Fidelity Investments

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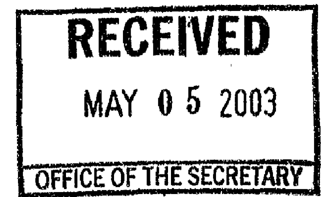

May 2,2003

Jonathan G. **Katz**
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Compliance Programs of Investment Companies and Investment Advisers, Rel. Nos. IC-25925 and IA-2107, File No. S7-03-03

Dear Mr. Katz:

Fidelity Management & Research Company (FMR) respectfully submits the following comments in connection with Investment Company Act Release No. 25925 and Investment Adviser Act Release No. 2107 (collectively referred to as the "Release") regarding the proposed adoption of rules under the Investment Company Act of 1940 (1940 Act) and the Investment Advisers Act of 1940 (Advisers Act) to require mutual funds and registered investment advisers to adopt and implement policies and procedures reasonably designed to prevent violations of the federal securities laws (Compliance Procedures). Proposed Rule 38a-1 under the 1940 Act (the "Rule) would require that a fund's board, including a majority of the fund's independent directors, approve detailed Compliance Procedures. The rule would also require the board, including a majority of the independent directors, to approve a chief compliance officer who would be charged with administering the Compliance Procedures and who would be required *to* annually provide to the board a written report on the operation of the fund's Compliance Procedures, including (i) any material changes to the compliance Procedures since the last report; (ii) any recommendations for material changes to the Compliance Procedures as a result of the annual review; and (iii) any material compliance matters requiring remedial action that occurred since the date of the **last** report.

FMR is the investment manager for over 280 registered investment companies in the Fidelity Group. The Fidelity Funds currently have aggregate assets in excess of $680 billion. In its role as investment manager of the Fidelity Funds, FMR has had extensive experience **concerning** the compliance and operations of investment companies and the role of a board of directors in compliance oversight. Our comments focus on **proposed** Rule 38a-1 under the 1940 Act.

FMR believes compliance plays an important and integral role in the investment process. Fidelity has developed a sophisticated technology and systems infrastructure

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that supports its various compliance functions. Although we are generally supportive of strengthening and enhancing compliance in the investment management industry, we believe that certain features of the Commission's proposals may be impractical in the context of current business models employed by various fund organizations. We therefore strongly support the points raised and the positions taken in the comment letter submitted by the Investment Company Institute (ICI) and offer the following additional comments.

- **Chief Compliance Officer**

Fidelity **is a** large organization that offers a number of investment products and services. To **support** those products and services, multiple affiliated entities throughout the Fidelity organization generally provide all investment management, distribution, accounting, pricing, tax, administrative, and transfer agency services.[1] Other critical functions, such as custody arid sub-custody services, are provided by external, indenendent organizations that also maintain some of the fund books and records. Oversight of service providers is performed by FMR, as fund adviser and administrator.

Within the Fidelity structure, compliance responsibility **is** distributed among experienced professionals at each of the internal service providers who have the knowledge and expertise to address the diverse and complex regulations under which the service providers and funds must operate. External service providers are held accountable for the quality of compliance and controls through contractual arrangements and periodic reporting to fund officers.

Because responsibility for providing services is distributed among several distinct business units that operate under varied and diverse regulations, we believe that the ICI is correct in its assessment of the impracticality of placing responsibility for the compliance aspects of all distribution, operational, and investment management functions under the jurisdiction of a single compliance officer since that person does not and cannot exercise effective control over the business operations of the separately managed service providers. **As** recommended by the ICI, we believe that **the** Rule should be amended to make each service provider accountable for compliance. Additionally, for external, independent service providers, the approval and renewal of contracts with these entities could be conditioned on a report concerning internal compliance and control procedures as a way to achieve the Commission's objective.

- **Alternative Approach**

As noted in the ICI letter and in many of the other comment letters, there is no immediate, compelling justification for the rule proposal and certainly no crisis requiring

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[1] **In** some cases, FMR serves **as subadvisor** to a **fund group** that has **primary** responsibility **for** oversight of most, if not all, Compliance functions. In these cases, the respective responsibility for various compliance and record **keeping** functions **is** allocated differently.

hasty action by the Commission. The industry has a proud history going back to the inception of the 1940 Act of supporting strong investor protection and efficient regulation of investment advisers and investment companies. It is a matter of record that the industry has expressed strong support for adequate funding for the Commission and **its** staff, including increased support for Commission staff oversight of the investment management industry though the inspections program. We continue to believe that there is no substitute for a robust inspections system operated by the Commission and its staff. This program of inspections, coupled with the fact that mutual funds operate under a stringent regulatory framework under the 1940 Act and the Advisers Act, has produced an excellent record of industry compliance. We join the ICI in its support for strengthening the current inspection system rather than imposing new, costly and potentially counterproductive measures.

In recent years, the U.S. capital markets have witnessed compliance missteps and outright fraud involving several large and reputable financial institutions and numerous operating companies. The mutual fund industry has largely avoided these problems, **a** testimony to the existing framework's success.

We recognize that the Commission may feel a need to take action to help restore investor confidence generally in all segments of the market, but precipitous action involving cosmetic measures would likely be costly and counterproductive. The essential common elements of a strong compliance program and recommended practices could be developed and documented, but the deadlines set forth in the Commission's rule proposal foreclose the opportunity for careful thought and meaningful input from industry **experts** and mutual fund industry participants.

Historically, when complicated regulatory matters needed to be addressed and resolved, the Commission and the industry have worked collaboratively to improve investor protection standards. The 1940 Act itself is an example of such informed collaboration. The 1970 Amendments to the 1940 **Act,** which created an improved system of corporate governance now contained in the statute and the various rules thereunder, came into being after careful study of various possible models for resolving a host of potential conflict of interest issues. The work to produce the current version of Rule 2a-7 under the 1940 Act represents yet another example of good regulatory process; and, in that case, the industry advocated for tougher controls than were originally proposed by the Cornmission. The amendments to Rule 17j-1 were based on the recommendations of an industry Blue Ribbon panel that ensured that the amendments were tough, practical and relevant.

In the current case, the Commission should consider developing a framework for dialog with the industry to **create** a series of industry best practices for the full range of investment, distribution **and operations** compliance areas. That dialog could begin by having the Commission issue a concept release on compliance and inviting comment on specific topic areas. We strongly believe that investor protection would be better served

by such a detailed study and review of how best to strengthen compliance controls and Commission oversight.

As pointed out in the ICI letter, even if the Commission acts immediately, there will need to be **a** substantial delay in the effective date of the proposed rules because they impose new requirements on all registrants and may require major revision to contracts, including the renegotiation of fee arrangements, some of which may require shareholder **approval.** Since there is no need for precipitous action by the Commission, **we** would urge that the adoption of the proposed rules be delayed while the industry and Commission work together to develop rules in the best traditions of the 1940 Act through a collaborative effort and that the Commission issue a call for further comment on the best ways to strengthen compliance and Commission oversight.

We hope that the foregoing is helpful to the Cornmission in **its** deliberations, and would be happy to provide any additional information to assist the Commission in its consideration of these matters.

Very truly yours,

Stanley N. Griffith

Stanley N. Griffith
Vice President and
Associate General Counsel

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