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Investment Management Developments

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SEC Steps Up Enforcement Efforts

Robert Khuzami, director of the Division of Enforcement of the Securities and Exchange Commission (SEC), recently announced plans to increase the SEC's enforcement efforts with the introduction of five national specialized units in the Division that will be dedicated to particular areas of securities law. Each unit will have a unit chief, and will be staffed nationally with people with expertise in a specific area.

The **Asset Management Unit**, which will work closely with the Office of Inspections, Compliance and Examinations, will focus on investment advisers, investment companies, hedge funds and private equity funds. Khuzami said that potential areas of focus for the unit may include disclosure, valuation, portfolio performance, due diligence and diversification, transactions with affiliates, misappropriation and conflicts of interest.

The **Market Abuse Unit** will focus on large-scale market abuses and complex manipulation schemes by institutional traders, market professionals and others. Khuzami said that the unit plans to build and use technological tools and screenings to analyze trading and activity across markets, allowing it to recognize patterns and relationships that it might not otherwise.

The **Structured and New Product Unit** will focus on complex derivatives and financial products, including credit default swaps and collateralized debt obligations and securitized products, while the **Foreign Corrupt Practices Act Unit** will focus on new and proactive approaches to identifying violations of the Foreign Corrupt Practice Act, which prohibits U.S. companies from bribing foreign officials for government contracts and other business. The fifth addition will be the **Municipal Securities and Public Pensions Unit**. Khuzami said that there are a number of areas that the unit will likely scrutinize, including offering and disclosure issues, tax and arbitrage-driven activity, unfunded or underfunded liabilities, and "pay to play" schemes.

In addition to these new units, effective August 11, 2009, the SEC amended its rules for one year to give enforcement staff the ability to issue subpoenas in connection with investigations under federal securities laws. In the past, the SEC would issue formal orders of investigation that authorized specifically-designated enforcement staff to exercise the SEC's statutory power to subpoena witnesses and take other related actions. The SEC is delegating the authority to issue formal orders of investigation to the Director of the Division of Enforcement, who will in turn delegate that authority to senior officers throughout the Division. This delegation will expedite the investigative process by reducing the time and paperwork previously associated with obtaining SEC authorization prior to issuing subpoenas. At the end of one year (*i.e.*, August 11, 2010), the SEC will evaluate whether to continue delegating that authority.

The Division is also streamlining its management structure with a number of internal changes, including redeploying branch chiefs to conduct investigations, and delegating the power to approve all routine case decisions to Division senior officers. In addition, Khuzami's approval will now be required for all tolling agreements.

Proposed New Regulatory Reform's Effect on Registered Funds

As widely reported, in mid-June 2009, the Obama Administration released a White Paper reshaping the U.S. financial regulatory system, with a plan to have reform in place before the end of 2009. This article discusses those proposals that may directly affect registered investment companies. The proposed reforms require the enactment of new legislation and rule changes; for each proposal, there now is concurrent legislation that has either been sent to Congress by the Administration, or introduced as a bill in one or both houses of Congress. At this time, it is unknown to what extent the Obama proposals may be enacted, and in what form. What follows is an overview of the key proposals addressed in the paper that may affect registered funds, as well as the related legislation currently being considered by Congress.

New Money Market Funds Regulation

In response to problems experienced by money market funds during 2008, the Administration is recommending that the SEC move to strengthen regulations surrounding money market funds. Specifically, the Administration has asked the SEC to:

- Require money market funds to maintain liquidity buffers;
- Reduce the maximum weighted average maturity of money market fund assets;
- Tighten applicable credit concentration limits;
- Improve credit risk analysis and management of money market funds; and
- Allow boards of money market funds to suspend redemptions in extraordinary circumstances to protect fund shareholders' interests.

However, the White Paper also stated that the Administration did not believe the above measures should be expected to prevent a run on money market funds "of the scale experienced in September 2008." Consequently, the Administration proposed that the President's Working Group on Financial Markets (the Working Group) prepare a report by September 15, 2009, that considers "fundamental changes to address systemic risk," which could include moving away from stable net asset values and/or requiring money market funds to have access to reliable emergency liquidity facilities from private sources. The due date of the report was later postponed to December 1, 2009, to give the group time to consider public comments. In addition, the proposal recommends that the SEC and the Working Group work to mitigate any potential adverse effects of a stronger regulatory framework, such as investor flight or reductions in the term of money market liabilities issued by financial firms.

The SEC recently proposed rule changes that mirror the proposals recommended by the Obama Administration. For more on those proposals, see our previous Investment Management Alert, "SEC Proposes Amendments to Rules for Money Market Funds," at http://www.drinkerbiddle.com/secrulesmmfunds/.

A "Reap What You Sow" Approach to Asset-Backed Securities

The White Paper seeks to address the recent problems with the asset-backed securities (ABS) market in which lenders and securitizers did not have sufficient incentives to consider the performance of the loans underlying the asset-backed securities. Accordingly, the White Paper recommends that federal banking agencies promulgate regulations requiring originators or sponsors of ABS to retain 5 percent of the credit risk of securitized credit exposures. In addition, the proposal calls for regulations that prohibit the originator from hedging or transferring that risk. It recommends that the agencies have the authority to provide exceptions or adjustments to the requirements, as needed, as well as to apply the requirements to securitization sponsors rather than loan originators.

The proposal also calls for the SEC to be given clear authority to require "robust ongoing reporting" by issuers of ABS. Specifically, the White Paper recommends that such reporting include providing investors and credit rating agencies with the information they need to assess the credit quality of the assets underlying the securitization at inception and throughout the life of the transaction, as well as to assess the other risks of ABS. In addition, the White Paper urges the industry to make the documentation for ABS transactions more transparent and understandable so that market participants can more easily assess the credit, market liquidity and other risks of ABS. The recommendations also suggest that the SEC and the Financial Industry Regulatory Authority (FINRA) expand the Trade Reporting and Compliance Engine (the standard electronic trade reporting database for corporate bonds) to include ABS.

Under legislation sent to Congress by the Administration in late July, banking regulators and the SEC would have the authority to issue regulations that require the securitizer of an ABS to retain 5 percent of the credit risk of the underlying assets. The legislation also expands the SEC's authority to require loan-level disclosure for ABS in a standard format in order to increase transparency of ABS.

Credit Rating Agencies' Disclosure

Another key component of the proposal is a recommendation that the SEC continue strengthening the regulation of credit rating agencies by requiring them to:

> Have policies and procedures that manage and disclose conflicts of interest;
> Differentiate the credit ratings assigned to structured credit products from those assigned to unstructured debt;
> Disclose credit rating performance measures for structured credit products in a way that allows comparisons across products and provides meaningful measures of the related uncertainty and potential volatility;
> Disclose what risks their credit ratings are designed to assess, as well as material risks not reflected in the ratings, including how the risks of structured products fundamentally differ from those of unstructured corporate debt; and
> Disclose sufficient information about their methodologies for rating structured finance products, including qualitative reviews of originators, so that users can reach their own conclusions about the methodologies.

