

Current developments for mutual fund audit committees*

Quarterly summary
03.31.2008

Table of contents:

PwC articles & observations for the three months ended March 31, 2008 pg. 2

Tax developments pg. 10

Summary of developments for the six months ended March 31, 2008 pg. 13

Publications of interest to mutual fund directors pg. 15

PwC articles &
observations for the
three months ended
March 31, 2008

FAS 157 implementation guidance

FASB Statement No. 157, “Fair Value Measurement,” is applicable for financial statements for years beginning after November 15, 2007 and interim periods within those fiscal years. SEC Division of Investment Management staff has indicated that they expect financial information submitted in mutual funds’ quarterly reports on Form N-Q to include the disclosures required by this standard. Therefore, fund managements who have first-quarter filings for periods ending February 29 and March 31, 2008 are focused on developing these disclosures.

FAS 157 is a principles-based standard that defines fair value, establishes a framework for measuring fair value under US generally accepted accounting principles and expands required disclosures. On February 5, 2008, the Investment Company Institute (ICI) provided its members with guidance regarding disclosures and distributed a matrix intended to help funds determine where securities fall within the fair value hierarchy. While such generic guidance may be helpful to fund management in developing disclosures, it is important for management to recognize that such guidance needs to be tailored to their funds’ specific facts and circumstances.

In addition to the ICI guidance, PricewaterhouseCoopers published a fair value measurement practice aid for client’s use. Certain industry-specific questions, however, are not necessarily covered by that practice aid. To help fill that gap, we’ve provided our typical response to some of the more common industry questions below. Your PwC audit team engagement leaders are in the best

position to discuss how FAS 157 may be applied to your particular funds.

Question: Rule 2a-7 under the Investment Company Act of 1940 permits money market funds to value investments at amortized cost. Are such investments subject to FAS 157, and if so, what level in the hierarchy are they?

Response: Outside of the money market fund environment, amortized cost valuation would not normally be a “fair value” method and thus not subject to FAS 157. However, Rule 2a-7 requires money market funds to perform a periodic “shadow pricing” at current market values and an affirmative determination by the board of directors that amortized cost, on an aggregate portfolio basis, does not materially deviate (within 0.5%) from current fair values. As a result, the use of amortized cost by money market funds appears to be more of what FAS 157 considers a “practical expedient” in lieu of management’s obtaining daily fair values for every investment in the money market fund. The ICI matrix discussed above takes a similar view.

We believe that investments held by the money market fund will need to be individually evaluated to determine their level in the hierarchy. Amortized cost valuation would typically not be a Level 1 valuation because it is not a current market price for the specific individual security. Moreover, in many cases (except, most notably, for US Treasuries) there is not an observable market for the identical money market instrument. If market deviations become significant and the fund is not subject to Rule 2a-7, the valuations should be consistent with any other mark-to-market portfolio based on source.

Question: When would the “cost” approach described in FAS 157 be an appropriate technique for an investment company?

Response: FAS 157’s reference to the “cost” approach has no relationship to historical cost. Rather, paragraph 18c of FAS 157 describes the “cost” approach as being “based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement costs).” Replacement cost is based on what it would take to “acquire or construct a substitute asset.” Accordingly, the “cost” approach is generally associated with assets with “service capacity,” such as long-lived, intangible and other depreciable assets, which can be constructed or developed.

Except possibly for securitizations, it is unlikely that a replacement cost approach would result in any different fair value measurement for a financial asset or liability than a market approach, since most financial instruments would be replaced simply by purchasing them in the market. Therefore, we expect its application will be rare in an investment company environment.

Question: What is the unit of account for determining the hierarchy level of a fund’s investment in another fund?

Response: In most cases, if a fund were to sell its investment in another fund, it could deliver only the ownership interest in that fund. It would have no rights to, and would be unable to deliver, any of the investments owned by the underlying fund. In those instances, the unit of account for FAS 157 valuation would be the ownership interests in the fund, without looking through to the underlying investments. For example, many registered fund of funds (FOFs) invest solely in other registered investment companies that permit daily redemption at net asset value (NAV). The investments in those other funds would likely constitute Level 1 inputs, depending on how

often purchase and redemption activity occurs. Since the unit of account for the FOFs’ financial statements is the investment in each of the funds — and not the underlying assets of each of the funds — mutual fund shares for which the underlying investments are all valued using Level 2 or Level 3 inputs might nonetheless be considered a Level 1 valuation for the FOFs’ interest in such funds.

Some registered FOFs, however, invest in unregistered private equity or hedge funds, or in registered “interval” funds that only repurchase shares periodically. Since the unit of account is the interest in the fund, several factors in addition to NAV would need to be considered in determining the valuations of investments in those funds, such as restrictions on liquidity and transferability. Depending on the significance of those factors, the valuations might ultimately be classified as Level 2 or Level 3 in the FAS 157 hierarchy. This would be the case even if a hedge fund invested entirely in Level 1 and Level 2 financial instruments because the unit of account is the interest in the hedge fund itself, not its underlying investments.

