

**SARBANES-OXLEY ACT OF 2002
SUPPLEMENTAL MEMORANDUM NO. 3:
REGISTERED INVESTMENT COMPANIES**

SARAH E. COGAN, CYNTHIA COBDEN, BRYNN PELTZ AND DAVID E. WOHL
SIMPSON THACHER & BARTLETT LLP

August 9, 2002

On July 30, 2002, President Bush signed into law the package of corporate governance, disclosure and accounting reforms contained in the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"). On August 1, 2002, the Board of Directors of the New York Stock Exchange approved proposed changes to the NYSE's listing requirements (the "Proposed NYSE Standards").¹ The Sarbanes-Oxley Act is discussed in detail in our July 31, 2002 memorandum entitled "*Sarbanes-Oxley Act of 2002: CEO/CFO Certifications, Corporate Responsibility and Accounting Reform*" (the "July 31 Memorandum") and our August 8, 2002 memorandum entitled "*Sarbanes-Oxley Act of 2002: Supplemental Memorandum No. 1*" (the "August 8 Memorandum"). Copies of each memorandum can be found on our website at www.simpsonthacher.com or by contacting any of those listed at the end of this memorandum.

This memorandum highlights significant provisions of the Sarbanes-Oxley Act that apply to registered investment companies and significant provisions of the Proposed NYSE Standards that apply to closed-end investment companies listed on the NYSE.

Significant Provisions of the Sarbanes-Oxley Act

Certification of Annual and Semi-Annual Reports

The Sarbanes-Oxley Act contains two new certification requirements for periodic reports filed with the SEC. Both of the new certification requirements are applicable to

¹ The recommendations of the NYSE's Corporate Accountability and Listing Standards Committee, which formed the basis for the Proposed NYSE Standards and which were published for public comment in a report released on June 6, 2002, are discussed in detail in our June 11, 2002 memorandum entitled "*Report of the New York Stock Exchange Corporate Accountability and Listing Standards Committee*" (the "June 11 memorandum").

companies that file periodic reports with the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended.

Section 906 Certification

Section 906 of the Sarbanes-Oxley Act generally requires CEOs and CFOs of public companies (or persons performing similar functions) to certify each periodic report *containing financial statements* filed with the SEC pursuant to the Exchange Act on or after July 30, 2002. Section 906 imposes criminal penalties for false certifications. Section 30 of the Investment Company Act of 1940, as amended, and the rules thereunder state that a registered investment company satisfies its Exchange Act reporting requirements by filing annual and semi-annual reports on Form N-SAR. Although Form N-SAR contains financial information in items 72 through 75, Form N-SAR does not include financial statements. Therefore, it appears that registered investment companies are not subject to Section 906.

For further discussion of the Section 906 certification requirements, please refer to the discussion under the caption “CEO/CFO Certifications and Corporate Responsibility – Section 906” in the July 31 Memorandum and the discussion under the caption “Sections 302 and 906: CEO/CFO Certifications” in the August 8 Memorandum.

Section 302 Certification

Section 302 of the Sarbanes-Oxley Act requires that the SEC adopt final rules by August 29, 2002 to require the CEO and the CFO of a public company (or persons performing similar functions) to provide – in addition to the certification required by Section 906 – a certification in each *periodic report* filed or submitted by the issuer pursuant to the Exchange Act. Section 302 mandates that the SEC’s rules regarding the certifications require that each CEO and CFO state that:

- the signing officer has reviewed the report that is the subject of the certification;
- based on that officer’s knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which the statements were made, not misleading;
- based on that officer’s knowledge, the financial statements, and other financial information included in the report, fairly present in all

material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;

- the signing officer is responsible for establishing and maintaining internal controls and has:
 - designed the internal controls to ensure that material information relating to the issuer is made known to the officer by others within the issuer, particularly during the period in which the periodic reports are being prepared;
 - evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report; and
 - presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;
- the signing officer has disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function):
 - all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
 - any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
- the signing officer has indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Registered investment companies are subject to Section 302, although the specifics of their obligations will not be clear until the SEC issues final rules. The SEC has set a deadline of August 19, 2002 for comments regarding the SEC's rulemaking

under Section 302. The SEC has requested comments on the following issues under Section 302 affecting registered investment companies:

- the appropriate location for the certification (*e.g.*, Form N-SAR or reports to shareholders);
- the appropriate individuals to provide the certification (*e.g.*, officers of the investment company, investment adviser, administrator and/or depositor);
- how the rules should apply to different types of investment companies (*e.g.*, managed investment companies and unit investment trusts); and
- any other matters that are specific to investment companies.

