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ALERT

Investment Regulation | March 2015

SEC Reminds the Fund Industry that Gifts May Violate the 1940 Act, Not Just the Code of Ethics

Late last month, the staff of the SEC's Division of Investment Management released Guidance Update No. 2015-01 (February 2015), reminding the investment management community of the potential conflicts of interest that arise when the personnel of an investment adviser to a registered investment company (a "fund") are presented with gifts by those doing business or seeking to do business with the fund.

This Guidance Update highlights the prohibition in Section 17(e)(1) of the 1940 Act on an affiliated person's acceptance of "any compensation (other than regular salary or wages from such [fund])" when acting as an agent of the fund in connection with the purchase or sale of any property on behalf of the fund, and reminds the industry of the Commission's position that gifts and/or entertainment meet the broad definition of "compensation" under this Section. For this reason, and since a fund's adviser and its officers, directors and employees are affiliated persons of the fund, the Guidance Update states (as an example) that a portfolio manager's acceptance of a gift or entertainment from a broker-dealer for the sale of the fund's portfolio securities would violate Section 17(e)(1).

The Guidance Update concludes that a fund's compliance policies and procedures adopted under Rule 38a-1 under the 1940 Act should address the potential violation of Section 17(e)(1) of the 1940 Act created by the receipt of gifts and entertainment by fund advisory personnel. While many compliance policies and procedures address the receipt of gifts and entertainment, the Guidance Update stands as a reminder for fund boards and advisers to consider this issue in the course of reviewing their compliance policies and procedures under Rule 38a-1.

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