investor protection. In addition, the amendments to rule 17j-1 incorporate performance standards rather than design standards.

The FRFA is available for public inspection in File No. S7-25-95. A copy may be obtained by contacting Penelope Saltzman, Senior Counsel, Office of Regulatory Policy, Division of Investment Management, at (202) 942-0690, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549-0506.

IX. Statutory Authority

The Commission is amending rule 17j-1 pursuant to the authority set out in sections 17(j) and 38(a) of the Investment Company Act [15 U.S.C. 80a-17(j) and 80a-37(a)] and sections 206(4) and 211(a) of the Advisers Act [15 U.S.C. 80b-6(4) and 80b-11(a)]. The amendments to registration forms are adopted pursuant to the authority set out 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 Commission is adopting amendments to rule 204-2 under the Advisers Act pursuant to the authority set out 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 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 amended as follows:

¹³⁶ We also did not adopt a proposed exception to the initial holdings report requirement. The proposed amendments would have excepted access persons from filing initial holdings reports if the information would duplicate information already maintained by the person's rule 17j-1 organization. Under the amended rule, all new access persons must file an initial holdings report. As discussed in note 34 *supra*, however, an access person may satisfy the requirement by simply confirming information required to be in the report that is maintained by the person's rule 17j-1 organization. This change from the proposed amendments accounts for the remainder of the increase in burden hours.

¹³⁷ See *supra* note 107.

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 is amended by adding the following citation to read as follows:

Authority: 15 U.S.C. 80a–1 *et seq.*, 80a–34(d), 80a–37, 80a–39, unless otherwise noted;

* * * * *

Section 270.17j–1 is also issued under secs. 206(4) and 211(a), Investment Advisers Act (15 U.S.C. 80b–6(4) and 80b–11(a));

* * * * *

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

§ 270.17j–1 Personal investment activities of investment company personnel.

(a) **Definitions.** For purposes of this section:

(1) **Access Person** means:

(i) Any director, officer, general partner or Advisory Person of a Fund or of a Fund's investment adviser.

(A) If an investment adviser is primarily engaged in a business or businesses other than advising Funds or other advisory clients, the term Access Person means any director, officer, general partner or Advisory Person of the investment adviser who, with respect to any Fund, makes any recommendation, participates in the determination of which recommendation will be made, or whose principal function or duties relate to the determination of which recommendation will be made, or who, in connection with his or her duties, obtains any information concerning recommendations on Covered Securities being made by the investment adviser to any Fund.

(B) An investment adviser is "primarily engaged in a business or businesses other than advising Funds or other advisory clients" if, for each of its most recent three fiscal years or for the period of time since its organization, whichever is less, 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 the other business or businesses.

(ii) Any director, officer or general partner of a principal underwriter who, in the ordinary course of business, makes, participates in or obtains information regarding, the purchase or sale of Covered Securities by the Fund for which the principal underwriter acts, or whose functions or duties in the ordinary course of business relate to the

making of any recommendation to the Fund regarding the purchase or sale of Covered Securities.

(2) **Advisory Person of a Fund** or of a Fund's investment adviser means:

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

(ii) Any natural person in a control relationship to the Fund or investment adviser who obtains information concerning recommendations made to the Fund with regard to the purchase or sale of Covered Securities by the Fund.

(3) **Control** has the same meaning as in section 2(a)(9) of the Act [15 U.S.C. 80a–2(a)(9)].

(4) **Covered Security** means a security as defined in section 2(a)(36) of the Act [15 U.S.C. 80a–2(a)(36)], except that it does not include:

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

(ii) Bankers' acceptances, bank certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements; and

(iii) Shares issued by open-end Funds.

(5) **Fund** means an investment company registered under the Investment Company Act.

(6) **An Initial Public Offering** means an offering of securities registered under the Securities Act of 1933 [15 U.S.C. 77a], the issuer of which, immediately before the registration, was not subject to the reporting requirements of sections 13 or 15(d) of the Securities Exchange Act of 1934 [15 U.S.C. 78m or 78o(d)].

(7) **Investment Personnel** of a Fund or of a Fund's investment adviser means:

(i) Any employee of the Fund or investment adviser (or of any company in a control relationship to the Fund or investment adviser) who, in connection with his or her regular functions or duties, makes or participates in making recommendations regarding the purchase or sale of securities by the Fund.