To review the PricewaterhouseCoopers practice aid for fair value measurement, please see:

[http://www.pwc.com/extweb/pwcpublishations.nsf/docid/0723aa0dfd9d4eff85257157000b870d/\\$File/PwC_FairValueGuide_Final07.pdf](http://www.pwc.com/extweb/pwcpublishations.nsf/docid/0723aa0dfd9d4eff85257157000b870d/$File/PwC_FairValueGuide_Final07.pdf).

Senior supervisors group's observations on risk management practices during the recent market turbulence

On March 6, 2008, the Senior Supervisors Group, which comprises banking representatives from France, Germany, Switzerland, the United Kingdom and the United States (including representatives from the Securities and Exchange Commission), issued a report entitled Observations on Risk Management Practices during the Recent Market Turbulence. The observations are expected to enable these supervisors to evaluate the efforts of the individual financial institutions they supervise and address weaknesses in risk management practices that emerged during the current and ongoing period of market turmoil.

Each supervisor is expected to determine that its financial institutions are making appropriate changes in risk management practices, including addressing deficiencies in senior management oversight, the use of risk measurement techniques, stress testing and contingency funding planning. These observations are also expected to help define an agenda for strengthening supervisory oversight of relevant areas, including:

- Managing liquidity risk
- Existing guidance on risk management practices, valuation practices and the controls over both
- Supporting appropriate forums to address issues that may benefit from discussions among market participants, supervisors and other key players, such as accountants (e.g., the appropriate accounting and disclosure treatments of exposures to off-balance-sheet vehicles)
- Strengthening the efficacy and robustness of the Basel II capital framework by developing more forward-looking approaches to risk and capital measures and providing high standards for what constitutes risk transfers, among other issues that surfaced during the market turbulence

Although these observations relate primarily to commercial and investment banking activities, investment management firms and fund directors may find these observations informative and useful when assessing the risk exposures of their investment management operations and their investment funds.

The full report on these observations is available at <http://www.sec.gov/news/press/2008/report030608.pdf>

Financial reporting during continuing stress in the credit markets

Continuing stress in the credit markets and the resulting impact on the valuation of various financial instruments, including fixed income investments, has become one of the most significant accounting and financial reporting issues currently facing entities as they assess their financial condition, including capital and liquidity needs. The effects of this stress are widespread. Financial services and non-financial services entities alike, including investment companies, are feeling the pressure. And as such, credit market stress represents an important matter for directors to consider.

PricewaterhouseCoopers, regulators and others are encouraging clients/registrants to cast a critical eye and assess:

- The liquidity of their investments
- The processes to assess valuations, including prices obtained from pricing service vendors and the resulting fair valuations of their investments
- The robustness and transparency of their relevant financial reporting disclosures

For affected investment companies, the financial reporting disclosures will likely impact what is included in the statement of investments, statement of operations, and statement of assets and liabilities. Several investment managers have entered into credit support arrangements with money market funds to protect their net asset values as needed. Other managers have purchased defaulted or otherwise troubled securities out of money market funds at amortized cost. These arrangements typically require separate disclosure in the statement of operations and financial highlights in accordance with paragraphs 7.57-7.58 of the AICPA Investment Company Audit

Guide. Footnote disclosures should also be enhanced to address such agreements, as well as — even if adviser support has not been required — credit or concentration risk exposures, such as real-estate-related collateralized debt obligations or similar securities. As required, fund management can consult AICPA Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, and FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* for additional information.

Fund management should consider discussing the impact of credit market stress on the fund's portfolio strategy in shareholder reports and other publicly available documents, as well as in the financial statements and related footnote disclosures.

On another matter involving disclosure, reports have circulated in recent weeks about numerous failed auctions of auction-rate preferred stock issued by closed-end funds. Fund management should consider disclosing information regarding failed auctions under the above-referenced AICPA SOP 94-6. Important issues to disclose include the potential effects on future preferred dividend rates caused by automatic "penalty rates" (and, equally, income available for distribution to common shareholders), as well as near-term impacts on fund operations, including commitments to redeem preferred stock.

Audit committee members may want to discuss the impact of the continuing stress in the credit markets on the funds' investments and performance with portfolio, trading and compliance management, in addition to the funds' chief accounting officer. Moreover, audit committee members may also want to review the appropriateness of the valuations used in the daily net asset value calculations, as well as the expected impact of current conditions on financial reporting, with the funds' chief financial and accounting officers and the funds' auditors.

Rogue trader incident demonstrates a pattern of recurring behavior

The recent rogue trader incident in Europe showed patterns similar to some previous well-known frauds (e.g., Amaranth, Allied Irish Bank and Barings). Examination of these common patterns can be instructive to both management and fund directors. The first pattern is that frauds generally occur over a long period of time in businesses where large positions are carried in the course of normal business. Second, the headline-making frauds were perpetrated by predominantly front-office individuals (as opposed to multiple persons) with knowledge and access to the middle- and back-office systems and processes. Finally, structural issues existed, such as lack of segregation of duties and proper oversight, and the red flags for these issues appear to have been dismissed, ignored or gone undetected.

