Investment Management Industry News Summary - August 2011

AUGUST 31, 2011

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IRS Suspends Registered Investment Company ("RIC") Commodities Investments Rulings

August 19, 2011 9:26 AM

The IRS recently suspended its practice of issuing private letter rulings to RICs to allow RICs to indirectly invest in commodities through controlled foreign subsidiaries and commodity-linked notes. Even though the IRS is still accepting requests for such rulings, it is not acting on them while it studies the issue.

Pursuant to Subchapter M of the Internal Revenue Code, 90 percent of a RIC's gross income must be derived each taxable year from certain "good income" sources that do not include direct investments in commodities or derivatives on commodities. To date, the IRS has issued around 70 private letter rulings pursuant to which a RIC's income from its investment in (i) a controlled foreign subsidiary that invests directly in commodities or commodity derivatives and/or (ii) certain commodity-linked notes has been held to constitute good income to the RIC.

Issuance of the rulings was suspended after the IRS associate chief counsel of financial institutions and products attended a CFTC roundtable on Rule 4.5. The CFTC is being lobbied to revise Rule 4.5(a)(1) to

require RICs that invest in commodities to register with the CFTC as commodity pool operators. The IRS says that it has not ordered the rulings to be stopped, but rather it is holding off from issuing new rulings to rethink the rulings it has previously given. It should be noted that after the suspension, the IRS, through a spokesman, noted that the CFTC did not suggest or demand that the IRS suspend their rulings.

For more information, please see Tax Analysts Daily Tax Highlights & Documents, July 28, 2011 edition.

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IRS Extends Deadline on Onerous New Tax Regulation

August 19, 2011 9:25 AM

On July 14, 2011, the IRS issued a notice which sets forth a timeline for the implementation of certain provisions of the Internal Revenue Code, commonly referred to as the "Foreign Account Tax Compliance Act" or "FATCA." While FATCA technically is effective January 1, 2013, the notice extends various deadlines for withholding, reporting and other obligations under FATCA.

For more information, please see
http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=9886.

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CFTC Issues Sweeping New Rules to Prohibit Fraud and Manipulation in the Swaps, Cash and Futures Markets

August 19, 2011 9:23 AM

On July 14, 2011, the CFTC unanimously adopted two final rules to prohibit fraud and manipulation, and attempted fraud and manipulation, in connection with any swap, commodity contract for sale in interstate commerce ("cash contract") or futures contract on or subject to the rules of a registered exchange ("futures contract"). New Rules 180.1 and 180.2 were adopted pursuant to Section 753 of the Dodd-Frank Act, which grants the CFTC broad new authority to implement Section 6(c) of the Commodity Exchange Act, as amended. Section 6(c) and these implementing rules augment the CFTC's pre-existing fraud and manipulation enforcement authority, which prohibits the use or attempted use of "any manipulative or deceptive device or contrivance," "in connection with" a swap, future or cash contract, in contravention of the rules and regulations required to be promulgated by the CFTC within one year after the Dodd-Frank

Act's enactment. The new rules, which will not apply retroactively, became effective on August 15, 2011.

For more information, please see
http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=9900.

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Court Vacates the SEC's Proxy Access Rule

August 19, 2011 9:22 AM

On July 22, 2011, the U.S.Court of Appeals for the D.C. Circuit ("DC Circuit"), in a unanimous decision by a three-judge panel, vacated the SEC's so-called "proxy access" rule. Rule 14a-11 under the Securities Exchange Act was adopted by the SEC in 2010 and was adopted as an alternative path for shareholders to nominate and elect directors of publicly traded companies. In support of its ruling, the DC Circuit stated that the SEC "acted arbitrarily and capriciously" by not adequately assessing the economic effects of the new regulation in violation of the Administrative Procedures Act. The Court stated that the SEC inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify certain costs or to explain why the costs could not be quantified; and failed to respond to substantial

problems raised by commenters on the rule. For these and other reasons, the Court stated that the decision to apply the rule to investment companies was also arbitrary. The panel particularly criticized the mutual fund related provisions of the rule, which as investment companies would have been subject to its purview.

For more information, please see[*http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf*]

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SEC Commissioner Casey to Leave Agency

August 19, 2011 9:21 AM

On August 5, 2011, the SEC announced that SEC Commissioner Kathleen L. Casey will be leaving the agency, having completed her five-year term on June 5, 2011.

For more information, please see[*http://sec.gov/news/press/2011/2011-163.htm*].

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SEC Issues No-Action Letter for Custody with Certain Derivatives Clearing Organizations or Clearing Members

August 19, 2011 9:19 AM

On July 29, 2011, the Division issued four no-action letters under Section 17(f) of the Investment Company Act of 1940 extending previous relief granted if a fund or its custodian places and maintains assets in the custody of certain derivatives clearing organizations registered with the Commodity Futures Trading Commission (the "CFTC") or certain clearing members of such organization for purposes of meeting such organization or clearing member's margin requirements for interest rate swap contracts ("IRS") or credit default swap contracts ("CDS"). The SEC had previously granted such relief for IRS on March 16, 2011 and March 24, 2011 and CDS on March 1, 2011, December 3, 2010 and July 16, 2010, and these letters extend such relief to December 31, 2011.

The SEC previously granted relief based on the requirement in the Dodd-Frank Act that the CFTC would adopt rules and issue interpretations implementing the Dodd-Frank Act by July 16, 2011 with respect to the centralized clearing of IRS and CDS. A substantial number of the requirements will not be effective by

July 16, 2011. The Division provided relief based on certain representations and noted in a footnote that it anticipates addressing these issues in a more permanent way when the CFTC's applicable rules become effective.

For more information, please see
http://sec.gov/divisions/investment/noaction/2011/lchclearnet072911-17f.htm;
http://sec.gov/divisions/investment/noaction/2011/iceclearcredit072911-17f6.htm;
http://sec.gov/divisions/investment/noaction/2011/cme072911-17f6.htm; and
http://sec.gov/divisions/investment/noaction/2011/cme072911-17f.htm.

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SEC Issues No-Action Letter for Auditors of Broker-Dealers Under Custody Rule

August 19, 2011 9:17 AM

On July 18, 2011, the SEC's Division of Investment Management (the "Division") issued a no-action letter extending no-action relief previously granted on October 12, 2010. The October 12, 2010 letter indicated that the SEC staff would not object if an investment adviser that is subject to Rule 206(4)-2 under the

Advisers Act engages an auditor that audits a broker or dealer to audit a private investment fund's financial statements subject to certain conditions. The October 12, 2010 letter applied to financial statements issued prior to the date the Public Accounting Oversight Board (the "PCAOB") adopted rules concerning the inspection of auditors of brokers and dealers or July 21, 2011, whichever date came first.

On July 14, 2011, the PCAOB issued a temporary rule which, if approved by the SEC, would establish an interim program of inspection related to audits of brokers and dealers (the "Temporary Rule"). All registered public accounting firms that audit brokers and dealers are covered by the Temporary Rule.

In the July 18, 2011 letter, the SEC staff extended the relief found in the October, 2010 letter until the earlier of the date the SEC approves a PCAOB-adopted permanent program for the inspection of broker and dealer auditors or December 31, 2013. The July 18, 2011 letter also expanded the relief for such auditors to: (1) perform a surprise examination of an investment adviser who maintains, or who has custody because a related person maintains, client funds or securities as qualified custodian in connection with advisory services provided to clients, or (2) prepare an internal control report. The relief will cease to apply if the Temporary Rule is withdrawn or disapproved.

For more information, please see http://www.sec.gov/divisions/investment/noaction/2010/sewardkissel101210.pdf and http://www.sec.gov/divisions/investment/noaction/2011/sewardkissel072111.pdf.

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SEC Raises Dollar Limit for "Qualified Persons"

August 19, 2011 9:15 AM

On July 12, 2011, the SEC issued an order increasing the dollar-based thresholds of the assets under management test and the net worth test found in the definition of "qualified person" in Rule 205-3 under the Investment Advisers Act of 1940 ("Advisers Act"). Under Rule 205-3, an investment adviser currently is permitted to charge performance fees if the client has at least $750,000 under the adviser's management or has a net worth of more than $1.5 million. The SEC's order raised the thresholds to $1 million of assets under management and a net worth of more than $2 million. As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the increase in the dollar thresholds is designed to adjust for inflation. The order is effective September 19, 2011.

For more information, please see http://www.sec.gov/news/press/2011/2011-109.htm and http://www.sec.gov/rules/other/2011/ia-3236.pdf

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SEC Adopts Rule Requiring Large Trader Reporting

August 19, 2011 9:12 AM

On July 27, 2011, the SEC adopted, with certain modifications, proposed Rule 13h-1 under the Securities Exchange Act of 1934, the "large trader reporting" rule. Rule 13h-1 will require "large traders" who exercise investment discretion and trade above specified volume thresholds to self-identify by (1) filing Form 13H with the Commission, and (2) providing a unique identification number, assigned by the Commission, to broker-dealers through whom they trade. Broker-dealers in turn will be required to maintain records of trading similar to the records they currently maintain in connection with the Electronic Blue Sheets ("EBS") system, supplemented with the time of order execution and the trader's ID number, and to report that information to the Commission on request. They also will be required to file Form 13H if they are large traders themselves.

For more information, please see http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=9904.

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