(ii) Any natural person who controls the Fund or investment adviser and who obtains information concerning recommendations made to the Fund regarding the purchase or sale of securities by the Fund.

(8) **A Limited Offering** means an offering that is exempt from registration under the Securities Act of 1933 pursuant to section 4(2) or section 4(6)

[15 U.S.C. 77d(2) or 77d(6)] or pursuant to rule 504, rule 505, or rule 506 [17 CFR 230.504, 230.505, or 230.506] under the Securities Act of 1933.

(9) **Purchase or sale of a Covered Security** includes, among other things, the writing of an option to purchase or sell a Covered Security.

(10) **Security Held or to be Acquired** by a Fund means:

(i) Any Covered Security which, within the most recent 15 days:

(A) Is or has been held by the Fund; or

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

(ii) Any option to purchase or sell, and any security convertible into or exchangeable for, a Covered Security described in paragraph (a)(10)(i) of this section.

(b) **Unlawful Actions.** It is unlawful for any affiliated person of or principal underwriter for a Fund, or any affiliated person of an investment adviser of or principal underwriter for a Fund, in connection with the purchase or sale, directly or indirectly, by the person of a Security Held or to be Acquired by the Fund:

(1) To employ any device, scheme or artifice to defraud the Fund;

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

(3) To engage in any act, practice or course of business that operates or would operate as a fraud or deceit on the Fund; or

(4) To engage in any manipulative practice with respect to the Fund.

(c) **Code of Ethics.**

(1) **Adoption and Approval of Code of Ethics.**

(i) Every Fund (other than a money market fund or a Fund that does not invest in Covered Securities) and each investment adviser of and principal underwriter for the Fund, must adopt a written code of ethics containing provisions reasonably necessary to prevent its Access Persons from engaging in any conduct prohibited by paragraph (b) of this section.

(ii) The board of directors of a Fund, including a majority of directors who are not interested persons, must approve the code of ethics of the Fund, the code of ethics of each investment adviser and principal underwriter of the Fund, and any material changes to these codes. The board must base its approval of a code and any material changes to the code on a determination that the code

contains provisions reasonably necessary to prevent Access Persons from engaging in any conduct prohibited by paragraph (b) of this section. Before approving a code of a Fund, investment adviser or principal underwriter or any amendment to the code, the board of directors must receive a certification from the Fund, investment adviser or principal underwriter that it has adopted procedures reasonably necessary to prevent Access Persons from violating the investment adviser's or principal underwriter's code of ethics. The Fund's board must approve the code of an investment adviser or principal underwriter before initially retaining the services of the investment adviser or principal underwriter. The Fund's board must approve a material change to a code no later than six months after adoption of the material change.

(iii) If a Fund is a unit investment trust, the Fund's principal underwriter or depositor must approve the Fund's code of ethics, as required by paragraph (c)(1)(ii) of this section. If the Fund has more than one principal underwriter or depositor, the principal underwriters and depositors may designate, in writing, which principal underwriter or depositor must conduct the approval required by paragraph (c)(1)(ii) of this section, if they obtain written consent from the designated principal underwriter or depositor.

(2) *Administration of Code of Ethics.*

(i) The Fund, investment adviser and principal underwriter must use reasonable diligence and institute procedures reasonably necessary to prevent violations of its code of ethics.

(ii) No less frequently than annually, every Fund (other than a unit investment trust) and its investment advisers and principal underwriters must furnish to the Fund's board of directors, and the board of directors must consider, a written report that:

(A) Describes any issues arising under the code of ethics or procedures since the last report to the board of directors, including, but not limited to, information about material violations of the code or procedures and sanctions imposed in response to the material violations; and

(B) Certifies that the Fund, investment adviser or principal underwriter, as applicable, has adopted procedures reasonably necessary to prevent Access Persons from violating the code.

(3) *Exception for Principal Underwriters.* The requirements of paragraphs (c)(1) and (c)(2) of this section do not apply to any principal underwriter unless:

(i) The principal underwriter is an affiliated person of the Fund or of the Fund's investment adviser; or

(ii) An officer, director or general partner of the principal underwriter serves as an officer, director or general partner of the Fund or of the Fund's investment adviser.