Rogue trading has been a problem since the beginning of organized trading. However, PricewaterhouseCoopers believes that, while it is extremely difficult to completely prevent rogue trading, it can be managed in an acceptable manner similar to other types of risks.

Fraudulent behavior is often caught by detective controls, and large failures tend to occur when those controls do not operate effectively. Poor detective controls, along with lax enforcement of internal controls, can compound the risk of a large fraud. Unfortunately, it is very difficult to design effective preventive controls without real-time monitoring by management.

In order for companies to manage the risks associated with rogue trading, we recommend a framework for trading and cash management operations covering the following areas:

- Establish or enhance your risk management strategy and the risk management function.
- Focus on the attributes and activities of your people and a culture that fosters ethical behavior, responsibility, accountability and control.
- Provide constant vigilance to maintain effective operations, systems and controls.
- Evaluate and enhance your risk measurement reporting, including forensics as a tool for real-time monitoring.

Investment management firms and financial institutions should give careful thought and consideration to the types of efforts they need to undertake in order to better manage the risks associated with rogue trading. These efforts can include better enforcement of existing controls; implementation of quick fixes where possible, sometimes in anticipation of longer-term automation or control improvement efforts; adjustment of internal audit and risk management team focus and plans; implementation of funding/accelerating selected projects in areas such as information security, risk management and automation of trading; and exploration of the potential for real-time monitoring.

CIFiR issues progress report to SEC

The SEC established the Advisory Committee on Improvements to Financial Reporting (CIFiR) to examine the US financial reporting system and make recommendations aimed at increasing the usefulness of financial information to investors, while reducing system complexity. On February 14, 2008, CIFiR submitted a progress report to the SEC, which will have a 30-day public comment period. The report contains 12 recommendations based on the following five main themes:

- Increase emphasis on the investor perspective in the financial reporting system.
- Consolidate the process of setting and interpreting accounting standards.
- Promote the design of more uniform and principles-based accounting standards.
- Create a disciplined framework for the increased use of professional judgment.
- Take steps to coordinate US generally accepted accounting principles (GAAP) with International Financial Reporting Standards (IFRS).

SEC Chairman Christopher Cox stated that the issuance of the progress report is an important step toward making financial information more understandable for investors and reducing unnecessary complexity. Mr. Cox also indicated that the SEC's professional staff will analyze the report and its proposals and will provide recommendations to the Commission for possible consideration later this year.

Mutual fund directors may find CIFiR's views on industry-specific accounting guidance and the convergence of

IFRS and GAAP of interest. These views are detailed in the following excerpts from the executive overview of the report covering Design of Standards and Global Convergence, respectively. The report suggests that CIFiR supports elimination of industry-specific GAAP, but over a transition period to reduce implementation costs, and that guidance applicable to legitimately different activities should be preserved but applied consistently regardless of industry.

Design of Standards

GAAP contains many detailed rules with several industry-specific exceptions and alternative accounting policies for the same transactions. Moreover, some of these rules have all-or-nothing results, which stem from bright line tests. This combination allows companies and auditors to reach a technically compliant conclusion that may be inconsistent with the underlying economic substance of the transaction, thereby potentially undermining an investor's complete and accurate understanding of the transaction. For example, transactions involving the right to use an asset for a promise to pay a series of payments in the future can be kept off a company's balance sheet if detailed rules are followed.

In response, we propose that the FASB move away from industry-specific guidance to activity-based guidance (e.g., from banking as an industry to lending as an activity by any company) and strive to reduce the number of alternative ways available under GAAP to account for the same transaction. We also plan to consider, among other possibilities, the feasibility of proportionate recognition rather than all-or-nothing results, to better reflect the rights conveyed by agreements and obligations incurred.

Some believe an increased use of fair value measurements will better portray the current valuation of past transactions and improve financial reporting. Others believe the increased use of fair valuation measurements will cause unnecessary volatility, will decrease the

reliability of financial statements, and will only increase investor confusion. We plan to deliberate, whether, among other approaches, to support the FASB's project to consider changing the income statement format into two or more groupings designed to help investors better understand the different sources of changes in a company's income — for example, by separating cash or accrued earnings from changes resulting from fluctuations in the fair value of assets such as publicly traded bonds.

More broadly, we will consider recommending that the FASB design accounting standards with more general principles and fewer detailed rules in order to prevent the manipulation of technical requirements to reach pre-conceived accounting results.

Global Convergence

At present, U.S. companies follow GAAP; in most other countries, publicly traded companies are increasingly following IFRS as adopted by the International Accounting Standards Board (IASB). We support the long-term goal of converging GAAP with IFRS in order to reduce accounting costs to investors and others in an increasingly global business environment. But we recognize that there are various paths to convergence, and it may take years for full convergence to be achieved. Therefore, we believe that it is quite useful to propose enhancements to the financial reporting system in the U.S.