At the same time, the proposals include recommendations for regulators to reduce their use of credit ratings in regulations and supervisory practices, when possible. The proposals also call for regulators to recognize the potential differences in performance between structured and unstructured credit products with the same credit rating. It also recommends that risk-based regulatory capital requirements reflect the risk of structured credit products, and minimize chances for firms to use securitization to reduce their regulatory capital requirements without a commensurate reduction in risk.

In late July, the Administration sent proposed legislation based on the above recommendations to Congress. This legislation is in addition to the proposed and adopted rule amendments released by the SEC in February 2009, which the Administration strongly supports. The proposed legislation would prohibit credit rating firms from consulting with any company that they also rate, as well as prohibit or require the management and disclosure of conflicts arising from the way a rating agency is paid, its business relationships, its affiliations or other conflicts. Each rating report would also disclose the fees paid by the issuer for a particular rating, as well as the total amount of fees paid by the issuer to the rating agency in the prior two years. Each rating agency would also be required to designate a compliance officer, and if a rating agency employee is hired by an issuer and that employee had worked on ratings for that issuer in the preceding year, that rating agency would be required to conduct a review of ratings to determine if any conflicts of interest existed, and adjust the ratings as necessary.

The legislation would also require disclosure of preliminary ratings to reduce "ratings shopping," as well as to use different symbols to distinguish the risk of structured products. In addition, the legislation would also require qualitative and quantitative disclosure of the risks and performance variance inherent in any given security.

The legislation would also establish a dedicated office within the SEC to strengthen supervision of rating agencies, and would make registration mandatory for all credit rating agencies. The SEC would then require each agency to document its policies and procedures for determination of the ratings, and the SEC would examine the internal controls, due diligence and implementation of rating methodologies.

The Treasury would also work with the Working Group, and presumably, its successor, the Financial Services Oversight Council, to determine where references to ratings can be removed from regulations, as well as require a General Accountability Office study on reducing reliance on ratings in federal and state regulations.

OTC Derivatives Regulation

The White Paper also recommends government regulation in several ways of the over-the-counter (OTC) derivatives markets, including credit default swaps. First, it recommends that all OTC derivatives be cleared through regulated central counterparties. In addition, the White Paper recommends that OTC derivatives dealers and other firms whose market activities create large exposure to counterparties be subject to a "robust and appropriate regime of prudential supervision and regulation" that will include:

> Conservative capital requirements;

> Business conduct standards;

> Reporting requirements; and

> Conservative requirements relating to initial margins on counterparty credit exposures.

The White Paper further recommends that the OTC derivatives market be made more transparent by amending the Commodities Exchange Act and related laws to authorize the Commodity Futures Trading Commission (CFTC) and SEC: to impose recordkeeping and reporting requirements (including an audit trail) on all OTC derivatives, as well as to ensure that they have "clear, unimpeded authority" to police and prevent fraud, market manipulation and other market abuses.

The SEC recently proposed rule changes that address the regulation of OTC derivatives regulation, based on the Obama Administration's recommendations. For more on those reforms, see the article on page 12 entitled, "Obama Administration Announces New Derivatives Trading Reform."

Harmonizing the Role of the CFTC and SEC

Also included in the proposal are recommendations that the CFTC and SEC identify all existing conflicts in statutes and regulations and recommend changes in a report to be delivered to Congress by September 30, 2009, in an effort to harmonize the regulation of futures (under the CFTC's purview) and securities (under the SEC's). The White Paper noted that, in many instances, the overlapping yet different regulatory authorities of both agencies has resulted in protracted legal disputes about whether a specific product should be regulated as a future or a security. The report would either explain why the differences in regulation of economically equivalent instruments are essential to protecting investors and maintaining market integrity and price transparency, or make recommendations for changes to eliminate the differences. If the SEC and CFTC cannot agree on recommendations and explanations of differences, the White Paper recommends that the issue be referred to the Financial Services Oversight Council, which should be required to address the differences and report to Congress within six months of its formation.

The SEC and CFTC recently began meeting in order to reach agreement on their respective roles.

Federal Reserve Oversight of Payment, Clearing and Settlement Systems

The White Paper proposes that the Federal Reserve have the responsibility and authority to conduct oversight of systemically important payment, clearing and settlement systems, and activities of financial firms. Under the proposal, the Federal Reserve would have the authority to collect information from any payment, clearing or settlement system to assess whether the system is systemically important. Each system would be subject to "regular, consistent and rigorous on-site safety and soundness examinations." If the system is already regulated by the CFTC or SEC, those agencies would remain the primary regulators of the system. That is, if the system is already subject to comprehensive regulation by either agency, they would lead those exams and reviews, though the Federal Reserve would have the right to participate, including to determine the scope and methodology of the exam or review. The CFTC or SEC would continue to have primary authority for enforcement. However, if the Federal Reserve and market regulator could not agree on the need for enforcement, the Federal Reserve would have emergency authority to take enforcement action, after consulting with the newly created Financial Services Oversight Council, which would attempt to mediate the differences.

The Obama Administration sent legislation to Congress at the end of July regarding this proposal. The legislation would create a Financial Services Oversight Council, which would replace the President's Working Group on Financial Markets and would have a permanent, full-time staff at the Department of the Treasury. The Council would have eight members: 1) the Secretary of the Treasury, who would serve as the Chair; 2) the Chairman of the Board of Governors of the Federal Reserve System; 3) the Chairman of the CFTC; 4) the Director of the proposed Consumer Financial Protection Agency; 5) the Chairperson of the Federal Deposit Insurance Corporation; 6) the Director of the Federal Housing Finance Agency; 7) the Director of the proposed National Bank Supervisor; and 8) the Chairman of the SEC. The country's largest financial firms that are found to pose a threat to the economy's financial stability based on their size, leverage and interconnectedness, dubbed "Tier 1 financial holding companies," would be subject to strong, consolidated supervision and regulation, and would face more conservative prudential standards than other bank holding companies.

In addition, the legislation would give the Federal Reserve strong statutory authority to oversee systemically important payment, clearing and settlement activities and systems. The Federal Reserve would be required to consult with the Council and to coordinate oversight with the CFTC and SEC, which will remain primary regulators of such systems.

Change in Prospectus Delivery Timing, Additional Investor Protections

The Administration also proposes authorizing the SEC to require that certain disclosures, including a summary prospectus, be provided to investors at or before the point of sale, rather than with the sale confirmation, as is generally the case now. Relatedly, the Administration suggests that the SEC should be given the monies to do more field testing, consumer outreach and testing of disclosures to individual investors. In addition, the Administration has also called for the SEC to establish a fiduciary duty for broker-dealers offering investment advice. It also recommends empowering the SEC to examine and ban forms of compensation that encourage intermediaries to put investors into products that are profitable to the intermediaries, but not in the investors' best interest. The proposal also suggests new legislation that would provide "simple and clear disclosure" to investors about the scope of their relationships with investment professionals, as well as prohibit certain conflicts of interest and sales practices.

In addition, the Administration is recommending legislation that would give the SEC the authority to:

- Conduct a study on the use of mandatory arbitration clauses in investor contracts, as well as the authority to potentially prohibit mandatory arbitration clauses in broker-dealer and investment advisory accounts with retail customers;
- Establish a fund to pay whistleblowers for information that leads to enforcement actions with significant financial rewards; and
- Expand available sanctions.