(d) *Reporting Requirements of Access Persons.*

(1) *Reports Required.* Unless excepted by paragraph (d)(2) of this section, every Access Person of a Fund (other than a money market fund or a Fund that does not invest in Covered Securities) and every Access Person of an investment adviser of or principal underwriter for the Fund, must report to that Fund, investment adviser or principal underwriter:

(i) *Initial Holdings Reports.* No later than 10 days after the person becomes an Access Person, the following information:

(A) The title, number of shares and principal amount of each Covered Security in which the Access Person had any direct or indirect beneficial ownership when the person became an Access Person;

(B) The name of any broker, dealer or bank with whom the Access Person maintained an account in which any securities were held for the direct or indirect benefit of the Access Person as of the date the person became an Access Person; and

(C) The date that the report is submitted by the Access Person.

(ii) *Quarterly Transaction Reports.* No later than 10 days after the end of a calendar quarter, the following information:

(A) With respect to any transaction during the quarter in a Covered Security in which the Access Person had any direct or indirect beneficial ownership:

(1) The date of the transaction, the title, the interest rate and maturity date (if applicable), the number of shares and the principal amount of each Covered Security involved;

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

(3) The price of the Covered Security at which the transaction was effected;

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

(5) The date that the report is submitted by the Access Person.

(B) With respect to any account established by the Access Person in which any securities were held during the quarter for the direct or indirect benefit of the Access Person:

(1) The name of the broker, dealer or bank with whom the Access Person established the account;

(2) The date the account was established; and

(3) The date that the report is submitted by the Access Person.

(iii) *Annual Holdings Reports.*

Annually, the following information (which information must be current as of a date no more than 30 days before the report is submitted):

(A) The title, number of shares and principal amount of each Covered Security in which the Access Person had any direct or indirect beneficial ownership;

(B) The name of any broker, dealer or bank with whom the Access Person maintains an account in which any securities are held for the direct or indirect benefit of the Access Person; and

(C) The date that the report is submitted by the Access Person.

(2) *Exceptions from Reporting Requirements.*

(i) A person need not make a report under paragraph (d)(1) of this section with respect to transactions effected for, and Covered Securities held in, any account over which the person has no direct or indirect influence or control.

(ii) A director of a Fund who is not an "interested person" of the Fund within the meaning of section 2(a)(19) of the Act [15 U.S.C. 80a-2(a)(19)], and who would be required to make a report solely by reason of being a Fund director, need not make:

(A) An initial holdings report under paragraph (d)(1)(i) of this section and an annual holdings report under paragraph (d)(1)(iii) of this section; and

(B) A quarterly transaction report under paragraph (d)(1)(ii) of this section, unless the director knew or, in the ordinary course of fulfilling his or her official duties as a Fund director, should have known that during the 15-day period immediately before or after the director's transaction in a Covered Security, the Fund purchased or sold the Covered Security, or the Fund or its investment adviser considered purchasing or selling the Covered Security.

(iii) An Access Person to a Fund's principal underwriter need not make a report to the principal underwriter under paragraph (d)(1) of this section if:

(A) The principal underwriter is not an affiliated person of the Fund (unless the Fund is a unit investment trust) or any investment adviser of the Fund; and

(B) The principal underwriter has no officer, director or general partner who serves as an officer, director or general partner of the Fund or of any investment adviser of the Fund.

(iv) An Access Person to an investment adviser need not make a

quarterly transaction report to the investment adviser under paragraph (d)(1)(ii) of this section if all the information in the report would duplicate information required to be recorded under §§ 275.204-2(a)(12) or 275.204-2(a)(13) of this chapter.

(v) An Access Person need not make a quarterly transaction report under paragraph (d)(1)(ii) of this section if the report would duplicate information contained in broker trade confirmations or account statements received by the Fund, investment adviser or principal underwriter with respect to the Access Person in the time period required by paragraph (d)(1)(ii), if all of the information required by that paragraph is contained in the broker trade confirmations or account statements, or in the records of the Fund, investment adviser or principal underwriter.