Later in 2008, we will identify and analyze some of the issues to be resolved in the move toward global convergence of accounting standards. At this time, we note that the principles contained in IFRS are less encumbered by detailed rules than GAAP; accordingly, GAAP will probably need to become less rules-based in order to promote the goal of global convergence. We also note that IFRS has little industry-specific guidance, and we encourage the IASB to continue in this manner, consistent with our proposal that the FASB issue activity-based standards rather than industry-specific accounting standards.

On the other hand, IFRS contains a number of alternative accounting policies for the same activity, and there are political pressures to add exceptions in certain countries. As part of the effort to promote global convergence, we urge the IASB to continue to reduce the number of alternative accounting policies currently available and to resist the political pressures for country exceptions.

For those interested in reading the entire CIFI report, it is available at the SEC's website (Rel. No. 33-8896; 34-57331; File No. 265-24, Progress Report of the SEC Advisory Committee on Improvements to Financial Reporting) <http://www.sec.gov/about/offices/oca/acifr.shtml>.

Tax developments

2008 federal tax legislative outlook

Overview

Efforts to enact tax legislation in 2008 are likely to be complicated by continued Democratic-Republican disagreements over revenue offsets and enforcement of Congressional “pay-as-you-go” (PAYGO) budget rules. Election-year political considerations are also likely to influence both the content and timing of any tax legislation considered this year, with the fate of the 2001 and 2003 Bush tax cuts expected to be an issue in this year’s Presidential race.

Democrats and Republicans moved to quickly enact an economic stimulus package earlier this year to address concerns that recent home mortgage and credit market turmoil could lead to a broader economic slowdown in consumer spending and the risk of recession.

On February 13, 2008, President Bush signed the Economic Stimulus Act of 2008 (the “Act”), a \$152 billion package of tax rebates and business investment incentives. While the Act did not include any offsetting revenue raisers, PAYGO budget rules are expected to be a key factor in the action taken on all other tax legislation this year.

Federal tax reform

The US tax system faces significant challenges over the next several years. For example, in the absence of legislative relief, a growing number of individuals will become subject to the alternative minimum tax (AMT), and individual income tax cuts enacted as part of the 2001 and 2003 Tax Acts, including the reduced tax rate applicable to qualified dividend income and long-term capital gains, will expire. Addressing either of these

concerns on a permanent basis would be extremely costly. At the same time, there is growing concern that differences between the US tax system and those of our major trading partners negatively affect the international competitiveness of US businesses.

In 2005, the Bush Administration attempted to draw attention to and facilitate discussion of the challenges facing the US tax system when it commissioned the Advisory Panel on Federal Tax Reform. The Administration, however, did not pursue federal tax reform initiatives after the Panel issued its report. More recently, the Treasury Department and members of Congress have taken steps to encourage further dialog about these challenges in Washington. For example, last October, Ways and Means Committee Chairman Rep. Charles Rangel (D-NY) introduced a comprehensive tax reform bill that would, among other things, repeal the individual AMT and reduce the corporate tax rate; and last December, the Treasury issued a report about ways the competitiveness of the US business tax system could be improved.

While the current Congress is unlikely to consider tax reform legislation this year, both the House Ways and Means and Senate Finance Committees are expected to hold a series of hearings on the topic. Finance Chairman Sen. Max Baucus (D-MT) has said he wants to lay the groundwork for tax reform in 2009–2010.

In 2008, mutual fund sponsors and shareholders will be closely watching Washington for potential developments regarding federal tax-related items that specifically affect their interests. Several of these items are discussed in the following paragraphs.

Expiring tax provisions that affect foreign shareholders of mutual funds

Despite the lobbying the Investment Company Institute (ICI) conducted on behalf of its members to extend a

provision that allowed foreign shareholders of regulated investment companies (RICs) to avoid US tax on RIC dividends that represent certain amounts of interest income and short-term capital gains (i.e., properly designated interest-related dividends or short-term capital gain dividends), Congress allowed the provision to expire effective for RIC tax years beginning after December 31, 2007.

Last fall, Congress considered, but did not enact, a proposed one-year extension of this provision and other expiring tax provisions. It is anticipated that Congress will once again consider the extension of expired tax provisions, such as this one, in 2008. However, it is uncertain when lawmakers will act or whether any extension would be retroactive to January 1, 2008. Until Congress acts, RICs and their foreign shareholders face uncertainty about the fate of this provision.

Taxation of exchange traded notes

The tax treatment of exchange traded notes (ETNs) emerged as a hot topic last fall when the ICI expressed to Congress that, in their view, the current tax treatment of ETNs gives the investment a competitive advantage over mutual funds and exchange traded funds. Under current rules, ETNs are generally considered to be taxed more favorably than mutual funds, because notes are taxed as prepaid forward contracts. Taxation as a prepaid forward contract allows the holder of an ETN, generally, to defer income on the investment and apply preferential capital gain rates to the income when recognized.

Shortly after the ICI voiced its concerns, Congress and the IRS took action to limit the tax benefits of some ETNs, and to more closely examine, in general, the tax treatment of ETNs. In December 2007, the IRS issued Revenue Ruling 2008-1 that prevents holders of a foreign currency ETN from treating the note as a prepaid forward contract, but, rather, requires the note to be taxed as a

debt instrument. At the same time, the IRS announced its intention to more closely study the tax issues associated with prepaid forward contracts, including ETNs, and requested comments from the public on specific issues.

Also in December, Rep. Richard Neal (MA-D) introduced legislation that would limit the favorable tax treatment that holders of ETNs currently receive by requiring holders of ETNs and other prepaid forward contracts to currently accrue income with respect to the investments. The House Ways and Means Subcommittee on Select Revenue Measures held a hearing on March 5, 2008 to further examine the tax treatment of derivatives, including ETNs. In its written testimony presented at the hearing, the ICI indicated its support for Rep. Neal's legislation and made suggestions for how the legislation may be improved from their perspective.

Disclosure of tax return positions

As of January 1, 2008, paid preparers of federal tax returns, including tax service providers to mutual funds, are required to follow new rules enacted last May that provide guidelines regarding when a paid preparer must disclose to the IRS positions taken on a tax return. Under the new rules, a paid preparer cannot knowingly prepare a federal tax return that reports a position that has a 50% or less likelihood of success if challenged by the IRS (i.e., a more-likely-than-not threshold), unless there is a reasonable basis for the position and the position is adequately disclosed. The new disclosure threshold applicable to paid preparers is considerably higher than the threshold under prior law, and is generally higher than the disclosure threshold applicable to taxpayers, including RICs, to avoid certain federal accuracy-related penalties.

On December 31, 2007 the IRS issued Notice 2008-13, which provides interim guidance to paid preparers of tax returns regarding how these new rules should be applied during 2008. The IRS also announced in the Notice that

they intend to revise the regulatory scheme governing tax return preparer penalties by the end of 2008, and requested public comments on these issues. Despite the helpful guidance provided by the IRS in the Notice, these new rules continue to pose challenges to the accounting profession and the government.

The Treasury Department seemingly acknowledged these challenges by including a proposal in President Bush's fiscal year 2009 budget, released in February 2008, that would conform the tax position disclosure threshold applicable to paid preparers to the disclosure threshold applicable to taxpayers, which is substantial authority. This proposal is similar to legislation introduced by Rep. Joseph Crowley (D-NY) in December 2007, which the AICPA has stated it strongly supports.

Mandatory cost basis reporting proposals

Lawmakers in Washington continue to show significant interest in a proposal that would require brokers to report cost basis information to their customers for many types of securities, including mutual fund shares, stocks and debt instruments. This proposal was initially set forth in Congress as a way to reduce the so-called Tax Gap, which is generally defined as the shortfall between the amount of tax voluntarily paid by taxpayers and taxpayers' actual liabilities. For the 2001 tax year, the IRS estimated that lost revenue from taxpayers' failure to accurately report capital gains accounted for approximately \$11 billion of the Tax Gap.

The concept of mandatory cost basis reporting by brokers enjoys support within Congress, where it was included in tax bills last year, but not enacted, and with the Bush Administration, where, in February 2008, it was included in the President's budget proposal for the second consecutive year. This proposal is likely to once again be considered by Congress in 2008, especially in bills where revenue offsets are needed.

The ICI has actively provided its views on mandatory cost basis reporting to the Congressional tax-writing committees. Some of the key observations the ICI made to Congress are:

- "A mandatory cost basis reporting regime will be costly and the cost will ultimately be borne by fund investors."
- Lawmakers must provide brokers a sufficient amount of time to implement systems and programming changes before the proposal is effective.

Many mutual fund families already calculate and provide the adjusted basis of fund shares sold to their shareholders as part of the year-end information reporting process. However, if such a proposal were enacted, it is possible that the law and any accompanying regulations could provide rules that would require a fund family to alter its current approach to calculating the amount of a shareholder's adjusted basis.

Summary of developments for the six months ended March 31, 2008

Accounting and financial reporting matters from the FASB, AICPA and SEC

On March 19, 2008 the FASB issued Statement No. 161 (FAS 161), Disclosures about Derivative Instruments and Hedging Activities. The new standard is intended to help investors better understand how derivative instruments and hedging activities affect an entity's financial position, financial performance and cash flows through enhanced disclosure requirements.

The new standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. <http://www.fasb.org/news/nr031908fas161.shtml>

On December 21, 2007 the SEC finalized the rule providing US issuers the option to use International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board. Previously, on August 7, 2007, the SEC issued a concept release relating to this issue. Final Rule: <http://www.sec.gov/rules/final/2007/33-8879.pdf>

Auditing matters from the PCAOB, AICPA and SEC:

On October 15, 2007, the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board issued Statement of Position (SOP) 07-2, "Attestation Engagements that Address Specified Compliance Control Objectives and Related Controls at Entities that Provide Services to Investment Companies, Investment Advisers, and other Service Providers." This SOP provides

guidance to auditors who are asked by investment companies' service providers to report on the suitability of the design and operating effectiveness of the service provider's controls in achieving specified compliance control objectives.

Compliance and regulatory matters from the SEC and others

On March 31, 2008, the U.S Treasury Department issued its blueprint proposals for reform of the regulatory structure for U.S. financial institutions. As a result of the recent financial market turmoil, the press reports focused on the need to overhaul the regulatory system to provide better oversight through three regulators, the market stability regulator, the prudential financial regulator and the business conduct regulator. In connection with the recommendation to merge the Securities and Exchange Commission and the Commodity Futures Trading Commission into the business conduct regulator, there are significant proposals that are relevant to the mutual fund industry and investment advisers. <http://www.treas.gov/press/releases/reports/Blueprint.pdf>

On March 13, 2008, the President's Working Group on Financial Markets (PWG) released recommendations for improving the US and global financial markets, which have experienced turmoil in recent months. The working group comprises the Secretary of the Treasury and the chairmen of the Federal Reserve Board, the Securities and Exchange Commission, and the Commodity Futures Trading Commission. Their objectives are to improve market transparency and disclosure, risk awareness and risk management, and oversight.

Their recommendations—issued in the form of a policy statement—aim to mitigate systemic risk, restore investor confidence and facilitate stable economic growth.

The group’s recommendations suggest the need for significant behavior changes and increased transparency for investors. The PWG intends to continue its assessment through the implementation of the recommendations by its members. The group plans to issue a progress statement in the fourth quarter 2008. Press Release and Policy Statement: <http://www.ustreas.gov/press/releases/hp871.htm>

On November 15, 2007 the SEC voted unanimously to propose rule changes intended to improve mutual fund disclosure. The proposed rules would require that all mutual fund investors receive a clear, concise summary of key information needed to make informed investment decisions. To achieve this, every mutual fund would be required to include key information in plain English in a standardized order at the front of the mutual fund statutory prospectus. The summary would include a fund’s investment objectives and strategies, risks, and costs. It also would include brief information regarding a fund’s top 10 portfolio holdings, investment advisers and portfolio managers, purchase and sale procedures and tax consequences, and financial intermediary compensation. Comments on this proposal were due by February 28, 2008. Press release: <http://www.sec.gov/news/press/2007/2007-234.htm>

Publications of interest to mutual fund directors

Independent Directors Council/Affiliates
(<http://www.idc1.org>)

Overview of fund governance practices: 1994 -2006, November 2007

http://www.idc1.org/getPublicPDF.do?file=fund_gov_practices_07

This overview focuses on a number of mutual fund board structures and practices common across the industry, and analyzes trends over the past 12 years. In general, while individual fund boards may differ, as a group they have gravitated toward practices thought to best serve the interests of shareholders.

Chief risk officers in the mutual fund industry: Who are they and what is their role within the organization?, August 2007

This report from the ICI is a compilation of information based on interviews with Chief Risk Officers (CROs) from 20 of the larger mutual fund organizations that have such a position. This publication is available to ICI members. Hard copies are also available from the ICI.

Board oversight of certain service providers, June 2007

<http://www.idc1.org/getPublicPDF.do?file=21229>

This report provides guidance for boards on the oversight of administrators, custodians, fund accounting agents, transfer agents and securities lending agents. The role of board oversight in selecting service providers is discussed, as well as the ongoing oversight of these providers.

Report of the working group on 12b-1, May 2007

http://www.ici.org/pdf/rpt_07_12b-1.pdf

This report presents the results of the Working Group's analysis and findings and the recommendations of the majority of its members relating to a broad range of distribution issues, including possible changes to Rule 12b-1.

ICI report on costs of eliminating discretionary broker voting on uncontested elections of investment company directors, December 2006

http://www.ici.org/pdf/wht_broker_voting.pdf

This report assesses the impact of the NYSE proposal to the SEC eliminating discretionary broker voting on uncontested elections of directors. The ICI surveyed its members and examined the costs associated with this proposal.

Independent director litigation risk, October 2006

<http://www.idc1.org>

This study assists mutual fund directors in understanding the nature of the director's litigation risk, as well as the management of such risk in private civil litigation.

Board consideration of fund mergers, June 2006

http://www.idc1.org/idc/idcarticle.do?file=task_force.jsp&division=menu4

In response to the increase in the number of fund mergers, this IDC report reviews the legal standards and business considerations relating to fund mergers and offers guidance to boards considering mergers of funds.

Fair value series: The role of the board, January 2006

<http://www.idc1.org>

This second installment of the joint IDC and ICI Fair Valuation Series provides an overview of the board's role in fair valuation and examples of the do's and don'ts that directors may want to consider. This publication is available to ICI and IDC members only.

An introduction to fair valuation, Spring 2005

<http://www.idc1.org>

This report from the IDC and ICI is the first installment of the Fair Valuation Series, and provides an overview of the issues to consider in developing and administering valuation policies and procedures.

IDC task force report on director oversight of mutual funds, May 2005

http://www.idc1.org/idc/idcarticle.do?file=task_force.jsp&division=menu4

This report examines the issue of independent director oversight of a number of funds within a single mutual fund complex. The report concludes that this arrangement is appropriate given the unique structure of mutual funds

and the benefits director oversight of multiple funds offers to shareholders, including enhanced board effectiveness and efficiency. It also highlights some of the strategies boards use to manage the increased workload inherent in the oversight of a number of funds.

IDC task force report on board self-assessments, February 2005

http://www.idc1.org/idc/idcarticle.do?file=task_force.jsp&division=menu4

This report addresses the requirement in the SEC's governance rules that all boards perform annual self-assessments. It provides guidance to boards implementing the requirement and outlines issues boards should consider.

IDC task force report on independent chair requirement, January 2005

http://www.idc1.org/idc/idcarticle.do?file=task_force.jsp&division=menu4

This report addresses the requirement adopted by the SEC that all boards of funds relying on certain exemptive rules be chaired by an independent director, and provides guidance to boards as they prepare to implement the new requirement. It outlines issues boards should consider, including those relating to the responsibilities of the independent chair and the selection and compensation of the independent chair.

Mutual Fund Directors Forum
(<http://www.mfdf.com>)

Practical guidance for directors on board self-assessments, January 2008

<http://www.mfdf.com/site/pages/documents/FinalSelf-AssessmentReport.pdf>

This report provides guidance on Board self-assessments and recommends that Boards ensure that every director is involved; provide all directors with adequate opportunity to discuss the findings that are made during the process; and plan follow-up action after the self-assessment is complete.

Rule 12b-1 best practices and practical guidance for mutual fund directors, May 2007

<http://www.mfdf.com/site/documents/12b-1Report.pdf>

This report released by the MFDF provides guidance and best practices for fund boards on the existing 12b-1 rule, although they also make clear there is a “strong need for a comprehensive reexamination” of this issue.

Cost implications of an independent chair and a 75% independent board, August 2005

<http://www.mfdf.com/site/pages/library.html>

The MFDF surveyed its members on the cost implications of the SEC’s changes regarding independent chair rule. Based on the responses, the MFDF found that the cost was on the low end of the SEC estimates, and the costs by fund were negligible.

Best practices and practical guidance for mutual fund directors, July 2004

http://www.mfdf.com/site/documents/best_pra.pdf

This report was written in response to a request from SEC Chairman Donaldson that the Forum, an organization of independent fund directors, develop written practical guidance and best practices for independent directors in areas in which director oversight and decision making is particularly critical for the protection of fund shareholders. The areas discussed include: board review of management contracts and fees; soft dollars, directed brokerage and revenue-sharing arrangements; valuation and pricing; Rule 12b-1 payments; and conflicts of interest between funds and their managers.

PricewaterhouseCoopers
(<http://www.pwc.com>)

**2008 Current Developments for Directors,
February 2008**

<http://www.pwc.com/Extweb/pwcpublications.nsf/docid/1F2C512AF2DBC07A852573FE0060E57A>

This publication looks at the key issues facing directors. Its purpose is to offer information, insights, and practical guidance so that directors' can meet the demands of their role more knowledgeably and enrich boardroom discussions. Key issues stand out in 2008 for directors include: implications of the changing credit markets; dealing with complexity and US competitiveness; spotlight stays on executive compensation; continued push for shareholder empowerment; financial reporting developments; SEC developments; developments impacting auditing.

Guide to Fair Value Measurements, December 2007

[http://www.pwc.com/extweb/pwcpublications.nsf/docid/0723aa0dfd9d4eff85257157000b870d/\\$File/PwC_FairValueGuide_Final07.pdf](http://www.pwc.com/extweb/pwcpublications.nsf/docid/0723aa0dfd9d4eff85257157000b870d/$File/PwC_FairValueGuide_Final07.pdf)

This guide describes the key concepts and requirements of FAS 157 and the fair value option, and includes specific discussion of the impact of the fair value measurement requirements in significant accounting areas. The purpose of this guide is to clarify a complex area of accounting by bringing together the relevant PricewaterhouseCoopers guidance on fair value measurements to provide an overall framework for the application of fair value measurements for the use of financial and non financial companies. It is expected that guidance will evolve as we all gain experience with this FASB pronouncement. See page 2 for additional information.

Working guide for an investment company's audit committee, October 2007

<http://www.pwc.com/extweb/pwcpublications.nsf/docid/93F100AF85AC247785257372002118B9>

The guide presents considerations for audit committees in a number of areas with significance to open- and closed-end funds' financial statements and their internal control, as well as matters pertaining to their relationships and communications with management and internal and independent auditors.

Strengthening internal control through forensic testing, July 2007

<http://www.pwc.com/extweb/pwcpublications.nsf/docid/DF75996E24A544878525735B00550C08>

This publication helps to explain the growing interest in forensic testing, while providing forensic testing guidance.

Similarities and differences*, A comparison of IFRS and US GAAP for investment funds, June 2007

<http://www.pwc.com/extweb/pwcpublications.nsf/docid/7FD21F10E3D4300B8525730400674531>

This publication is for those who wish to gain a broad understanding of the key similarities and differences between International Financial Reporting Standards (IFRS) and accounting principles generally accepted in the United States specifically applicable to investment funds.

Looking ahead: Strengthening the structural foundation of the US investment management industry – internal control, January 2007

<http://www.pwc.com/extweb/pwcpublishations.nsf/docid/5449A14C8BCD471D852572E60056721B>

Our 2007 “Looking Ahead” publication describes the current environment and recent industry developments that will require continued investments in internal control to achieve financial reporting, compliance and operations objectives.

Reporting practices of fund chief compliance officers: An investment management industry survey, August 2006

This survey contains information on the initial and important practices undertaken by fund CCOs in preparing and providing their annual (and, in some cases, interim) compliance reports. These practices, among others, pertain to the areas of focus of the annual reviews conducted, the development of the framework of the annual reports and their content, the manner in which the reports were presented and discussed with fund directors, and expectations about changes in fund compliance programs going forward. Please contact your PwC representative for a copy of this report.

2006 Global investment management survey, June 2006

<http://www.pwc.com/Extweb/onlineforms.nsf/docid/2BE83BF0B49ED3768525718E007C77D6>

The investment management industry will look very different in five years according to PricewaterhouseCoopers’ Global Investment Management Survey 2006, a survey of 81 investment management organizations from around the world.

Interactive data in the mutual fund industry – Your questions answered, June 2006

<http://www.pwcglobal.com/extweb/pwcpublishations.nsf/docid/00118548F6099A7885257199004B9E06>

“Interactive data” is a means to improving the transparency of information, and the SEC is encouraging its use. This publication will help you determine whether interactive data should be considered by your organization.

Rethinking postretirement benefits, June 2006

<http://www.cfodirect.pwc.com/CFODirectWeb/Controller.jpf?ContentCode=THUG-6QCTCY&ContentType=Content>

This PwC publication offers an in-depth look at the FASB postretirement accounting project, its impact on companies and capital markets, and the changing pact with the American worker.

Audit committee effectiveness – What works best, 3rd Edition, August 2005

<http://www.pwc.com/extweb/pwcpublishations.nsf/docid/ac69ad1832098eb585257045005267b1>

This report, sponsored by the Institute for Internal Auditors Research Foundation, captures how Audit Committee practices have developed and provides numerous examples of how leading Audit Committees are not just coping, but are succeeding in discharging their evolving and substantial responsibilities.

SEC

(<http://www.sec.gov>)

Progress report of the SEC Advisory Committee on Improvements to Financial Reporting, February 2008

<http://www.sec.gov/rules/other/2008/33-8896.pdf>

The progress report contains the Committee's developed proposals, conceptual approaches, and matters for future considerations on improving the financial reporting system in the United States. See page 7 for additional information.

Audit committees and auditor independence, April 2007

<http://sec.gov/info/accountants/audit042707.pdf>

This brochure published by the SEC's Office of the Chief Accountant highlights certain SEC rules and other authoritative pronouncements relevant to Audit Committee oversight responsibilities regarding the auditor's independence.

Literature review on independent mutual fund chairs and directors, December 2006

<http://www.sec.gov/rules/proposed/s70304/oeamemo122906-litreview.pdf>

<http://www.sec.gov/rules/proposed/s70304/oeamemo122906-powerstudy.pdf>

This is an SEC Office of Economic Analysis Memorandum prepared to review academic literature that examines the relationship between mutual fund governance (in particular, the presence of independent chairs and directors) and performance, expenses and compliance. In general, the analysis reports results to be consistent with two conclusions in the governance literature. First, boards with a greater proportion of independent directors

are more likely to make decisions, such as negotiating lower adviser fees that may potentially lead to higher returns. Second, no consistent evidence exists that chair or board independence is associated with lower fees and/or higher returns for fund shareholders in the various studies performed.

A second companion Memorandum, entitled "Power Study as Related to Independent Mutual Fund Chairs," examines whether the various studies performed demonstrate the existence of a statistically significant relationship between fund governance and performance, particularly with respect to board chair independence. The analysis suggests that most studies assessing the impact of chair independence on returns do not have sufficient power to reliably conclude that a relationship does or does not exist.

Exemptive rule amendments of 2004: The independent chair condition, April 2005

<http://www.sec.gov/news/studies/indchair.pdf>

This report responds to a requirement of the Consolidated Appropriations Act of 2005 to submit a report to the Senate Appropriations Committee that: (1) provides a justification for the final rules issued requiring, as a condition for reliance on 10 exemptive rules adopted by the SEC, that a mutual fund's board of directors be chaired by an independent director; and (2) analyzes whether mutual funds chaired by independent directors perform better, have lower expenses, or have better compliance records than mutual funds chaired by interested directors. The report's conclusions include that the relationship between an independent chairperson and fund performance and fees are inconclusive, and that the Commission and its staff continue to monitor how fund boards operate with an independent chair. Two SEC Commissioners objected to the conclusions of the report and submitted separate letters to the Senate Appropriations Committee to explain their objections.

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BS-BS-08-0630-A.0408.SHC