

INVESTMENT MANAGEMENT NO-ACTION AND INTERPRETIVE LETTERS

EXECUTIVE SUMMARY

We reviewed the process for preparing, issuing, and tracking no-action and interpretive letters in the Office of Chief Counsel, Division of Investment Management. Several offices within the Division processed these letters. However, we focused on the process in the Office of Chief Counsel because it processed approximately 88% of the no-action and interpretive matters closed in FY 1999. We found that the Office's process was generally effective in preparing, issuing, and tracking these letters.

Our recommendations address ways in which the Office of Chief Counsel can enhance its efficiency and effectiveness in processing letters. Our recommendations include: issuing and enforcing guidance for submitting requests; developing and implementing formal timeframes in processing letters; distributing written procedures; and improving workload information. We also suggested that the Division put these letters on the Commission's website.

In addition, we suggested that the Office of Public Utility Regulation enter into its tracking system the initial dates that it received no-action letter requests.

Prior to our audit, the Office of Chief Counsel began to implement a new letter log tracking system, add additional workload categories to the system, and change its procedures for updating the system. These steps will help improve the Office's workload tracking.

SCOPE AND OBJECTIVES

The objective of this audit was to evaluate the effectiveness and efficiency of the Division of Investment Management's (IM) process for preparing, issuing, and tracking no-action and interpretive letters. We reviewed IM's process for letters issued in FY 1999. We did not evaluate IM's interpretation of the securities laws in these letters. Also, we did not evaluate IM's process for preparing, issuing, and tracking no-action letters relating to shareholder matters under Rule 14a-8 (17 C.F.R. 240.14a-8).

We reviewed applicable regulations and procedures and interviewed staff in the Division of Investment Management's Office of Chief Counsel (OCC), Office of Public

Utility Regulation, and the Office of Insurance Products. Also, we contacted attorneys involved with no-action letters in the Divisions of Market Regulation and Corporation Finance. In addition, we contacted attorneys at the Commodity Futures Trading Commission (CFTC) and the Investment Company Institute (ICI) to discuss the no-action letter process.

The audit fieldwork was performed between April and August 2000, in accordance with generally accepted government auditing standards.

BACKGROUND

The Division of Investment Management's Office of Chief Counsel provides no-action relief and interpretations to entities primarily regarding the Investment Company Act of 1940 and the Investment Advisers Act of 1940. IM's Office of Insurance Products, Office of Investment Company Regulation, and its Office of Public Utility Regulation also issued a small number of no-action and interpretive letters.

No-action and interpretive letters provide the public with informal interpretations of the federal securities laws and the Commission's rules, and assurances that the divisions would not recommend enforcement action under these laws and rules as a result of proposed transactions or actions. These letters represent the views of the staff and are not binding on the Commission. Also, no-action letters do not preclude the Enforcement Division from recommending enforcement action as a result of the transaction, although this rarely occurs.

The investment company industry refers to these letters for guidance in areas of the law in which guidance does not otherwise exist because of the relative lack of case law or formal Commission rules and interpretations. No-action letters represent a prospective method of promoting compliance with the securities laws by providing the industry with guidance before transactions are executed. These letters give the industry flexibility in conducting business while protecting investors and reducing the regulatory burden on the industry.

As noted above, the OCC processes approximately 88% of IM's no-action letters. IM's Chief Counsel heads this office. The OCC is organized into two offices, the Offices of International Issues and Financial Institutions, each headed by an Assistant Chief Counsel. Each Assistant Chief Counsel has one special counsel and from five to eight staff attorneys reporting to them. While OCC's processing of no-action and interpretive letters is described below, the other offices in IM that issue no-action and interpretive letters use a similar process.

Entities requesting interpretive or no-action letters submit their written requests to the OCC. The Chief Counsel and the Assistant Chief Counsels scan the requests and decide which office will review which requests. The Assistant Chief Counsels attempt to assign the requests to particular staff attorneys based on the attorneys' interest and experience in an area as well as their current workloads. If the issues in the request involve other offices or divisions in the Commission, the OCC sends them a copy of the request.

The staff attorneys review the letters in detail to determine the question posed and the relief requested. Also, they research previous letters, applicable laws and regulations, and other sources. They contact the requester for any needed clarifications and additional information. They then discuss their preliminary results with the special counsel, Assistant Chief Counsel, and, if needed, the Chief Counsel.

If the OCC decides that a written response is appropriate, the staff attorney will prepare a draft letter and forward it to the special counsel or Assistant Chief Counsel. The special counsel and the Assistant Chief Counsel review the draft, make any needed revisions, and forward it to the Chief Counsel for review. After the Chief Counsel's review and approval, the staff attorney typically signs the letter and issues it to the requester. Any related responses from other Commission offices and divisions are incorporated into the letter or sent separately by the office or division. The staff attorney then sends copies of the request and letter to the IM Library, to selected Commission staff depending on the subject matter, and to Public Reference.