(3) *Review of Reports.* Each Fund, investment adviser and principal underwriter to which reports are required to be made by paragraph (d)(1) of this section must institute procedures by which appropriate management or compliance personnel review these reports.

(4) *Notification of Reporting Obligation.* Each Fund, investment adviser and principal underwriter to which reports are required to be made by paragraph (d)(1) of this section must identify all Access Persons who are required to make these reports and must inform those Access Persons of their reporting obligation.

(5) *Beneficial Ownership.* For purposes of this section, beneficial ownership is interpreted in the same manner as it would be under § 240.16a-1(a)(2) of this chapter in determining whether a person is the beneficial owner 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. Any report required by paragraph (d) of this section may contain a statement that the report will not be construed as an admission that the person making the report has any direct or indirect beneficial ownership in the Covered Security to which the report relates.

(e) *Pre-approval of Investments in IPOs and Limited Offerings.* Investment Personnel of a Fund or its investment adviser must obtain approval from the Fund or the Fund's investment adviser before directly or indirectly acquiring beneficial ownership in any securities in an Initial Public Offering or in a Limited Offering.

(f) *Recordkeeping Requirements.*

(1) Each Fund, investment adviser and principal underwriter that is required to adopt a code of ethics or to

which reports are required to be made by Access Persons must, at its principal place of business, maintain records in the manner and to the extent set out in this paragraph (f), and must make these records available to the Commission or any representative of the Commission at any time and from time to time for reasonable periodic, special or other examination:

(A) A copy of each code of ethics for the organization that is in effect, or at any time within the past five years was in effect, must be maintained in an easily accessible place;

(B) A record of any violation of the code of ethics, and of any action taken as a result of the violation, must be maintained in an easily accessible place for at least five years after the end of the fiscal year in which the violation occurs;

(C) A copy of each report made by an Access Person as required by this section, including any information provided in lieu of the reports under paragraph (d)(2)(v) of this section, must be maintained for at least five years after the end of the fiscal year in which the report is made or the information is provided, the first two years in an easily accessible place;

(D) A record of all persons, currently or within the past five years, who are or were required to make reports under paragraph (d) of this section, or who are or were responsible for reviewing these reports, must be maintained in an easily accessible place; and

(E) A copy of each report required by paragraph (c)(2)(ii) of this section must be maintained for at least five years after the end of the fiscal year in which it is made, the first two years in an easily accessible place.

(2) A Fund or investment adviser must maintain a record of any decision, and the reasons supporting the decision, to approve the acquisition by investment personnel of securities under paragraph (e), for at least five years after the end of the fiscal year in which the approval is granted.

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, 77z-2, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a-8, 80a-24, 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), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, and 80a-29, unless otherwise noted.

5. Item 1 of Form N-1A [referenced in §§ 239.15A and 274.11A] is amended by revising paragraph (b)(3) to read as follows:

Form N-1A

* * * * *

Item 1. Front and Back Cover Pages

* * * * *

(b) * * *
(3) A statement that information about the Fund (including the SAI) can be reviewed and copied at the Commission's Public Reference Room in Washington, D.C., and that information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-202-942-8090. State that reports and other information about the Fund are available on the EDGAR Database on the Commission's Internet site at <http://www.sec.gov>, and that copies of this information may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the Commission's Public Reference Section, Washington, D.C. 20549-0102.

* * * * *

6. Item 13 of Form N-1A [referenced in §§ 239.15A and 274.11A] is amended by adding paragraph (f) 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 13. Management of the Fund

* * * * *

(f) *Codes of Ethics.* Provide a brief statement disclosing whether the Fund and its investment adviser and principal underwriter have adopted codes of ethics under rule 17j-1 of the Investment Company Act [17 CFR 270.17j-1] and whether these codes of ethics permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by the Fund.

Instruction: A Fund that is not required to adopt a code of ethics under rule 17j-1 of the Investment Company Act is not required to respond to this item.

* * * * *

7. Item 23 of Form N-1A [referenced in §§ 239.15A and 274.11A] is amended

by adding paragraph (p) and an Instruction to read as follows:

Form N-1A

* * * * *

Item 23. Exhibits

* * * * *

(p) *Codes of Ethics.* Any codes of ethics adopted under rule 17j-1 of the Investment Company Act [17 CFR 270.17j-1] and currently applicable to the Fund (*i.e.*, the codes of the Fund and its investment advisers and principal underwriters). If there are no codes of ethics applicable to the Fund, state the reason (*e.g.*, that the Fund is a Money Market Fund).

