Investment Management Industry News Summary - September 2009

SEPTEMBER 30, 2009

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Department of Labor Approves Use of Summary Prospectuses by Employee Benefit Plans

September 15, 2009 10:41 AM

On September 8, 2009, the U.S. Department of Labor ("DOL") approved the use of "summary prospectuses" for mutual funds offered by participant-directed individual account employee benefit plans (e.g., 401(k) plans) ("Eligible Plans"). Generally speaking, mutual funds will be required to include summary prospectuses when they update their full statutory prospectuses in 2010.

Eligible Plans may satisfy their prospectus delivery obligations under the DOL's regulations under Section 404(c) of ERISA by delivering a mutual fund's summary prospectus, rather than the full prospectus, to plan participants, so long as the summary prospectus is the most recent prospectus received by the plan. Eligible Plans and their participants will be able to receive a mutual fund's full statutory prospectus, upon request, via the fund's website or toll-free number.

For more information, please see:

http://www.dol.gov/ebsa/regs/fab2009-3.html

For more information on summary prospectuses generally, please see the WilmerHale "Email Alert –SEC Approves Mutual Fund Summary Prospectuses," dated January 20, 2009:

http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=8747

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Senator Drafting Legislation to Permit SEC Self-Funding

September 15, 2009 10:39 AM

On September 3, 2009, Senator Charles E. Schumer (D-NY), announced that he is drafting legislation that will allow the SEC to fund its own operations by using the transaction and registration fees it collects from the institutions it oversees. Unlike U.S. banking regulators, the SEC must go through the annual Congressional appropriations process. Senator Schumer noted that in 2007, the SEC brought in fees totaling $1.54 billion, but only secured $881.6 million in funding

through the Congressional appropriations process. He indicated that additional funding would enable the SEC to attract professionals with the expertise required to uncover complex financial fraud, such as Madoff's Ponzi scheme. SEC Chairman Schapiro has already expressed support for the proposal.

For more information, please see:

http://schumer.senate.gov/new_website/record.cfm?id=317505

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Adviser to Madoff Feeder Funds Settles with Massachusetts Securities Regulator

September 15, 2009 10:34 AM

On September 8, 2009, Fairfield Greenwich Advisors and Fairfield Greenwich (Bermuda) LTD. (together "Fairfield"), registered investment advisers to private investment funds ("Feeder Funds") that invested with Bernard L. Madoff Securities LLC, settled with the Massachusetts Securities

Division, as to the Feeder Funds' investments with the now-defunct Madoff firm. Without admitting any wrongdoing, Fairfield agreed to pay $8 million in restitution to Massachusetts investors and a $500,000 fine to the Commonwealth of Massachusetts.

For more information, please see:

http://www.sec.state.ma.us/sct/sctfairfield/fairfield_consent.pdf

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Amicus Briefs Filed in Mutual Fund Fee Case Before U.S. Supreme Court

September 15, 2009 10:28 AM

On August 27, 2009, Harris Associates L.P., the respondent in Jones v. Harris Associates, pending before the U.S. Supreme Court, filed its opposition brief. Subsequently, a number of amicus curiae briefs were filed in support of the respondent, including briefs by the Investment Company Institute ("ICI"), the Independent Directors Council ("IDC") and the Mutual Funds Directors Forum.

The case is on review on a petition for certiorari of a decision by the United States Court of Appeals for the Seventh Circuit which rejected the standard articulated by the Second Circuit Court of Appeals in Gartenberg v. Merrill Lynch ("Gartenberg standard") under Section 36(b) of the Investment Company Act of 1940 (the "Investment Company Act") and adopted a new standard for reviewing advisory fee challenges under Section 36(b). The Gartenberg standard requires a court reviewing an excessive fee claim to weigh factors most relevant to the case at hand, and to give appropriate weight to the independent directors' approval of the fee. In rejecting the Gartenberg standard and articulating a new test, the Seventh Circuit stated: "[a] fiduciary duty differs from rate regulation. A fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation. The trustees (and in the end investors, who vote with their feet and dollars), rather than a judge or jury, determine how much advisory services are worth." In other words, absent an adviser deceiving the independent trustees or otherwise hindering their ability to negotiate a favorable advisory fee, the courts in the Seventh Circuit will be deferential to the fee negotiated by the trustees.

The Supreme Court agreed to consider whether the Seventh Circuit erroneously held that a shareholder's claim that the fund's adviser charged an excessive fee (more than twice the fee charge to non-affiliated funds managed by the adviser) is not cognizable under Section 36(b), unless the shareholder can demonstrate that the adviser deceived the fund's directors who approved the fee.