If the OCC decides that a written response is not warranted, it will contact the requester by telephone. The OCC might advise the requester to seek exemptive relief, point out the applicable guidance when the law is clear on the matter, or provide appropriate oral guidance. The OCC generally does not provide oral no-action relief.

AUDIT RESULTS

The OCC's no-action and interpretive letter process appears to provide the Division with an effective means to issue guidance to the public in applying substantive areas of the 1940 Acts. The OCC, however, could implement additional steps to ensure the guidance is provided as quickly as possible.

Guidance

Staff attorneys indicated a high degree of confidence in the guidance and support provided by managers. We distributed a questionnaire to the 14 staff attorneys who were in the OCC at the time of our audit. A total of 13 of those attorneys responded to our questionnaire. One of the questions asked whether the attorneys received any training in processing no-action and interpretive letters. Of the 13 attorneys that responded, 9 indicated that they received no such training. Of the 9 that received no training, 8 rated their level of guidance and support as "excellent" or "good". In fact, 6 of the 8 felt that training was unnecessary.

Another question asked whether written guidance was needed. Of the 12 responses to our question, 8 indicated no need for it. Of the 8 that indicated no need for written guidance, 7 rated their level of guidance and support as "excellent" or "good".

A third question asked the attorneys about their understanding of management's expectations. Of the 13 responses, 10 indicated that they had an "excellent" or "good" understanding of management expectations. These responses indicate that a

majority of the staff attorneys feel that their managers are doing an excellent to good job of communicating their expectations and of providing guidance and support to them.

Submission of Requests

OCC staff and managers indicated that poorly drafted request letters were one of the biggest obstacles to the no-action and interpretive letter process. The OCC, however, generally will not reject these letters. Instead, the staff coordinates with the requester to resolve any issues with particular no-action letters. The OCC staff considered a certain amount of clarification of the request letter to be normal. Poorly drafted request letters, however, require more research and clarifications by the staff than necessary. As a result, staff attorneys spend considerable amounts of time performing research, analysis and other activities, including revising the request letters that should possibly have been performed by the requesters and their counsel.

In Investment Company Act Release No. 14492, dated May 8, 1985, the Commission provided specific procedures for submitting applications for exemptive relief from certain provisions of the Investment Company and Investment Advisers Act of 1940. Persons submitting requests for no-action and interpretive letters were also required to follow this guidance where applicable. Most of the attorneys we spoke with were unfamiliar with these procedures so requesters were not required to follow the guidelines in the Release. The Commission issued several other, more general guidelines for submitting requests¹. Release No. 14492, however, appears to provide the most detailed guidance.

Recommendation A

The Division of Investment Management should make entities that request no-action and interpretive letters aware of the guidelines in Release 14492. If necessary, the Division should develop and publish additional guidelines that are tailored exclusively for no-action and interpretive letter requests.

The Division should consider posting any new guidelines on the Commission's Web site. Also, the Division should ensure that entities follow the guidance in drafting and submitting their requests.

Timeframes

OCC managers review weekly reports on the status of the no-action and interpretive letters assigned to their staff. They use these reports to track the progress of the letters. Because of the diversity of topics addressed in the letters and the complexity of many of the issues presented in the requests, the OCC does not set specific time frames for the various steps in the processing of requests.

Sometimes, in processing no-action and interpretive requests, OCC attorneys request supplemental information from requesters. OCC does not provide a

¹ Securities Act of 1933 Releases No. 6269, December 5, 1980; No. 6253, October 28, 1980; No. 5127, January 25, 1971; and No. 5098, October 29, 1970.

response until after it receives and reviews the supplemental information. The OCC also does not set time limits for the requesters to submit their supplemental information.

Investment Company Release No. 14492 states that the Division is to provide initial comments on exemptive applications within 45 days of receipt of the application, with additional time allowed for novel or complex applications. Requesters must submit supplemental information within 60 days of receipt of comments or explain in writing why additional time is needed. These guidelines also apply to no-action and interpretive letters to the extent applicable.

Recommendation B

The OCC should examine whether internal processing timeframes are appropriate for the no-action and interpretive letter process. For example, it could establish timeframes for contacting the requesters on the status of their requests.

Written Procedures

As noted above, OCC staff attorneys rated their managers highly in terms of guidance, support, and in ensuring that the staff understood what was expected of them. These responses indicated a high degree of confidence in management. However, these responses also suggest that, for a number of staff attorneys, managers provide their primary source of guidance.