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

* * * * *

8. Item 18 of Form N-2 [referenced in §§ 239.14 and 274.11a-1] is amended by adding paragraph 5 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 18. Management

* * * * *

5. *Codes of Ethics:* Provide a brief statement disclosing whether the Registrant and its investment adviser and principal underwriter have adopted codes of ethics under Rule 17j-1 of the 1940 Act [17 CFR 270.17j-1] and whether 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. Also explain in the statement that these codes of ethics can be reviewed and copied at the Commission's Public Reference Room in Washington, D.C., that information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-202-942-8090, that these codes of ethics are available on the EDGAR Database on the Commission's Internet site at <http://www.sec.gov>, and that copies of these codes of ethics may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the Commission's Public Reference Section, Washington, D.C. 20549-0102.

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.

* * * * *

9. Item 24 of Form N-2 [referenced in §§ 239.14 and 274.11a-1] is amended by adding new paragraph 2.r. to read as follows:

Form N-2

* * * * *

Item 24. Financial Statements and Exhibits

* * * * *

2. * * *

r. copies of any codes of ethics adopted under 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 the reason (*e.g.*, the Registrant is a Money Market Fund).

* * * * *

10. Item 20 of Form N-3 [referenced in §§ 239.17a and 274.11b] is amended by adding paragraph (d) 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 20. Management

* * * * *

(d) Provide a brief statement disclosing whether the Registrant and its investment adviser and principal underwriter have adopted codes of ethics under Rule 17j-1 of the 1940 Act [17 CFR 270.17j-1] and whether 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. Also explain in the statement that these codes of ethics can be reviewed and copied at the Commission's Public Reference Room in Washington, D.C., that information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-202-942-8090, that these codes of ethics are available on the EDGAR Database on the Commission's Internet site at <http://www.sec.gov>, and that copies of these codes of ethics may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the Commission's Public Reference Section, Washington, D.C. 20549-0102.

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.

* * * * *

11. Item 28 of Form N-3 [referenced in §§ 239.17a and 274.11b] is amended by removing the word "and" at the end of paragraph (b)(14), removing the period at the end of paragraph (b)(15) and in its place adding a semicolon, removing the period at the end of paragraph (b)(16) and in its place adding "; and", and adding new paragraph (b)(17) to read as follows:

Form N-3

* * * * *

Item 28. Financial Statements and Exhibits

* * * * *

(b) * * *

(17) copies of any codes of ethics adopted under 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 the reason (*e.g.*, the Registrant is a Money Market Fund).

* * * * *

12. 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) and an Instruction 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 the registrant and its investment adviser and principal underwriter have adopted codes of ethics under Rule 17j-1 of the Investment Company Act of 1940 [17 CFR 270.17j-1] and whether 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. Also explain that these codes of ethics can be reviewed and copied at the Commission's Public Reference Room in Washington, D.C., that information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-202-942-8090, that these codes of ethics are available on the EDGAR Database on the Commission's Internet site at <http://www.sec.gov>, and that copies of these

codes of ethics may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address: publicinfo@sec.gov, or by writing the Commission's Public Reference Section, Washington, D.C. 20549-0102.

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.

* * * * *

13. The Instructions As To Exhibits of Form N-5 [referenced in §§ 239.24 and 274.5] are amended by adding paragraph 13 to read as follows:

Form N-5

* * * * *

Instructions as to Exhibits

* * * * *

13. Copies of any codes of ethics adopted under Rule 17j-1 under the Investment Company Act of 1940 [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 the reason (*e.g.*, the registrant is a Money Market Fund).