We understand that the Investment Company Institute intends to submit a comment letter. We would be pleased to assist in the preparation of comment letters by others.

For further discussion of the Section 302 certification requirements, please refer to the discussion under the caption “CEO/CFO Certifications and Corporate Responsibility – Section 302” in the July 31 Memorandum and the discussion under the caption “Sections 302 and 906: CEO/CFO Certifications” in the August 8 Memorandum.

Reporting of Trades by Officers, Directors, Principal Shareholders and Others

Section 403 of the Sarbanes-Oxley Act amends Section 16(a) of the Exchange Act to shorten to two business days the length of time that directors, officers and principal shareholders of a company with equity securities registered pursuant to Section 12 of the Exchange Act have to report changes in ownership of the issuer’s securities on Form 4. Closed-end investment companies are subject to Section 16(a) of the Exchange Act by operation of Section 30(h) of the 1940 Act. Section 30(h) also expands the list of reporting persons to include a fund’s investment adviser, its directors, certain officers and affiliates.

Under existing law, officers, directors and persons beneficially owning 10% or more of any class of securities of a closed-end investment company, as well as the fund’s investment adviser, its directors, certain officers and affiliates, generally had to report on Form 4 changes in that person’s ownership of fund securities or the purchase

or sale of a security-based swap agreement involving the securities before the 10th day after the close of the calendar month during which the change occurred. Section 403 amends the Exchange Act to provide that Form 4 must be filed before the end of the second business day following the day on which the reportable transaction is executed, except for cases in which the SEC determines that this reporting deadline is not feasible.

The Sarbanes-Oxley Act provides that this amendment to Section 16(a) of the Exchange Act will become effective August 29, 2002.

In supplemental information issued by the SEC on August 6, 2002, the SEC stated that it is considering rules that provide exemptions from the two business day reporting deadline for Form 4 only for narrowly specified types of transactions where objective criteria prevent the reporting person from controlling (or in many cases even knowing) the timing of the transaction execution and where it has concluded that the two day period would not be feasible. The SEC's supplemental information indicates that the SEC does not intend to consider rules providing exemptions from the two business day requirement based on non-feasibility for transactions categorized by type of issuer, type of reporting person or size of transaction. The SEC anticipates that the new rules will become effective by the August 29, 2002 effective date of Section 403.

In addition to the provisions set forth above, by July 30, 2003:

- the statements filed to report a change in ownership or the entering into of a security-based swap must be filed electronically;
- the SEC must provide each statement on a publicly accessible Internet site not later than the end of the business day following a filing; and
- the issuer (if it maintains a corporate website) must provide each statement on the website not later than the end of the business day following a filing.

To encourage and facilitate electronic filing of Forms 4 and other Section 16 reports, the SEC has announced that it will accept EDGAR filings of reports that are not presented in the standard box format and omit the horizontal and vertical lines separating information items, so long as all required information is presented in the proper order.

For further discussion of the enhanced disclosure requirements, please refer to the discussion under the caption "Enhanced Disclosure - Reporting of Equity Trades by Officers, Directors and Principal Shareholders" in the July 31 Memorandum and the

discussion under the caption “Section 403: Two-Day Deadline for Form 4 Filings” in the August 8 Memorandum.

Auditor Independence and Standards

Section 201 of the Sarbanes-Oxley Act limits the scope of non-audit and consulting services that accounting firms can perform for their public audit clients, including registered investment companies. Prohibited services include, among others, bookkeeping, financial information systems design, appraisal, investment adviser services and legal services and expert services unrelated to the audit. Section 202 of the Sarbanes-Oxley Act also requires (apart from specified *de minimus* exceptions) the audit committee of a registered investment company to pre-approve all audit and non-audit services performed by the company’s auditors. Auditors and their fund clients will not have to comply with Sections 201 and 202 (and other provisions in Title II of the Sarbanes-Oxley Act dealing with auditor independence) until after the initiation of the auditor registration regime with the Public Company Accounting Oversight Board established pursuant to Section 101 of the Sarbanes-Oxley Act.

For further discussion of the new standards for public accounting firms, please refer to the discussions under the captions “Regulation of the Accounting Profession” and “Auditor Independence and Standards” in the July 31 Memorandum.

Independence Standards for Audit Committee Members

Under Section 301 of the Sarbanes-Oxley Act, the SEC is required, by April 26, 2003, to adopt rules having the effect of prohibiting any issuer from having its securities listed on any national securities exchange (such as the NYSE) or traded on the automated quotation facility of any national securities association (such as the Nasdaq Stock Market) if that issuer is not in compliance with requirements set forth in the Act relating to independent audit committees. One of these requirements is that audit committees must be comprised solely of independent board members.

The Sarbanes-Oxley Act defines an “independent” director for this purpose as one who, except in his or her capacity as a member of the audit committee, another board committee or the board:

- does not accept *any* consulting, advisory or other compensation from the issuer; and
- is not an affiliated person (as defined by the 1940 Act) of the issuer or its subsidiaries.

Both prongs of the Sarbanes-Oxley Act's definition of independent director present *per se* bars on qualifying as an independent director, as contrasted with the Proposed NYSE Standards, discussed below, which generally require that the independence of any director be determined by the board of directors based on all relevant facts and circumstances. Until the SEC adopts rules pursuant to Section 301, we recommend that all funds examine the independence of audit committee members and review broadly all relationships that could be implicated by these standards.

For further discussion of the new standards for audit committees, please refer to the discussion under the caption "CEO/CFO Certifications and Corporate Responsibility - Independent Audit Committees" in the July 31 Memorandum and the discussion under the caption "Independence Standards for Audit Committee Members" in the August 8 Memorandum.

Significant Provisions of the Proposed NYSE Standards

Requirements for Audit Committee Membership

Under the current NYSE rules, the audit committee of a NYSE-listed closed-end fund must have at least three directors, all of whom must be independent. The Proposed NYSE Standards require the audit committee to be composed solely of independent directors, and set a heightened standard of independence for audit committee membership. The Proposed NYSE Standards regarding independence generally require that the independence of any director be determined by the board of directors based on all relevant facts and circumstances, as opposed to the *per se* test contained in the Sarbanes-Oxley Act described above. The Proposed NYSE Standards also require the audit committee chair to have accounting or related financial management expertise. Currently, all audit committee members must be financially literate and one member must have accounting or related financial management expertise.

In addition, if an audit committee member serves on the audit committee of more than three public companies, the board of a NYSE-listed fund must determine that the committee member's simultaneous service would not impair such member's ability to serve effectively. To the extent that a fund complex has the same audit committee for more than three funds, at least one of which is NYSE-listed, the board of each listed fund will have to make this finding for each audit committee member. In addition, each listed fund's annual proxy statement must include disclosure of the board's determination.

For further discussion of the audit committee independence requirements and other Proposed NYSE Standards, please refer to the June 11 Memorandum.²

* * * *

If you have any questions regarding the Sarbanes-Oxley Act, the Proposed NYSE Standards and their application to registered investment companies, please contact Sarah E. Cogan (scogan@stblaw.com), Cynthia Cobden (ccobden@stblaw.com), Brynn Peltz (bpeltz@stblaw.com) or David E. Wohl (dwohl@stblaw.com) of our firm at (212) 455-2000.

SIMPSON THACHER & BARTLETT LLP

² The June 11 Memorandum does not address certain modifications and clarifications made to the NYSE Corporate Accountability and Listing Standards Committee's recommendations in response to public comments, which are discussed in the NYSE's August 1, 2002 press release announcing the approval of the Proposed NYSE Standards. We intend to publish a memorandum describing these changes and the proposed rules implementing the Proposed NYSE Standards when the rules become publicly available. In the meantime, please contact one of the attorneys referred to below if you wish to discuss these modifications.