On September 3, 2009, the ICI filed an amicus brief (the "ICI brief") in support of the respondent. The ICI brief asserts, among other things, that the Gartenberg standard is the appropriate approach to judicial review of adviser compensation because it allows a flexible framework for a court to decide which factors are most relevant to the advisory agreement that the boards are considering. In addition, the Gartenberg standard has provided fund boards and advisers with useful guidance, ensured investor protection, and has prevented courts from becoming involved in technical disputes regarding business judgment. The ICI brief argues that comparisons between fees paid by mutual funds and by institutional clients can be highly misleading as the services, business risks, portfolio management, and legal and compliance requirements are not similar. Further, the ICI brief asserts that the fund industry is highly competitive, evidenced by decreasing fees as investors continue to receive higher quality services. WilmerHale was counsel to the ICI.

The IDC also filed an amicus brief ("IDC brief") in support of the respondent. The IDC brief stresses the crucial role played by independent directors in evaluating and approving fund advisory contracts. Further, the IDC brief asserts that a departure from the Gartenberg standard would have courts review advisory fees in the first instance which would remove this responsibility from independent directors. The IDC brief argues that this is contrary to Congress' intended deference to fund boards' business judgment in the process of approving investment advisory fees. Such a departure would not be in the best interests of investors, because it could allow plaintiffs' attorneys to litigate fees paid by almost any fund, with the resulting litigation costs passed on to the fund's investors.

The Supreme Court will hear oral arguments in the case on November 2, 2009 and will issue its opinion prior to the end of its term in June 2010.

For more information, please see the WilmerHale Email Alert, Supreme Court Agrees to Review Jones v. Harris Associates, dated March 9, 2009:

http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=8823

For more information on the ICI brief, please see:

http://www.ici.org/pdf/09_scotus_jvh_ici_brief.pdf

For more information on the IDC brief, please see:

http://www.idc.org/pdf/09_scotus_jvh_idc_brief.pdf

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SEC and CFTC Hold Joint Meetings Regarding Harmonization of Market Regulation

September 15, 2009 10:27 AM

On September 2-3, 2009, the SEC and the Commodity Futures Trading Commission ("CFTC") held joint meetings seeking public input regarding the harmonization of existing regulatory frameworks for securities and futures products. During the two-day meetings, the agencies heard from five panels discussing, among other things, margin requirements, market and exchange regulation, clearance and settlement, intermediary regulation, enforcement and investor protection, and the regulation of pooled investment vehicles. The panels represented a broad range of interests from investors and academia to exchanges, trade associations and law firms.

For more information, please see "Speech by SEC Chairman: Opening Remarks before the SEC-CFTC Joint Meetings on Regulation Harmonization":

http://www.sec.gov/news/speech/2009/spch090209mls.htm

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SEC Inspector General Releases Madoff Report

September 15, 2009 10:21 AM

As has been widely reported, on September 2, 2009, the SEC Office of Inspector General (the "Inspector General") released an executive summary of its report regarding the failure of the SEC to uncover Bernard Madoff's multi-billion dollar Ponzi scheme. On September 4, 2009, the SEC released the Inspector General's full 477-page report.

The Inspector General's executive summary and report concluded, among other things, that:

- despite six substantive complaints between June 1992 and December 2008, the SEC failed to investigate Madoff properly;
- had the SEC taken appropriate measures to investigate Madoff, the SEC could have uncovered the fraud well before Madoff eventually confessed;
- the SEC's most serious error was likely its failure to confirm Madoff's alleged trading with independent third parties;
- there were no inappropriate connections between SEC personnel involved in examining or investigating Madoff's firm and Madoff or his family that impacted the conduct of the examination or investigation;
- the fact that Madoff's hedge fund business was not registered at the time of the SEC examinations did not impede the examiners' ability to gather information from Madoff because the SEC was authorized to examine all of Madoff's firm's books and records, whether they were related to its broker-dealer business or its hedge fund business;
- the SEC staff's examinations and investigations of Madoff's firm uncovered suspicious evidence. However, the staff either ignored these concerns or was satisfied with Madoff's answers to their questions, despite his answers being implausible or obvious lies and misrepresentations;
- despite an SEC enforcement investigation resulting from a complaint that explicitly alleged that it was "highly likely" that "Madoff was operating a Ponzi scheme," the SEC staff did not investigate the possibility that Madoff was operating such a scheme; and
- the SEC staff's numerous examinations and investigations of Madoff's firm, which did not result in any charges of wrongdoing, reassured certain investors who may have been uncertain about whether to invest with Madoff.

For SEC Chairman Mary Schapiro's statement regarding the Inspector General's report, please see:

http://www.sec.gov/news/speech/2009/spch090409mls.htm

For the "Executive Summary – Report of Investigation, United States Securities And Exchange Commission, Office Of Inspector General, Investigation of Failure of the SEC To Uncover Bernard Madoff's Ponzi Scheme," please see:

http://www.sec.gov/news/studies/2009/oig-509-exec-summary.pdf

For the "Report of Investigation, United States Securities And Exchange Commission, Office Of Inspector General, Investigation of Failure of the SEC To Uncover Bernard Madoff's Ponzi Scheme," please see:

http://www.sec.gov/news/studies/2009/oig-509.pdf

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