* * * * *

14. Item 52 of Form N-8B-2 [referenced in § 274.12] is amended by adding paragraph (e) and an Instruction 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

* * * * *

Policy of Registrant

52. * * *

(e) Provide a brief statement disclosing whether the trust and its principal underwriter have adopted codes of ethics under rule 17j-1 of the Act [17 CFR 270.17j-1] and whether 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. Also explain that these codes of ethics can be reviewed and copied at the Commission's Public Reference Room in Washington, D.C., that information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-202-942-8090, that these codes of ethics are available on the EDGAR Database on the Commission's Internet site at <http://www.sec.gov>, and that copies of these codes of ethics may be obtained, after paying a duplicating fee, by electronic request at the following E-mail address:

publicinfo@sec.gov, or by writing the Commission's Public Reference Section, Washington, D.C. 20549-0102.

Instruction: A trust that is not required to adopt a code of ethics under Rule 17j-1 under the Act [17 CFR 270.17j-1] is not required to respond to this item.

* * * * *

15. 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) Copies of any codes of ethics adopted under rule 17j-1 under the 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 the reason (*e.g.*, the trust invests only in direct obligations of the United States Government).

* * * * *

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

16. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(17), 80b-3, 80b-4, 80b-6(4), 80b-6a, 80b-11, unless otherwise noted.

* * * * *

17. Section 275.204-2 is amended by revising paragraph (a)(12)(i), redesignating paragraphs (a)(12)(ii) and (a)(12)(iii) as paragraphs (a)(12)(iii) and (a)(12)(iv), adding new paragraph (a)(12)(ii), redesignating newly designated paragraph (a)(12)(iii)(B) as paragraph (a)(12)(iii)(C), adding new paragraph (a)(12)(iii)(B), revising paragraph (a)(13)(i), redesignating paragraphs (a)(13)(ii) and (a)(13)(iii) as paragraphs (a)(13)(iii) and (a)(13)(iv), adding new paragraph (a)(13)(ii), redesignating newly designated paragraphs (a)(13)(iii)(B) and (a)(13)(iii)(C) as paragraphs (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 in a security in which the investment adviser or any advisory representative (as defined in paragraph (a)(12)(iii)(A) of this section) of the investment adviser has, or by reason of the transaction

acquires, any direct or indirect beneficial ownership, except:

(A) Transactions 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; and

(B) Transactions in securities that are: direct obligations of the Government of the United States; bankers' acceptances, bank certificates of deposit, commercial paper, and high quality short-term debt instruments, including repurchase agreements; or shares issued by registered open-end investment companies.

(ii) The record required by paragraph (a)(12)(i) of this section must state the title and amount of the security involved; the date and nature of the transaction (*i.e.*, purchase, sale or other acquisition or disposition); the price at which it was effected; and the name of the broker, dealer, or bank with or through whom the transaction was effected. Any record required by paragraph (a)(12)(i) of this section also may contain a statement declaring that the record of the transaction will not be construed as an admission that the investment adviser or advisory representative has any direct or indirect beneficial ownership in the security. A transaction must be recorded no later than 10 days after the end of the calendar quarter in which the transaction was effected. An investment adviser will be considered to have made a record required by paragraph (a)(12)(i) of this section if:

(A) The investment adviser receives a broker trade confirmation or account statement in the time period required by this paragraph (a)(12)(ii);

(B) The broker trade confirmation, account statement or other records of the investment adviser contains all the information required by this paragraph (a)(12)(ii);

(C) The investment adviser keeps the broker trade confirmation, account statement, and other records containing the information required by this paragraph (a)(12)(ii); and

(D) All broker trade confirmations and account statements that are printed on paper and kept under paragraph (a)(12)(ii)(C) of this section are organized in a manner that allows easy access to and retrieval of any particular confirmation or statement.

(iii) * * *

(B) *Beneficial ownership* will 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, an investment adviser that is primarily engaged in a business or businesses other than advising registered investment companies or other advisory clients, must maintain a record of every transaction in a security in which the investment adviser or any advisory representative (as defined in paragraph (a)(13)(iii)(A) of this section) of the investment adviser has, or by reason of the transaction acquires, any direct or indirect beneficial ownership, except:

(A) Transactions 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; and

(B) Transactions in securities that are: direct obligations of the Government of the United States; bankers' acceptances, bank certificates of deposit, commercial paper, and high quality short-term debt instruments, including repurchase agreements; or shares issued by registered open-end investment companies.