Legislation regarding the above recommendations was sent to Congress by the Obama Administration in mid-July. Specifically, the legislation would give the SEC authority to establish a fiduciary duty for any broker, dealer or investment adviser who gives investment advice about securities. The SEC would also have the authority to examine and ban forms of compensation that encourage financial intermediaries to steer investors into certain products that are profitable to the intermediary. The legislation also would give the SEC authority to prohibit mandatory arbitration clauses in broker-dealer, municipal securities dealer, and investment advisory agreements.

In addition, the legislation would give the SEC the authority to regulate the quality and timing of disclosures and prospectuses, including that it could require a summary prospectus and disclosure of fund expenses prior to the completion of fund sales. While the SEC adopted final rules adopting the use of a summary prospectus in January 2009, there is currently no proposed rule that requires a summary prospectus or other disclosure to be delivered prior to the completion of fund sales. The legislation would also encourage additional consumer testing by the SEC.

The legislation would also harmonize liability standards among securities laws, and rectify inconsistencies. Currently, an individual barred from being an investment adviser because of misconduct can still apply to become a broker-dealer. The legislation would give the SEC authority to remove regulated persons from all aspects of the securities industry. Lastly, the legislation would make permanent the recently established Investor Advisory Committee.

Potential Reform of Target Date Funds

On June 18, 2009, the SEC and the Department of Labor (DOL) held a joint hearing to address concerns regarding target date mutual funds. Target date funds are mutual funds that allocate their investments among various asset classes, automatically adjusting their allocation to more conservative investments as their target date approaches. Because of their “set it and forget it” appeal, target date funds are a rapidly growing industry. They are available in approximately 77 percent of company retirement plans and are often used as default investment selections because they are approved as a qualified default investment alternative by the DOL. Target date funds are forecasted to make up 20 percent of defined contribution savings by 2010, and 33 percent by 2015.

Despite their popularity with investors, target date funds have recently faced sharp criticism due to the widely divergent performance figures of funds with the same target date during the 2008-2009 market turmoil. According to SEC Chairman Mary Schapiro, in 2008 for example, losses among 2010 target date funds ranged between -3.6 percent and -41 percent. The divergence has highlighted the fact that funds with the same target year may have varying investment strategies and approaches to asset allocation. Consequently, the SEC and others have expressed concern that the names of target date funds lead investors to make incorrect assumptions about income guarantees and asset allocation/risk exposure of the funds on certain dates.

Several different recommendations were made to the SEC and DOL at the joint hearing. Sen. Herb Kohl (D-Wis.), chairman of the Senate Special Committee on Aging, recommended regulations to standardize the composition of target date funds. Industry representatives, however, strongly opposed regulations that would cap equity exposure or otherwise standardize asset allocation paths (glide paths) that funds follow to reduce their equity exposure and become more conservative over time. The Investment Company Institute (ICI) recommended better educating investors about divergent investment strategies of target date funds by disclosing the following in a prominent manner:

- The relevance of the target date, including what happens on that date;
- The fund's assumptions about investors' withdrawal intentions at and after the target date;
- The age group for which the fund is designated;
- An illustration of the fund's glide path; and
- A statement in the risk disclosure section that indicates that there are investment risks associated with target date funds and that the fund is not guaranteed.

Thus far, the SEC has stated that it will examine whether the use of a particular target date in a fund's name is misleading, and consider whether its rule governing fund names should be revised to require clarification when target dates are included in fund names.

SEC Proposes Shareholders' Rights Rules; Enhanced Governance Disclosure

Recently, the SEC proposed a new rule and amendment that would give certain shareholders the right to nominate directors on corporate boards—including registered investment companies—as well as to modify nomination procedures. According to SEC Chair Schapiro, the proxy access initiative is intended to empower shareholders by giving them a meaningful opportunity to nominate directors to boards. Proxy access to shareholders is highly controversial, however, and if the rule and amendment are adopted, it is likely that the SEC will see opposition and, potentially, even legal action.

The SEC also recently proposed rule amendments to enhance governance disclosure for proxy and registration statements. Importantly, the SEC is also proposing mandated disclosure with respect to a board's role in oversight of risk management.

Shareholder Nominees in Proxy Materials

Proposed new Rule 14a-11 to the Securities Exchange Act of 1934 (the Exchange Act) would give certain shareholders the ability to include a nominee, or nominees, for director in company proxy materials, as long as the investment company's governing documents (such as the charter and bylaws) or the relevant state law do not otherwise prohibit it. Under the proposal, shareholders would be able to use shareholder proposals to modify the company's nomination procedures or disclosure about elections, as long as those proposals do not conflict with fund governing documents, state law or SEC rules.

To be eligible to have their nominee(s) in the proxy materials, the shareholder or shareholders must meet certain proposed threshold stock ownership and other requirements. The percentages required range from 1 percent to 5 percent, depending on the size of the company, as follows:

Size of Company	Percentage Required
Registered investment company with net assets of $700 million or more	At least 1 percent
Registered investment company with net assets of $75 million-$699.9 million	At least 3 percent
Registered investment company with net assets of less than $75 million	At least 5 percent

In order to meet the above thresholds, shareholders would be permitted to aggregate their holdings. The shareholders must own that percentage of the fund's securities for at least one year, and in the case of a shareholder group, each member of the group would have to meet the requirement.

Shareholders who submit nominees would be required to notify the fund of their intent in order for the shareholders' nominees to be included in the proxy materials, and the shareholders must also file the notice (called Schedule 14N) with the SEC on the date it is provided to the fund. The notice would need to be provided by the date set by a fund's advance notice provisions, or in the absence of a provision, no later than 120 calendar days before the date the fund mailed its proxy materials the prior year.

Schedule 14N would require the following:

> Name and address of the nominating shareholder or each member of the nominating shareholder group;

> Disclosure of the amount and percentage of securities owned and entitled to vote at the meeting;

> A written statement from the record holder verifying that the shareholders had held the securities for at least one year as of the date of the notice on Schedule 14N;

> A written statement regarding the nominating shareholder's or group's intent to continue to own the requisite shares through the shareholder meeting at which directors are elected, as well as the shareholder's intent regarding continued ownership after the election; and

> A certification that to the best of the nominating shareholder's or group's knowledge and belief, the securities are not held for the purpose or effect of changing the control of the issuer or gaining more than a limited number of seats on the board of directors.

Qualifying shareholders would be able to include at least one shareholder nominee in the proxy materials, but not more than 25 percent of the board of directors, whichever is greater. That is, if a board has 12 directors, a qualified shareholder could include up to 3 qualified nominees in the proxy materials.

Requirements for Funds that Receive Notice from a Nominating Shareholder or Group

Within 14 days of receiving notice, the fund would be required to notify the shareholder or group if it determines that it may exclude the nominee. A fund may determine that it is not required under proposed Rule 14a-11 to include a nominee in its proxy materials if it determines any of the following:

> Proposed Rule 14a-11 is not applicable to the fund (*i.e.*, applicable state law or a company's governing documents prohibit shareholders from nominating candidates for the board of directors; however, if a company's governing documents do prohibit nomination rights, shareholders who want to amend the provision may seek to do so by submitting a shareholder proposal.);

> The nominating shareholder or group has not complied with the requirements of the Rule;

> The nominee does not meet the requirements of the Rule;

> Any representation required to be included in the notice to the fund is false or misleading in any material respect; or

> The fund has received more nominees than it is required to include by proposed Rule 14a-11 and the nominating group is not entitled to have its nominee included under the criteria proposed in Rule 14a-11(d)(3).

The shareholder or group then has 14 days to respond. If the fund determines that it may still exclude the nominee, the fund must provide notice to the SEC and the nominating shareholder or group of its intent to exclude, and the notice must be provided at least 80 days before it files the fund definitive proxy materials with the SEC. At its discretion, as soon as practicable, the SEC staff may provide an informal statement of its views on the matter to the fund and nominating shareholder. At least 30 days prior to filing its definitive proxy statement, the fund must then provide the nominating shareholder or group with notice of whether it will include or exclude the nominee(s).

A fund would not be required to include a shareholder nominee in its proxy materials if his or her candidacy or board membership would violate controlling state or federal law, or the rules of a national securities exchange or national securities association. In addition, the nominating shareholders would have to represent that their nominee is not an "interested person" as defined in Section 2(a)(19) of the Investment Company Act of 1940 (1940 Act).

The fund would include in its proxy materials disclosure regarding the nominating shareholder, as well as the nominees themselves. The SEC is proposing amending Rule 14a-9 so that a nominating shareholder or group relying on Rule 14a-11, an applicable state law provision, or a company's governing documents to include a nominee in company proxy materials would be liable for any materially false or misleading statements in information provided by the nominating shareholder or group to the company (in its shareholder notice on Schedule 14N). Likewise, the proposed rule also contains express language that the fund company would not be responsible for information that is provided by the nominating shareholder or group under Rule 14a-11 and then repeated by the company in its proxy statement, except where the company knows or has reason to know that the information is false or misleading. In addition, any information that is provided to the fund company in the notice from the nominating shareholder or group under Rule 14a-11 and then included in the company's proxy materials would not be incorporated by reference into any filing under the Securities Act of 1933, the Exchange Act or the 1940 Act unless the company specifically incorporates it.

The SEC is also proposing an amendment to codify prior staff interpretations regarding the types of proposals that fund companies could continue to exclude. Specifically, a fund company could exclude a shareholder proposal under amended Rule 14a-8(i)(8) if it would:

- Disqualify a nominee who is standing for election;
- Remove a director from office before his/her term expired;
- Question the competence, business judgment or character of a nominee or director;
- Nominate a specific individual for election to the board of directors, other than pursuant to Rule 14a-11, an applicable state law provision or a company's governing documents; or
- Otherwise affect the outcome of the upcoming election of directors.

Enhanced Disclosure for Proxy and Registration Statements

In early July, the SEC also proposed amendments to enhance corporate governance disclosures that registrants are required to make in their proxy and information statements, annual reports and registration statements under the securities laws. The proposed amendments have two major elements that expressly relate to registered investment companies: enhanced director and nominee disclosure, and new disclosure about the structure of fund boards and the board's role in the risk management process.

Specifically, the SEC is proposing to amend Item 401 of Regulation S-K to enhance disclosure for each director and director nominee so that it details the particular experience, qualifications, attributes or skills that qualify that person to serve as a director of the company and as a member of any committee that the person serves on or is chosen to serve on, in light of the company's business and structure. The expanded disclosure would apply to incumbent directors as well as nominees.

In addition, the SEC has proposed required disclosure of any directorships of public companies held by each director and nominee at any time during the past five years. It also proposed to increase the reporting period for specified legal proceedings involving directors, executive officers and persons nominated to become directors that are material to an evaluation of the ability or integrity of any director, director nominee or executive officer from five years to 10 years.

The SEC also proposed a new disclosure requirement to Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A that would require disclosure of a company's leadership structure (*e.g.*, whether and why a lead independent director is designated, and the role the lead independent director plays in the leadership of the company) and why the company believes it is the best structure for it at the time of filing. The fund would also be required to disclose whether the board chair is an "interested person" of the fund, as defined in Section 2(a)(19) of the 1940 Act. If the chair is an interested person, a fund would be required to disclose whether it has a lead independent director and what specific role the lead independent director plays in the leadership of the fund.

Risk Management Disclosure

The SEC proposed to require disclosure in proxy and information statements about the board's role in the fund's risk management process and the effect that this has on the fund's leadership structure. According to the Release, the SEC believes it is important for investors to understand a board's, or board committee's role in this area, given the role that risk and adequacy of risk oversight have played in the recent market crisis. According to the Release, such disclosure might include:

> How the board implements and manages its risk management function;

> Whether the persons who oversee risk management report directly to the board as a whole, or to one of the board's standing committees; and

> Whether and how the board or board committee monitors risk.

The proposals would amend the disclosures in proxy statements (in Schedules 14A and 14C), as well as Forms N-1A and N-2. Comments on the proposed amendments regarding this enhanced disclosure were due by September 15, 2009.

Obama Administration Announces New Derivatives Trading Reform

The Obama Administration delivered legislative language to Congress in mid-August that details regulatory reform of OTC derivatives. The proposed legislation follows up on the discussion of OTC reform in the Administration's white paper, "Financial Regulatory Reform: A New Foundation." As part of the Administration's proposed legislation, credit default swap markets and all other OTC derivative markets will be subject to comprehensive regulation.

Specifically, the proposals would require that standardized OTC derivatives be centrally cleared by a derivatives clearing organization regulated by the CFTC or a securities clearing agency regulated by the SEC. Similarly, standardized OTC derivatives will have to be traded on a CFTC- or SEC-regulated exchange or alternative swap execution facility.

In addition, the legislation will require higher capital and margin requirements for non-standardized derivatives, in an effort to facilitate substantial migration of OTC derivatives onto central clearinghouses and exchanges. At the same time, any OTC derivative that is accepted for clearing by any regulated central clearinghouse will be presumed to be standardized.

The legislation also requires transparency for all OTC derivative markets by giving all relevant federal financial regulatory agencies access (on a confidential basis) to the OTC derivative transactions and related positions of individual market participants. Likewise, the public would have access to aggregated data on open positions and trading volumes.

The proposed legislation also would regulate any firm that deals in OTC derivatives and any other firm that takes large positions in OTC derivatives. Those dealers and major market participants that are banks would be regulated by the federal banking agencies, while those that are not would be regulated by either the CFTC or SEC.

Enhanced Municipal Securities Disclosure

In mid-July, the SEC voted unanimously to propose rule amendments to improve the quality and timeliness of municipal securities disclosure. The enhanced disclosure requirements are designed to provide investors (such as mutual funds) with better notice of adverse events affecting a bond issuer and the bond offering. The amendments would also expand the rule to cover variable rate demand obligations.

Currently, the following events, if material, require notice: 1) principal and interest payment delinquencies; 2) non-payment related defaults; 3) unscheduled draws on debt service reserves reflecting financial difficulties; 4) unscheduled draws on credit enhancements reflecting financial difficulties; 5) substitution of credit or liquidity providers, or their failure to perform; 6) adverse tax opinions or events affecting the tax-exempt status of the security; 7) modifications to rights of security holders; 8) bond calls; 9) defeasances; 10) release, substitution or sale of property securing repayment of the securities; and 11) rating changes.

The SEC proposes amending Rule 15c2-12 under the Exchange Act to include notice of four additional events: 1) tender offers; 2) bankruptcy, insolvency, receivership or similar proceeding of the obligated person; 3) consummation of a merger, consolidation or acquisition involving an obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and 4) appointment of a successor or additional trustee, or the change of name of a trustee, if material.

The amendments would also delete the condition in Rule 15c2-12 that requires notice of all of the listed events only "if material." Instead, the SEC proposes that notice of the following events be given, regardless of a materiality determination, because of their importance to investors: 1) principal and interest payment delinquencies with respect to the securities being offered; 2) unscheduled draws on debt service reserves reflecting financial difficulties; 3) unscheduled draws on credit enhancements reflecting financial difficulties; 4) substitution of credit or liquidity providers, or their failure to perform; 5) defeasances; and 6) rating changes.

A copy of the release is available at http://www.sec.gov/rules/proposed/2009/34-60332.pdf.

SEC Short Sale Regulation

The SEC has issued two announcements recently relating to the regulation of short sales. First, on July 27, 2009, the SEC announced several actions aimed at preventing short sale abuses and increasing public disclosure of short sale information. More recently, on August 17, 2009, the SEC announced that it is seeking public comment on a new approach to short selling price test restrictions (uptick rule) that differs from the two approaches previously proposed.

Effects of the Actions Announced on July 27:

The actions announced on July 27 affect temporary rules enacted in October 2008 to stop short sale abuses. The SEC 1) made permanent a rule designed to curtail naked short selling, 2) allowed a short sale reporting interim rule to expire, and 3) announced a public roundtable on September 30, 2009, to discuss additional short sale measures. These actions are discussed in more detail below.

- ***Permanent Amendment to Regulation SHO.*** Rule 204 of Regulation SHO makes permanent the provisions of the Interim Final Temporary Rule 204T which was adopted on October 17, 2008, and expired on July 31, 2009. Rule 204 requires that clearing firms or their participating broker-dealers purchase or borrow securities of like kind and quantity to close out any positions in which shares of equity securities have not been delivered by the close of business on the settlement date (a "fail to deliver"). Failure to satisfy the close-out requirement results in a penalty under which a clearing firm, or its participating broker-dealer, cannot accept a short sale order in the relevant security or effect a short sale in the security for its own account unless it first borrows or enters into a bona fide agreement to borrow the security (a "pre-borrow requirement"). The restriction remains in place until the clearing firm closes out the fail to deliver position by purchasing securities of like kind and quantity and the purchase has been cleared and settled.

- ***Expiration of Rule 10a-3T.*** Interim rule 10a-3T under the Exchange Act expired on July 31, 2009. Rule 10a-3T required certain institutional investment managers to provide short sale and short position information for Section 13(f)securities [1] (excluding options) to the SEC on Form SH. Instead of making permanent the interim final rule, the SEC announced that it is working together with several self regulatory organizations (SROs) to increase the public availability of short sale related information through a series of other actions. The SEC has not yet specified which SROs it anticipates will participate. These actions include:

  - *Daily Publication of Short Sale Volume Information.* The SROs will begin publishing on their websites the aggregate short selling volume in each individual equity security for that day.

  - *Disclosure of Short Sale Transaction Information.* The SROs will begin publishing on their websites on a one-month delayed basis information regarding individual short sale transactions in all exchange-listed equity securities.

  - *Twice Monthly Disclosure of Fails to Deliver Data.* The SEC will enhance the publication on its website of fails to deliver data so that fails to deliver information is provided twice per month and for all equity securities, regardless of the fails level.

[1] Section 13(f) securities generally include equity securities that trade on an exchange or are quoted on the Nasdaq National Market, some equity options and warrants, shares of closed-end investment companies, and some convertible debt securities. A current list of 13(f) securities is available at: http://www.sec.gov/divisions/investment/13flists.htm

> ***Public Roundtable.*** The SEC intends to hold a public roundtable on September 30, 2009, as part of its examination of whether additional measures are required to address short sale abuses and enhance market quality. The roundtable will focus on securities lending, pre-borrowing, and possible additional short sale disclosures. The roundtable of investors, issuers, financial services firms, SROs and academics will consider, among other things:

- Adding a short sale indicator to the tapes;
- Requiring public disclosure of individual large short positions;
- A mandatory pre-borrow requirement (potentially on a pilot basis); and
- Securities lending issues, such as compensation, disclosure, collateral and cash-reinvestment.

New Short Sale Prohibition Considered:

The August 17, 2009, release announced that the SEC is reopening the comment period to the "Amendments to Regulation SHO" (originally closed on June 19, 2009) to allow comments on a new "alternative uptick rule." The alternative uptick rule would allow short selling only at an increment above the national best bid. This approach is an alternative to two previous approaches the SEC had proposed in April 2009: 1) a permanent market-wide short sale restriction based on either the last sale price or the national best bid and/or 2) a "circuit-breaker" approach that would restrict short sales for a particular security if the price of that security experienced severe declines.

The alternative uptick rule differs from the previous market-wide short sale prohibitions as it would not allow short selling at the current national best bid or last sale price. The SEC noted that because the alternative uptick rule would only permit short selling at an increment above the national best bid, it would not allow short sales to get immediate execution (even in an advancing market) and therefore would restrict short selling to a greater extent than either of the proposed market-wide short sale restrictions. The SEC recognized that this greater restriction could potentially lessen some of the benefits of short sales, such as increased market liquidity and greater pricing efficiency. The SEC also noted that the alternative uptick rule could possibly be implemented more quickly and with less cost than the prior proposals.

Comments on this alternative were due by September 21, 2009. The SEC particularly sought comments on the alternative uptick rule as a permanent market-wide approach and whether the alternative uptick rule should be combined with a circuit breaker approach.

No-Action Relief for TALF Loans

In a recently issued no-action letter to Franklin Templeton Investments, SEC staff stated that it would not recommend enforcement action against an open-end or closed-end registered investment company if its funds participate in the government-offered Term Asset-Backed Securities Loan Facility (TALF). Prior to this no-action letter, although investment companies were included in the definition of an "eligible company" able to participate in TALF, they were unsure how to participate in TALF loans without violating the limitations on senior securities and custodial requirements set forth in the 1940 Act.

Section 18 of the 1940 Act generally restricts the ability of funds to issue or sell senior securities without meeting certain asset coverage requirements. In a policy statement published in Release No. IC-10666 (Apr. 18, 1979), the SEC took the position that the restrictions of Section 18 also applied to reverse repurchase agreements, firm commitments and standby commitments, and noted that it would view securities with comparable effects on a fund's capital structure in the same manner. The SEC further stated that the concerns underlying Section 18, however, could be alleviated if an investment company establishes and maintains segregated accounts to cover the fund's obligations created by transactions in such securities. In its request for no-action relief, Franklin Templeton said that TALF loans would affect a fund's capital structure in a manner analogous to the effect of reverse repurchase agreements, and proposed to address the asset coverage requirements of Section 18 by establishing and maintaining separate accounts in the manner set forth in Release No. IC-10666 for reverse repurchase agreements. In response, the SEC agreed that it would not recommend enforcement under Section 18 of the 1940 Act if the funds took TALF loans without treating the borrowing as a senior security for purposes of compliance with Section 18.

Section 17(f) and the rules thereunder set forth various requirements with regard to the custody of fund securities. The TALF program, however, is structured in a manner such that a primary dealer may hold assets as an agent of the fund in violation of the requirements of Rule 17f-1. Franklin Templeton's request for no-action relief noted that the safekeeping concerns underlying Rule 17f-1 and Section 17(f) were not raised by the TALF program. In response, the SEC staff stated that it would not recommend enforcement under Section 17(f) with respect to the funds' participation in the "unique custody arrangement necessitated by the TALF program."

For a copy of the no-action letter please see: http://www.sec.gov/divisions/investment/noaction/2009/franklintempleton061909.htm

SEC Grants No-Action Relief for Foreign Funds Investing in U.S. Funds in Excess of 1940 Act Limitations

On August 4, 2009, the staff of the SEC granted no-action relief to a group of foreign investment companies (Foreign Funds) in connection with purchases of shares of registered U.S. investment companies (U.S. Funds) in excess of the amounts limited by Sections 12(d)(1)(A)(ii) and (iii) of the 1940 Act. *Dechert LLP*, SEC No-Action Letter (pub. avail. Aug. 4, 2009) (No-Action Letter). Sections 12(d)(1)(A)(ii) and (iii) prohibit an investment company and companies it controls from investing more than 5 percent of its total assets in any one acquired registered investment company and more than 10 percent of its total assets in all acquired investment companies. Congress enacted Section 12(d)(1) to prevent abuses inherent with the pyramiding of ownership caused by one investment company owning shares in another.

The Foreign Funds argued, and the SEC agreed, that the acquired U.S. Funds and their shareholders remain protected from the abuses of pyramiding ownership, specifically the improper exercise of voting control and undue influence from the threat of redemptions, by Sections 12(d)(1)(A)(i) and (B), which restrict an acquiring fund from owning more than 3 percent of any one investment company and restrict a fund from knowingly selling more than 3 percent of its shares to any one investment company and more than 10 percent to investment companies generally. The Foreign Funds contended that the SEC has no regulatory interest in enforcing the provisions of Section 12(d)(1) from which the Funds sought no-action relief, because these provisions are intended solely to protect U.S. funds and their shareholders, and not foreign funds and their shareholders, from duplicative fees and unnecessary complexity. In this case, the Foreign Funds represented that they would not offer any interests in the U.S. or to U.S. persons.

The SEC granted relief relying on the Foreign Funds' representations that:

1) Each Foreign Fund will not offer to sell securities to any "U.S. Persons" as defined in Rule 902(k) under Regulation S of the Securities Act of 1933 (Regulation S);

2) Each Foreign Fund will sell securities only in the United States consistent with the definition of "Offshore Transactions" as defined in Regulation S;

3) Each Foreign Fund will hold no more than 3 percent ownership of any one U.S. Fund after acquisition pursuant to Section 12(d)(1)(A)(i); and

4) Each U.S. Fund will not knowingly sell more than 3 percent of its outstanding voting stock to any single investment company or more than 10 percent to investment companies generally pursuant to Section 12(d)(1)(B).

The SEC's ruling presents an opportunity for U.S. registered investment companies to seek investments from foreign funds that have previously been unable to gain significant exposure to the U.S. securities markets through a single investment vehicle because of the limitations of Sections 12(d)(1)(A)(ii) and (iii). Domestic registered investment companies seeking investments from foreign funds must still comply with Section 12(d)(1)(B) and should monitor closely the amount of their voting securities that will be held by investment companies, including foreign investment companies, after the sale of their securities.

A copy of the No-Action Letter is available at http://www.sec.gov/divisions/investment/noaction/2009/dechert080409.htm.

SEC Proposes New Rules to Curb 'Pay to Play' Activity

The SEC recently proposed new rules under the Investment Advisers Act of 1940 (Advisers Act) aimed at curtailing "pay to play" activity. The proposed rules are intended to prevent advisers from making political contributions or other payments to influence their selection by government officials to provide advisory services for public programs such as public pension plans and 529 Plans (Plans). The practice is rarely explicit, and the result is that these Plans may be subject to inferior advisory services and higher fees.

Proposed rule 206(4)-5 of the Advisers Act has three prohibitions:

1) ***Two-Year Timeout.*** The SEC would prohibit investment advisers from providing advisory services for compensation to a governmental entity within

two years after the adviser, any of its partners, executive officers or solicitors (including any PAC controlled by the adviser) made a contribution to an elected official who could influence the selection of the adviser.

Executive officers would include the adviser's president, vice presidents in charge of a principal business unit or division of the adviser, and other officers or persons who perform investment advisory services, solicit for an adviser, or supervise, directly or indirectly, other executive officers. Contributions by non-executive employees would not trigger the rule's prohibitions. Government entities under the proposed rule include all state and local governments, their agencies and instrumentalities, and all public pension plans and other collective government funds. An official would include an incumbent, candidate or successful candidate for elective office of a government entity if the office is directly or indirectly responsible for, or can influence the outcome of, the selection of an adviser, or has authority to appoint any person who could do so. Contributions would generally be any gift, subscription, loan, advance, deposit of money or anything of value made for the purpose of influencing an election, including any payments for election debt, or transition or inaugural expenses.

Contributions made would be attributed to any other adviser that employs or engages the person who made the contribution within the two-year period. Likewise, the two-year time out would continue in effect after the person who made the triggering contribution left the advisory firm.

The proposed rule does allow for an exception that permits advisers' employees to contribute up to $250 to public officials if the employees are entitled to vote for that official. There is also an exception intended to address situations in which the adviser triggers the ban inadvertently, which would be available for contributions made to officials other than those for whom they were entitled to vote and which, in the aggregate, do not exceed $250 to any one official, per election. The adviser must have discovered the contribution within four months of it being made, and cause it to be returned within 60 days of that date. No adviser would be entitled to rely on that exception more than twice in a 12-month period. In addition, advisers could apply to the SEC for exemptive relief from the rule when imposition of it is inconsistent with the rule's intended purpose or when it is triggered by inadvertent contributions.

2) ***Third Party Solicitor Ban.*** An adviser would be prohibited from providing or agreeing to provide, directly or indirectly, payment to any person who is not a related person of the adviser for solicitation of government advisory business on behalf of such adviser. The ban would apply to placement agents and consultants as well.

3) ***Ban on Coordinating/Soliciting Contributions.*** The third component of the SEC's proposed rulemaking is a ban on coordinating or soliciting contributions or payments for officials of government entities to which the investment adviser is seeking to provide investment advisory services. This proposal also extends to political parties of states or localities in which the investment adviser is providing advisory services to government entities.

In addition, the SEC proposed an amendment to Rule 204-2 of the Advisers Act, which would require registered advisers with government clients to make and keep certain records of contributions made by the adviser, its partners, executive officers and solicitors. Specifically, the rule would require advisers to make and keep a list of its partners, executive officers and solicitors; the states in which the adviser has or is seeking government clients; the identity of those clients and the contributions made. The records would be confidential and reviewed by SEC staff only in the course of an adviser examination.

The SEC has also proposed a "catch all provision," which makes it unlawful for investment advisers or their executives or employees to do anything indirectly which, if done directly, would result in a violation of Rule 206(4)-5. This rule would prevent advisers from circumventing the rule by directing or funding contributions through third parties such as attorneys or family members.

The SEC is recommending that the proposed rules apply to investment advisers as well as those who use the private adviser exemption (*i.e.*, those advisers with fewer than 15 clients) available under 203(b)(3) of the Advisers Act. The proposed rule would not apply, however, to most small advisers that are registered with the state securities authorities, and certain other advisers that are exempt from SEC registration.

The SEC is recommending that the rule not distinguish if the government plan contracted directly with investment advisers for advisory services or by means of planned participation in pooled investment vehicles managed by the advisers. The proposals would also apply to government pension plans as well as government sponsored but participant directed plans, such as 529s, 457s or 403(b) plans.

The Proposed Rule can be found at http://www.sec.gov/rules/proposed/2009/ia-2910.pdf.

Update on Massachusetts' and Federal Information Security Regulations

There have been recent developments in federal and state privacy regulation. The following updates our ongoing coverage of the topic, first described in our article, "Recent Developments in State Regulations Affecting Protection of Personal Information," published in the December 2008 *Investment Management Developments* (available at http://www.drinkerbiddle.com/dec08imgdevelopments/) and most recently described in our article, "Update on Massachusetts' and Federal Information Security Regulations," published in the May 2009 *Investment Management Developments* (available at http://www.drinkerbiddle.com/imgdev0509/).

Interagency Proposal for Model Privacy Form under the Gramm-Leach-Bliley Act

The SEC reopened the public comment period on a proposal for a model privacy form that had been introduced in March 2007, so that it could solicit public comment on the results of recent consumer testing to evaluate the form. The proposed amendments would, if adopted, create a safe harbor for a model privacy notice form that financial institutions may use to provide disclosures required under the privacy rules adopted by agencies of the federal government that supervise financial services firms pursuant to Section 504 of the Gramm-Leach-Bliley Act (GLB).

In 2007, these agencies proposed amendments to their rules that implement the privacy provisions of GLB. These rules require financial institutions, including investment companies, to provide initial and annual privacy notices to their customers. The proposed amendments would accommodate the use of a specified, short-form model privacy notice. The SEC's version of the form is Model Form S-P. Institutions that elect to use the proposed short-form notice would be given "safe harbor" status under the federal privacy rules, which is not currently provided for institutions that use the sample clauses in Appendix A of Regulation S-P. The "safe harbor" status would mean that they would be deemed to be in compliance with the rules. As proposed, the use of the law would be voluntary and funds could continue to use their more detailed privacy notices.

The Proposed Rule reopening the comment period can be found at http://www.sec.gov/rules/proposed/2009/34-59769.pdf.

The Proposed Rule describing the form in further detail can be found at http://www.sec.gov/rules/proposed/2007/34-55497.pdf.

The Model Form S-P would modify Regulation S-P, but should not be confused with the more comprehensive overhaul of Regulation S-P in the proposed rule issued by the SEC on March 4, 2008, discussed previously in the May 2009 *Investment Management Developments* (link provided above).

Massachusetts Proposes Revised Privacy Regulations

The Massachusetts Office of Consumer Affairs and Business Regulation recently published for comment a second set of proposed revisions to the Massachusetts Data Privacy Standards. The standards require every "person" (including natural persons, corporations and other legal entities such as investment companies and their service providers) that "owns, licenses, stores or maintains personal information" about a Massachusetts resident to develop and implement a comprehensive written information security program. Many in the mutual fund industry, including the ICI, have raised concerns that these privacy standards are much more onerous, comprehensive and specific than other federal and state regulations.

The proposed Massachusetts revisions address certain of these industry concerns. The proposed revisions largely track the SEC's proposed revisions to Regulation S-P, which would require funds to have, maintain and monitor a comprehensive information security program to protect personal information. In contrast to the existing Massachusetts standards, however, the proposed revisions:

> Take a "risk-based" approach to maintaining data security under which a business, in developing a written security program, should take into account its size, the nature of its business, the kind of records it maintains, and the risk of identity theft posed by its operations;

> Increase the flexibility with which a service provider can comply with the privacy standards by treating as "guidance" a number of specific requirements that were previously required to be included in a business's written information security;

> Are technology neutral and apply a technical feasibility test to all computer security requirements; and

> Require that any third-party service provider to a fund contractually agree to implement and maintain appropriate security measures for personal information.

This risk-based approach is consistent with the federal privacy rules. The new flexibility with respect to compliance with specific requirements is intended to strike a fair balance between consumer protections and business realities by recognizing that the size of a firm and the amount of personal information it handles play a role in the data security plan the firm creates. The easing of the technology requirements is an attempt to respond to industry concerns that firms would incur significant costs to modify their technology systems to comply with the rule. Instead, firms will incorporate a technology feasibility test to determine whether technology modifications would be required.

The compliance deadline for all provisions has been extended from January 1, 2010, to March 1, 2010, thereby giving the industry more time to comply. A hearing on the proposed revisions was held on September 22, 2009.

A copy of the proposed revisions, a notice of the public hearing, a press release announcing their publication, and a "Frequently Asked Questions" explaining the proposed revisions and their scope can be found at http://www.ici.org/pdf/23720.pdf (accessible with an ICI password).

FINRA Proposes New Disclosure Regarding the Distribution and Sale of Investment Company Securities

In June 2009, FINRA issued Notice 09-34, proposing new FINRA Rule 2341 regarding the distribution and sale of investment company securities. NASD Rule 2830 currently regulates member firms' activities in connection with the distribution and sale of investment company securities. The proposed rule adds some significant new disclosures to investors regarding the receipt of cash compensation by broker-dealers. These disclosure changes would be required to be reflected in fund prospectuses. A copy of Notice 09-34 is available at http://www.finra.org/Industry/Regulation/Notices/2009/P119014.

Proposed Changes to Prospectus Disclosure

The proposed rule modifies the cash compensation provisions of NASD Rule 2830(l), including provisions relating to prospectus disclosure. The proposal conflicts with the SEC's recent amendments to Form N-1A, which require only a general statement regarding financial intermediary compensation. Although FINRA has jurisdiction only over broker-dealers, because FINRA forbids broker-dealers from selling or distributing securities whose prospectuses do not contain the information required by FINRA, its rules can effectively control investment company prospectus disclosure.

First, the proposed rule requires that standard "sales charges and service fees," rather than all cash compensation, be described in the prospectus. Second, the proposed rule eliminates the term "special cash compensation" and instead requires prospectus disclosure where a member firm received greater (or special) sales charges or service fees than are ordinarily paid in connection with sales of fund shares.

The proposed rule also includes new interpretative material expanding the definition of cash compensation and special arrangements. Under the new interpretations, cash compensation includes revenue sharing paid in connection with the sale and distribution of investment company securities (and therefore member firms would be required to disclose revenue sharing arrangements pursuant to the rule). The new interpretations also clarify that a special sales charge or service fee arrangement include any arrangement under which a member firm receives greater sales charges or service fees than other member firms selling the same investment company securities, even if an offeror would have made the same arrangement available to other member firms had they requested it.

Realistically, it is impossible for a broker-dealer to know whether an investment company has different compensation arrangements with its other broker-dealers. Therefore, if the proposed rule goes into effect, broker-dealers will likely seek to modify contractual arrangements with each investment company available on their platforms and require representations from each investment company that it makes the required prospectus disclosures regarding such special arrangements.

Proposed Changes to Broker-Dealer Disclosure

The proposed rule also adds new disclosure requirements for broker-dealers that offer investment company securities. A member firm that receives cash payments in addition to the standard sales charges and service fees would have to:

1) Disclose that information about a fund's fees and expenses may be found in the fund's prospectus;

2) If applicable, disclose the following:

    - That the firm receives cash payments from offerors in addition to the standard sales charges and service fees disclosed in the prospectus;
    - The nature of such payments received in the last 12 months; and
    - A list of the offerors making such payments listed in descending order of payments received; and

3) Provide a reference to a web page or toll-free number containing updated information, which must be updated at least every six months. Alternatively, it must disclose updated information to customers every six months.

Written disclosure would initially need to be provided at the time the account is opened or at the time of a customer's first purchase of an investment company security. For existing accounts, member firms would have to provide the written disclosure within 90 days of the adoption of the rule or at the time of the customer's next purchase of an investment company security.

U.S. Supreme Court to Consider Challenge to PCAOB

The U.S. Supreme Court recently agreed to consider *Free Enterprise Fund v. Public Company Accounting Oversight Board*, a case that questions the constitutionality of the creation of the Public Company Accounting Oversight Board (PCAOB) under the Sarbanes-Oxley Act (Sarbanes-Oxley). The plaintiffs contend that the provisions of Sarbanes-Oxley that created the PCAOB violates the separation of powers clause of the U.S. Constitution.

The PCAOB was established to oversee the accounting industry. It registers public accounting firms, establishes auditing and ethics standards, conducts inspections and investigations of registered firms, and imposes sanctions. The board's budget and processes are subject to review by the SEC, which also appoints its five board members. The SEC can also remove board members for cause.

The challenge was brought by a non-profit public interest organization whose members are subject to PCAOB regulation, and an accounting firm subject to PCAOB regulation. The plaintiffs' primary argument is that the makeup of PCAOB violates the separation of powers clause because it does not permit adequate presidential control over the selection and removal of PCAOB members. That is, its members are not appointed by the President and cannot be removed by him.

If the plaintiffs prevail, the PCAOB would, at least temporarily, be inoperative. More importantly, it would also raise a question as to the validity of the remaining provisions of Sarbanes-Oxley, because, unlike many statutes, Sarbanes-Oxley does not contain a severability clause that would prevent the entire statute from being stricken if one section is determined to be invalid.

Upcoming Seminars of Interest to Fund Directors and Trustees

Date	Sponsoring Organization	Seminar Title	Location	Cost
September 30, 2009	IDC#	Directors' Chapter Meeting	Washington, DC	Free; open to fund directors only
October 5, 2009	MFDF*	Mutual Fund Accounting and Financial Oversight: What Every Director Needs to Know	Washington, DC	MFDF members: $350 Non-members: $700
October 7, 2009	IDC#	Directors' Chapter Meeting	Denver, CO	Free; open to fund directors only
October 7, 2009	MFDF*	Director Discussion Series: Regulatory Changes	Pittsburgh, PA	Free to independent directors
October 7, 2009	IDC#	Webinar on Asset Management Acquisitions	NA	Free to directors IDC members: $75 Non-members: $100
October 8, 2009	IDC#	Directors' Chapter Meeting	Chicago, IL	Free; open to fund directors only
October 15, 2009	MFDF*	Mutual Fund Accounting and Financial Oversight: Complex Financial Oversight	Chicago, IL	MFDF members: $350 Non-members: $700
October 16, 2009	MFDF* and Management Practice	Assessing Best Execution and the Use of Soft Dollars	Chicago, IL	MFDF members: $595 Non-members: $995
November 4, 2009	MFDF* and Management Practice	Assessing Best Execution and the Use of Soft Dollars	Los Angeles, CA	MFDF members: $595 Non-members: $995
November 5, 2009	MFDF*	Director Discussion Series: Open Forum Discussion	Chicago, IL	Free to independent directors

Date	Sponsoring Organization	Seminar Title	Location	Cost
November 10, 2009	MFDF*	Mutual Fund Accounting and Financial Oversight: Complex Financial Oversight	New York, NY	MFDF members: $350 Non-members: $700
November 11 – 13, 2009	IDC#	Investment Company Directors Conference (includes new director program)	Amelia Island, FL	IDC Members: $600 Non-members: $1,100 Directors: $600 Guests: $100
November 17, 2009	IDC#	Directors' Chapter Meeting	Dallas, TX	Free; open to fund directors only
December 9, 2009	MFDF*	Mutual Fund Accounting and Financial Oversight: Complex Financial Oversight	Boston, MA	MFDF members: $350 Non-members: $700
January 20, 2010	IDC#	Directors' Chapter Meeting	San Francisco, CA	Free; open to fund directors only
January 21, 2010	IDC#	Directors' Chapter Meeting	Los Angeles, CA	Free; open to fund directors only
January 26 – 28, 2010	MFDF*	4th Annual Directors' Institute	Coral Gables, FL	MFDF members: $700 Non-members: $1,400
February 16, 2010	IDC#	Directors' Chapter Meeting	West Palm Beach, FL	Free; open to fund directors only
April 15 – 16, 2010	MFDF*	10th Annual Policy Conference: "Critical Issues for Investment Company Directors"	Washington, DC	Not yet available
May 5 – 7, 2010	IDC#	Investment Company Directors Workshop	Washington, DC	Not yet available.

For more information on seminars offered by the Independent Directors Council, visit www.idc.org.

* For more information on seminars offered by the Mutual Fund Directors Forum, visit www.mfdf.com.

Investment Management Group

For more information about the matters discussed in this publication, please contact your regular Drinker Biddle lawyer or any member of our Investment Management Group.

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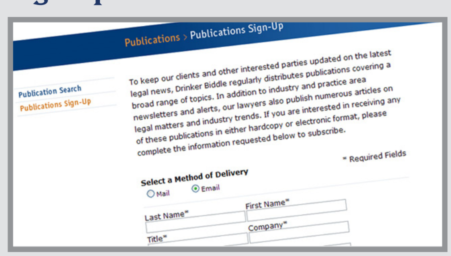

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