



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

April 30, 1998

Mr. David Silver  
President  
ICI Mutual  
1401 H Street, N.W.  
Washington, DC 20005

Dear Dave:

Thanks for your letter and your thoughts on the recent acquisitions of mutual fund advisers by unregulated entities. I could not agree with you more that acquirers of mutual fund advisers must be aware of and understand the requirements of the Investment Company Act and should appreciate the importance of effective compliance practices. I also believe that good compliance practices by mutual funds and their advisers are vital to maintaining the integrity of the mutual fund industry in this era of consolidation.

As you note, the Commission does not have the authority to regulate directly all upstream affiliates of mutual fund advisers. Although the Commission can and does require disclosure of significant facts regarding a proposed merger, it cannot in many cases require a potential acquirer of a mutual fund adviser to meet particular operational or financial standards. I believe, however, that the federal securities laws, together with an effective inspections program, provide the Commission with sufficient means to satisfy its objective of protecting investors, even in this time of consolidation.

I fully agree with you that a well-funded compliance system is not a luxury but a necessity. As Barry Barbash said in his recent speech at the Mutual Funds and Investment Management Conference, integrating the compliance systems of merged entities is a task that cannot be ignored or undertaken halfheartedly. Barry also stressed that proper coordination, clear communication and responsible oversight of compliance systems are extremely important after a merger. The Commission staff knows that merged entities sometimes have difficulty effectively integrating their compliance systems, and the staff has increased its focus on internal controls and compliance systems in its inspections. As part of this process, the staff encourages mutual funds and their advisers to establish their own monitoring and control systems. Depending on the circumstances, the staff may suggest that a fund or its adviser develop a strong internal audit program, an active risk management program and a global compliance program.

For a company to create an effective compliance culture, high standards must be established at the top levels of the organization. A company's compliance with these standards will address many of the concerns that you raise in your letter. For example, a compliance-oriented board of directors will take seriously the fiduciary duties that are owed to a fund by its adviser and the fund's board. This board will recognize that a mutual fund is not a subsidiary of, and does not belong to, an investment adviser or the adviser's parent. Compliance personnel who know that they have the board's support are more likely to communicate to the organization the importance of good compliance practices.

The Commission and its staff will continue their efforts to communicate to potential acquirers of mutual fund advisers the need for a thorough understanding of their responsibilities under the federal securities laws. The staff also will continue, through the inspections process, to focus on the compliance systems, operations and control environments of mutual fund complexes. If the staff finds significant deficiencies in a particular area, it will notify the senior management of the fund and the fund's adviser. In certain cases, it also may be appropriate for the staff to notify the parent company's board. The Commission has sued investment advisers that lacked adequate internal controls or procedures designed to detect or prevent violations of the federal securities laws, or that failed to implement those procedures. We will not hesitate to bring similar enforcement actions in the future.

Thank you again for your letter. As you note, many believe that this era of consolidation in the financial services industry is just beginning. The Commission and its staff remain concerned about the need to protect mutual fund investors in this environment. I noted that you sent a copy of your letter to Barry Barbash, and I also have provided a copy to Lori Richards, who is director of our inspections program.

Sincerely,



Arthur Levitt  
Chairman