(ii) The record required by paragraph (a)(13)(i) of this section must state the title and amount of the security involved; the date and nature of the transaction (*i.e.*, purchase, sale or other acquisition or disposition); the price at which it was effected; and the name of the broker, dealer or bank with or through whom the transaction was effected. Any record required by paragraph (a)(13)(i) of this section also may contain a statement declaring that the record of the transaction will not be construed as an admission that the investment adviser or advisory representative has any direct or indirect beneficial ownership in the security. A transaction must be recorded no later than 10 days after the end of the calendar quarter in which the transaction was effected. An investment adviser will be considered to have made a record required by paragraph (a)(13)(i) of this section if:

(A) The investment adviser receives a broker trade confirmation or account statement in the time period required by this paragraph (a)(13)(ii);

(B) The broker trade confirmation, account statement or other records of the investment adviser contains all the information required by this paragraph (a)(13)(ii);

(C) The investment adviser keeps the broker trade confirmation, account

statement, and other records containing the information required by this paragraph (a)(13)(ii); and

(D) All broker trade confirmations and account statements that are printed on paper and kept under paragraph (a)(13)(ii)(C) of this section are organized in a manner that allows easy access to and retrieval of any particular confirmation or statement.

(iii) * * *

(B) *Beneficial ownership* will 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.

* * * * *

By the Commission.

Dated: August 20, 1999.

Jonathan G. Katz,

Secretary.

[FR Doc. 99-22310 Filed 8-26-99; 8:45 am]

BILLING CODE 8010-01-P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 522

Implantation or Injectable Dosage Form New Animal Drugs; Zeranol

AGENCY: Food and Drug Administration, HHS.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the animal drug regulations to reflect approval of a supplemental new animal drug application (NADA) filed by Schering-Plough Animal Health Corp. The supplemental NADA provides for use of a zeranol implant in steers fed in confinement for slaughter for improved feed efficiency.

EFFECTIVE DATE: August 27, 1999.

FOR FURTHER INFORMATION CONTACT: Jack Caldwell, Center for Veterinary Medicine (HFV-126), Food and Drug Administration, 7500 Standish Pl., Rockville, MD 20855, 301-827-1600.

SUPPLEMENTARY INFORMATION: Schering-Plough Animal Health Corp., 1095 Morris Ave., P.O. Box 3182, Union, NJ 07083-1982, filed supplemental NADA 38-233 that provides for use of Ralgro® Magnum (zeranol) implant in steers being fed in confinement for slaughter at a dose of 72 milligrams per steer for improved feed efficiency. The

supplemental NADA is approved as of June 25, 1999, and the regulations are amended in 21 CFR 522.2680(d)(3)(ii) to reflect the approval. The basis of approval is discussed in the freedom of information summary.

In accordance with the freedom of information provisions of part 20 (21 CFR part 20) and § 514.11(e)(2)(ii) (21 CFR 514.11(e)(2)(ii)), a summary of safety and effectiveness data and information submitted to support approval of this application may be seen in the Dockets Management Branch (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852, between 9 a.m. and 4 p.m., Monday through Friday.

Under section 512(c)(2)(F)(iii) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 360b(c)(2)(F)(iii)), this supplemental approval for food-producing animals qualifies for 3 years of marketing exclusivity beginning June 25, 1999, because the supplemental application contains substantial evidence of the effectiveness of the drug involved, any studies of animal safety or, in the case of food-producing animals, human food safety studies (other than bioequivalence or residue studies) required for approval and conducted or sponsored by the applicant. Three years marketing exclusivity is limited to use of the drug for improved feed efficiency in steers fed in confinement for slaughter.

FDA has carefully considered the potential environmental impact of this action and has concluded that the action will not have a significant impact on the human environment and an environmental impact statement is not required. FDA's finding of no significant impact and the evidence supporting that finding, contained in an environmental assessment, may be seen in the Dockets Management Branch (address above) between 9 a.m. and 4 p.m., Monday through Friday.

This rule does not meet the definition of "rule" in 5 U.S.C. 804(3)(A) because it is a rule of "particular applicability." Therefore, it is not subject to the congressional review requirements in 5 U.S.C. 801-808.

List of Subjects 21 CFR Part 522

Animal drugs.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs and redelegated to the Center for Veterinary Medicine, 21 CFR part 522 is amended as follows: