

Regulation Overview

SEC Rule 38a-1



SEC RULE 38a-1 FOR MUTUAL FUNDS

SEC Rule 38a-1 requires mutual fund boards to adopt written policies and procedures designed to prevent the fund from violating federal securities laws. Supervision of compliance matters is the joint responsibility of the fund's advisers, principal underwriters, custodians, auditors, administrators and transfer agents.

Rule 38a-1 was designed to protect investors by ensuring that all funds and advisers have internal programs to be in compliance with the federal securities laws. A critical element of the rule is the designation of a Chief Compliance Officer (CCO) who is charged with the administration of the written compliance policies and procedures.

WHO IS AFFECTED BY SEC RULE 38a-1?

Directors/trustees of registered mutual funds will be most affected. A fund's board members will, however, be allowed to satisfy their oversight obligation by reviewing summaries of compliance programs that are prepared by the Chief Compliance Officer (CCO), the fund's legal counsel, or other persons familiar with the compliance programs.

Rule 38a-1 calls on the board to consider the adequacy of the policies and procedures in light of other recent compliance experiences and additional factors. Board members of registered funds are urged to consider "best practices" used by other funds and to consult with fund counsel (independent directors/trustees have to consult with their "special" counsel), compliance specialists as well as other experts who are familiar with successful compliance practices used by similar funds or service providers.

WHAT ARE THE REQUIREMENTS OF SEC RULE 38a-1?

Funds need to maintain copies of their compliance policies and procedures, and the CCO's annual reports for five years. This recordkeeping requirement has been expanded to also include:

- copies of briefing materials provided to a fund's board of directors regarding their approval of the fund and its service providers' compliance programs; and
- copies of any records documenting a fund's annual review.

Rule 38a-1 provides fund complexes with flexibility so that each complex may apply the rule in a manner best suited to its organization. For example, a fund complex could adopt compliance policies and procedures that encompass the activities of the funds, the adviser and affiliated underwriters and transfer agents, while approving the policies and procedures of other service providers, such as subadvisers, over which it has oversight responsibility under the rule.

Rule 38a-1 requires a fund's board and a majority of its independent directors to approve the policies and procedures of its fund and each of its service providers. The approval must be based on a finding by the board that the policies and procedures are reasonably designed to prevent violation of the federal securities laws by the fund and its service providers.

Directors may satisfy their obligations under the rule by reviewing summaries of compliance programs prepared by the CCO, legal counsel or other persons familiar with the compliance programs. The summaries should familiarize directors with the salient features of the programs (including programs of service providers) and provide them with a good understanding of how the compliance programs address particularly significant compliance risks.

WHEN IS SEC RULE 38a-1 EFFECTIVE?

Effective Date: February 5, 2004. Compliance Date: October 5, 2004.

WHAT ARE THE PENALTIES FOR SEC RULE 38a-1?

The consequences of failing to meet governance requirements are severe. The SEC fined five of the largest investment banks in the world over USD \$8 million for having inadequate procedures and systems in place for the retrieval of email as defined by SEC 17a-4. Goldman, Sachs & Co., Citigroup Inc.'s Salomon Smith Barney, Morgan Stanley & Co., Deutsche Bank Securities Inc., and U.S. Bancorp Piper Jaffray Inc. all agreed to pay and to review and report on procedures for email retention. These penalties foreshadow potential industry penalties of more than USD \$1 billion and individual fines up to USD \$500 million for some brokerages. The penalties for non-compliance include not only fines, but also license suspensions or revocations.

HOW DO FIRMS COMPLY WITH SEC RULE 38a-1?

Rule 38a-1 requires fund boards to adopt written policies and procedures reasonably designed to prevent the fund from violating the federal securities laws. The procedures must provide for the oversight of compliance by the fund's advisers, principal underwriters, administrators, and transfer agents (collectively, "service providers") through which the fund conducts its activities. Thus, under Rule 38a-1, a fund must have procedures reasonably designed to ensure compliance with its disclosed policies regarding market timing. These procedures should provide for monitoring of shareholder trades or flows of money in and out of the funds in order to detect market timing activity, and for consistent enforcement of the fund's policies regarding market timing.

WHAT DOES ZL TECHNOLOGIES PROVIDE?

ZL's compliance platform provides a comprehensive set of tools for small and large businesses to comply with SEC Rule 38a-1, including:

- Email archiving and WORM storage
- Email retention policy management
- Email search and discovery
- Email storage management
- Email attachment management
- Instant messaging archival

ZL Technologies provides an all-in-one solution, which stores data on virtually any non-rewriteable device library, jukebox, etc. (CD-R, DVD-R, and magneto optical disc, et al). ZL Technologies automatically generates a comprehensive and hierarchically searchable index for headers, message body, size, and attachments. ZL Technologies' advanced search with proximity and context sensitivity matching allows companies greater granularity of searches according to use within sentences, paragraphs, and whole documents. Simultaneous cross-alias searching easily prevents multiple searches of the same user, reducing time and resources spent in the event of a pressing audit. ZL Technologies also provides a full auditor application, which enables internal or external auditors to capture specific mails and generate an annotated thread for tracking the entire review lifecycle. The quick summary for lexical analysis and compliance. Analysis for reviewers provides easy summarization of compliance review logs, frequency and occurrences. Additional advantages with ZL Technologies are optional performance enhancements, data compression, data encryption, attachment staging and management, and a parallel mail system for disaster response.

ABOUT ZL TECHNOLOGIES

Established in 1999, ZL Technologies, Inc. (ZL) provides cutting-edge enterprise software solutions for email archiving, regulatory compliance, litigation support, corporate governance, content management, file archiving, and secure email. ZL's flagship product, the Unified Archive, offers comprehensive email and file archiving and management for companies using Lotus Notes/Domino, Microsoft Exchange, Bloomberg, and others. The suite provides a highly flexible framework that is fully scalable, enabling organizations of all sizes to meet legal discovery, compliance, and storage management requirements. With a proven track record and an impressive list of clients, including Walgreens, Bank of New York Mellon, Pacific Life, and Morgan Keegan, among other top global institutions, ZL has emerged as the premier provider of email archiving and compliance solutions. For more information, please visit www.ZLTI.com

To learn more about how ZL Technologies can help you take control of your data, call us at 408.240.8989 or visit us online at www.ZLTI.com