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Investment Management Industry News Summary - May 2011

MAY 31, 2011

This Summary, which draws from a wide range of sources, endeavors to condense important investment management regulatory news of the preceding week into one, easily digestible source. This Summary is not intended as legal advice. Readers should not act upon information contained in this Summary without professional legal counsel. This Summary may be considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

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CFTC Proposes Rescinding Private Fund Exemptive Rules

May 23, 2011 10:41 AM

The CFTC has proposed eliminating the exemptions provided under Rules 4.13(a)(3) and 4.13(a)(4) for commodity pool operators ("CPOs") and Rule 4.14(a)(8)(i)(D) for commodity trading advisors ("CTAs"). These rules (the "Private Fund Exemptive Rules") are relied upon by many private fund managers and advisers that directly or indirectly (i.e., through a fund of funds) trade futures contracts and commodity options for exemption from registration with the CFTC.

If adopted, the proposed elimination would require these private fund managers and advisers to register as CPOs and CPAs, respectively, if they wish to continue or begin trading futures, commodity options and, as of July 21, 2011, swaps. Any such managers and advisers of private funds that trade in both securities and commodities would be subject to dual SEC-CFTC registration.

In addition, the CFTC proposes an amendment to Rule 4.7, which, if adopted, would subject CPOs relying on the rule to certain additional reporting obligations. Rule 4.7 currently exempts certain private fund managers and advisers from certain disclosure, reporting and regulatory requirements. If adopted, private fund managers and advisers relying on the rule would be required to provide certified financial statements in their funds' annual reports to investors. Private fund managers and advisers that are eligible for the Rule 4.7 exemption operate and advise private funds offered only to qualified eligible persons ("QEPs"). The CFTC's proposal would further amend the definition of a QEP to incorporate the definition of "accredited investor" under Regulation D of the Securities Act of 1933, as amended (the "1933 Act").

The text of the proposed amendments can be found here: http://www.cftc.gov/LawRegulation/DoddFrankAct/Dodd-FrankProposedRules/index.htm

FINRA Proposes Changes to Cash Compensation Disclosures for Sales of Investment Company Securities

May 23, 2011 10:37 AM

On April 19, 2011, FINRA filed with the SEC proposed changes to NASD Rule 2830, which would replace the NASD rule with FINRA Rule 2341 (the “cash compensation rule”). These changes represent significant changes from the initial proposal filed by FINRA in 2009. The current cash compensation rule, among other things, prohibits FINRA members from accepting cash compensation from “offerors” (generally, investment companies, their advisers, administrators and underwriters and their affiliates) unless such compensation is disclosed in the fund’s prospectus. In addition, if a member establishes a “special cash compensation” arrangement with an offeror that is not available to all members, the member’s name and the details of the arrangement must be disclosed in the fund’s prospectus.

The revised proposed rule would make the following principal changes:

- **Broader definition of “cash compensation.”** The proposed changes would materially broaden the definition of “cash compensation” to include revenue sharing arrangements in connection with the sale of fund shares. Revenue sharing arrangements are subject to the rule regardless of the basis of calculation (e.g., total amount of fund shares held by a member’s customers or amount of shares sold). FINRA’s initial proposal specifically excluded revenue sharing arrangements from required disclosure regarding cash compensation. In addition, fees received for sub-administrative and similar services would be included in the definition, as well as sums received in connection with a member’s annual sales meeting.
- **Point-of-sale disclosure of non-standard (i.e., greater) cash compensation.** The proposal would eliminate the requirement of disclosure of cash compensation arrangements from the fund’s prospectus and instead place the disclosure requirement on the FINRA member. Specifically, the proposal would require a FINRA member receiving non-standard compensation (including revenue-sharing arrangements) in connection with the sale of investment company securities to “prominently disclose”: (i) if applicable, that the firm has, in the previous calendar year, entered into an arrangement to receive cash compensation from an offeror in addition to the standard sales charges and fees disclosed in the fund’s prospectus; and (ii) that “this additional cash compensation arrangement may influence the selection of investment company securities that the member and its associated persons offer or recommend to investors.” In addition, members would be required to provide a link or toll-free number with certain additional, updated information.

FINRA has proposed an effective date of one year after approval by the SEC.

See the proposed rule change filing here: http://www.sec.gov/rules/sro/finra/2011/34-64386.pdf

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Effective Date of New Anti-Spinning Rule Extended to September 26, 2011

May 23, 2011 10:15 AM

On May 18, 2011, the SEC approved FINRA's proposed amendment delaying effectiveness of certain provisions of FINRA Rule 5131 (the "Anti-Spinning Rule") until September 26, 2011 (previously scheduled to go into effect on May 27, 2011). The Anti-Spinning Rule, among other things, prohibits the practice of "spinning," or the allocation by certain underwriters of IPO shares to the executive officers and directors of current or potential investment banking clients in return for such clients' business. Specifically, the Anti-Spinning Rule prohibits such allocation by FINRA members of new issues to any account in which an executive officer or director of a public company or covered non-public company, or a person who is materially supported by such executive officer or director, has a beneficial interest if (i) the company is a current investment banking client of the member, (ii) the company is expected to retain the member for investment banking services within the next three months, or (iii) the express or implied condition exists that the company will retain the member in the future in return for such allocation. Certain exceptions, similar to those of FINRA Rule 5130, apply in certain cases. In addition, the Anti-Spinning Rule provides for a 25% de minimis exception which is more substantial than the 10% de minimis exception under FINRA Rule 5130. Similar to FINRA Rule 5130, advisers to private funds and investment accounts that participate in IPOs will need to receive verification of the beneficial owners' eligibility to participate within 12 months prior to participation in an IPO. The annual verification may be obtained via a “negative consent” process after receipt of the initial verification.

On April 18, 2011, FINRA, citing member concerns regarding the time necessary to implement adequate policies and procedures, proposed the amendment to delay effectiveness of paragraphs (b) and (d)(4) of the Anti-Spinning Rule. In addition, the amendment eliminates paragraph (b)(1) of the Anti-Spinning Rule, which required that members maintain and enforce policies and procedures reasonably designed to ensure that investment banking personnel have no involvement or influence, directly or indirectly, in new issues allocation decisions.

See the text of the SEC’s approval of the Anti-Spinning Rule here:http://www.sec.gov/rules/sro/nasd/2010/34-63010.pdf

See the text of the SEC’s approval of the extension of effectiveness of the Anti-Spinning Rule here:http://sec.gov/rules/sro/finra/2011/34-64512.pdf

See the text of FINRA’s proposed amendment to the Anti-Spinning Rule here:http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p123521.pdf

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Proposed Bill H.R. 1082 Would Exempt Private Equity Advisers from Registration

May 23, 2011 9:44 AM

The House of Representatives Subcommittee on Financial Services and Capital Markets has introduced a bill to the full House of Representatives that would amend Section 203 of the Advisers Act to provide an exemption from registration under the Advisers Act for advisers to private equity funds. The bill directs the SEC to consider how to define a "private equity fund." While an adviser to such a fund would not be required to register with the SEC, H.R. 1082 contemplates ongoing reporting requirements, to be determined by the SEC.

*More information regarding the proposed bill is available here:*http://thomas.loc.gov/cgi-bin/bdquery/z?d112:h.r.1082:

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SEC Proposes Inflation Adjustments to Tests Under "Qualified Client" Definition

May 23, 2011 8:44 AM

The Dodd-Frank Act, among other things, amended Section 205(e) of the Investment Advisers Act of 1940, as amended (the "Advisers Act") to state that the SEC shall adjust these dollar amount tests for inflation beginning July 21, 2011 and every five years thereafter.

On May 10, 2011, the SEC proposed amending Rule 205-3 under the Advisers Act to adjust the dollar amounts of the assets under management test and the net worth test under the "qualified client" definition in order to account for inflation. The assets under management test is currently set at $750,000 and the net worth test is currently set at $1.5 million.

The SEC's proposal would increase the assets under management test to $1 million and the net worth test to $2 million. In addition, the amendment would change the definition of "qualified client" to exclude the value of a person's primary residence and any debt secured by the property. The SEC notes that while this latter change is not required by the Dodd-Frank legislation, it is consistent with a parallel change to the definition of "accredited investor" that was mandated by Dodd-Frank and was effective in July 2010.

*The full text of the rule proposal is available here:*http://www.sec.gov/rules/proposed/2011/ia-3198.pdf

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Securities and Exchange Commission ("SEC") Expected to Consider Extending Registration Deadline for Investment Advisers

May 23, 2011 8:38 AM

The SEC has recently indicated, in letters dated April 8, 2011 and April 27, 2011, that it expects to consider extending until the first quarter of 2012 the deadline by which advisers currently relying upon the "private adviser exemption" must register with the SEC, as well as the deadline for mid-sized advisers (generally, those with between $24 million and $100 million in assets under management) to transition from registration with the SEC to state registration.

The SEC noted that it expected to complete its rulemaking in connection with the Dodd-Frank Act, including regarding exemptions for venture capital funds and advisers to private funds with less than $150 million in assets under management in the U.S., by the July 21, 2011 deadline noted in the Dodd-Frank legislation. However, citing the administrative burden attendant compliance with various provisions of the rules promulgated under the Dodd-Frank Act in such a short time, the SEC stated that it is likely to extend the effective dates of such rules past July 21, 2011, giving registering advisers adequate time to comply with the requirements of registration with the SEC.

The April 8, 2011 letter is available at: http://www.sec.gov/rules/proposed/2010/ia-3110-letter-to-nasaa.pdf considered advertising under the rules of the Supreme Judicial Court of Massachusetts.

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