Most of the OCC staff indicated that they learned how to process no-action and interpretive letters through actually processing them. Only one staff attorney in our survey acknowledged receipt of written procedures. These procedures, “Guidelines for Responding to No-Action Requests and Handling Public Inquiries”, were apparently developed and used by attorneys who are no longer with the Commission. It is not clear exactly when these guidelines were developed, one attorney estimated that they were developed over three years ago. The OCC managers were not immediately familiar with them. The lack of written policies and procedures could result in inefficiencies (*e.g.*, managers unnecessarily providing verbal guidance to the staff).

The OCC generally disagreed that the lack of written policies and procedures resulted in managers spending more time providing procedural guidance. The OCC indicated that the managers provide guidance to the staff attorneys on the legal substance of the no-action and interpretive requests.

The current OCC staff is experienced in processing no-action and interpretive letters. New attorneys, however, would need to learn the procedures. In the absence of written policies and procedures, other OCC staff attorneys or managers would become the primary source of guidance for new attorneys in identifying legal research sources, consulting with other offices, divisions and agencies, or determining the appropriate response format. Written policies and procedures would provide another source of guidance for these new attorneys.

Recommendation C

The OCC should review the “Guidelines for Responding to No-Action Requests,” revise it as appropriate, and ensure that all appropriate staff receives a copy.

Internal List of Contacts

OCC attorneys sometimes contact attorneys in other divisions for advice on specific areas of the securities laws. If the OCC attorneys know whom to contact, they will contact that attorney by phone or electronic mail. If they do not know which particular attorney to contact, they will contact the head of the appropriate office. One questionnaire response included a recommendation for an internal list of subject matter experts in securities law that OCC staff could call for specific questions. The list would include the attorneys’ direct dial telephone number. A list would provide all OCC attorneys, especially newer attorneys, with direct contacts for securities law questions.

Some OCC managers expressed reservations concerning developing such a list. They were concerned about the inappropriate release of the attorneys’ direct dial numbers and problems with the accuracy of the list because of the degree of attorney turnover throughout the Commission.

Recommendation D

The OCC should, in cooperation with other Commission offices and divisions, determine the feasibility of developing an internal list of Commission securities law subject matter experts that OCC staff can call for assistance. If feasible, the OCC should develop the list.

Workload Information

OCC reported 360 interpretive matters and no-action requests closed in FY 1999. This category included 59 confidential treatment requests on Form 13f.²

The Office classified its workload into three categories: no-action and interpretive matters; shareholder and investor inquiries; and special projects. The OCC explained that it used these categories consistently each year to categorize its workload and calculate its budget statistics. As a result, each of these categories includes a wide range of activities not necessarily reflected in the category titles. The titles of these categories should better reflect the types of matters included in them.

² Institutional investment managers use Form 13F to report their holdings of certain securities with an aggregate fair market value of at least \$100 million over which they exercise investment discretion. In certain instances, these institutional investment managers may request confidential treatment for information in these filings. IM reviews the request and determines if confidential treatment is appropriate. We refer to these requests, not instances where IM provides interpretations of Rule 13f (17 C.F.R.240.13f-1).

OCC recognized this issue and, in connection with implementing its new, web-based letter log system, developed six additional categories for tracking workload. The categories include a separate category for 13f confidential treatment matters. This should improve workload tracking. Also, the new letter log system will include the necessary fields and functionality to more accurately identify and count no-action and interpretive letters, along with the other categories of work.

The Office of Public Utility Regulation did not enter the no-action letter request receipt date until after preliminary work was completed. As a result, the dates in their tracking system did not always reflect the total amount of time spent processing the requests.

Recommendation E

OCC should ensure that no-action and interpretive releases and 13f matters are included in the categories designated for them.

Recommendation F

The Office of Public Utility Regulation should enter into their tracking system the correct date that processing began on their no-action and interpretive letters.

No-Action and Interpretive Letters on the SEC Website

The Commission has an Internet site where the public may download and print a variety of documents, including company filings, proposed and final rules, and interpretive releases. The Commission does not currently provide no-action and interpretive letters on its website.

According to Office of Management and Budget Circular A-130, "Management of Federal Information Resources", agencies should use electronic media and formats as appropriate to make government information more easily accessible and useful to the public. Certain vendors provide databases of no-action letters, and some letters may be found on the Internet, but the general public generally does not have easy access to a central source for the Division's no-action letters.

It may be impractical to place historical no-action letters on the Commission's web site because of the volume of letters. Also, requesters often submit their letters to the Commission in paper form. The Commission would have to convert these requests to an electronic format to post them to the Commission's website. In addition, request letters for which no response letter was issued by IM should probably not be posted.

Recommendation G

The Division of Investment Management should consider placing its no-action letters on the Commission's Web site as appropriate. One possible location is with the proposed and final rules and interpretive releases.