

REGULATORY ADMINISTRATION DIGEST

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This Regulatory Administration Digest is provided for informational and educational purposes only and is not accounting, legal or tax advice, opinion or a substitute for the advice of your legal counsel or other professional advisors.

The following is a summary of select developments in investment management regulation during the first quarter of 2013.

New SEC Chair Appointed

On Feb. 7, 2013, President Obama nominated Mary Jo White to be the 31st Chair of the Securities and Exchange Commission (the "SEC"). Ms. White's nomination was confirmed by the U.S. Senate on April 8 and she was sworn in as Chair on April 10. She most recently served as chair of the litigation department at Debevoise & Plimpton in New York. Prior to that, Ms. White served as the U.S. Attorney for the Southern District of New York from 1993 to 2002. According to an SEC press release, as U.S. Attorney, she "specialized in the prosecution of complex securities and financial institution frauds and international terrorism cases."

During her confirmation hearing before the Senate Banking Committee, Ms. White provided a glimpse at her priorities following confirmation and highlighted three areas of focus: (i) "finish, in as timely and smart a way as possible, the rulemaking mandates contained in the Dodd-Frank Act and JOBS Act"; (ii) "further strengthen the enforcement function of the SEC – it must be fair, but it also must be bold and unrelenting"; and (iii) position "the SEC . . . to fully understand all aspects of today's high-speed, high-tech, and dispersed marketplace so that it can be wisely and optimally regulated, which means without undue cost and without undermining its vitality."

The SEC Press Release is available [here](#).

SEC Renews Focus on Money Market Fund Reform

Reports indicate that the SEC plans to unveil a new money market reform proposal early in 2013. The New York Times DealBook blog recently quoted an SEC spokesman as stating that "the staff expects to have something for the commission's consideration in the near future." The blog also quoted a BlackRock executive who commented that he "think[s] we're going to see some type of announcement from the SEC shortly" and "expected that it would involve some money market funds dropping their stable \$1 a share



value and moving to a so-called floating net asset value.” In addition, on March 7, David W. Grim, Deputy Director of the SEC Division of Investment Management, stated that “the staff is engaged with the Commissioners and hard at work on developing a money market fund reform recommendation.”

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In November 2012, the Financial Stability Oversight Council (“FSOC”) published its recommendations for money market fund reform, which include a floating share value and capital buffers. The FSOC recommendations followed the decision by the SEC to abandon similar proposals after they were opposed by three of the five SEC commissioners.

A transcript of Mr. Grim’s speech is available [here](#) and the DealBook blog post is available [here](#).

2013 SEC Exam Priorities Announced

On February 21, 2013, the SEC National Examination Program (“NEP”) published its examination priorities for 2013. The NEP covers issues impacting a wide-range of financial institutions, including investment companies and investment advisers. The market-wide priorities identified by the NEP include fraud detection and prevention, corporate governance and enterprise risk management, conflicts of interest and technology controls.

For the investment adviser/investment company program, the NEP identified three focus areas: ongoing risk; new and emerging issues; and policy topics. The following table summarizes elements of the NEP’s review with respect to each area.

Ongoing Risk	<ul style="list-style-type: none"> • Safety of Assets • Marketing/Performance • Conflicts of Interest Related to Investment Opportunities • Fund Governance
New and Emerging Issues	<ul style="list-style-type: none"> • New Registrants • Dually Registered IA/BD • “Alternative” Investment Companies • Payments for Distribution in Guise
Policy Topics	<ul style="list-style-type: none"> • Money Market Funds • Compliance with Exemptive Orders • Compliance with Pay-to-Play Rule



The NEP publication is available [here](#).

Social Media the Focus of the First SEC “IM Guidance” Series Publication

On March 15, 2013, the SEC Division of Investment Management published a guidance update to clarify the obligations of mutual funds and other investment companies to seek review of materials posted on their social media sites. The Division notes that many mutual funds and other investment companies may be filing social media site materials with the Financial Industry Regulatory Authority (FINRA) unnecessarily. According to the Division, “whether a communication need be filed depends on the content, context, and presentation of the particular communication or set of communications and requires an examination of the underlying substantive information transmitted to the social media user and consideration of any other facts and circumstances.”

The IM Guidance Update provides examples of the kinds of communications that the staff believes would not be subject to a requirement to file with the SEC pursuant to Section 24(b) of the Investment Company Act of 1940 (“1940 Act”) or Rule 497 under the Securities Act of 1933 (“1933 Act”) if it is not required to be filed under FINRA Rule 2210, and provides examples of communications that would trigger a filing requirement.

The following are interactive communications the Division believes generally **need not be filed**:

Communication Type	Sample Posts
An incidental mention of a specific investment company or family of funds not related to a discussion of the investment merits of the fund.	“Fund X Family of Funds invites you to their annual benefit for XYZ Charity.”
The incidental use of the word “performance” in connection with a discussion of an investment company or family of funds, without specific mention of some or all of the elements of a fund’s return (e.g., 1, 5 and 10 year performance).	“We update the performance of our funds every month and publish the results on <website url>*.”
A factual introductory statement forwarding or including a hyperlink to a fund prospectus or to information that is filed pursuant to Section 24(b) or Rule 497.	“John Doe is the new portfolio manager for ABC fund. <website url>*.”

*The content of the attached hyperlink “<website url>” must be filed with FINRA.

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An introductory statement not related to a discussion of the investment merits of a fund that forwards or includes a hyperlink to general financial and investment information such as discussions of basic investment concepts or commentaries on economic, political or market conditions.

"Here's a Q&A with our Portfolio Manager, John Doe, regarding his views on the economy for 2013. <website url>."

A response to an inquiry by a social media user that provides discrete factual information that is not related to a discussion of the investment merits of the fund. The response may direct the social media user to the fund prospectus or to access information filed with FINRA pursuant to Section 24(b) or Rule 497 or to contact the issuer through a different medium (e.g., phone, e-mail).

INQUIRY: "What is a better investment, buying real estate or buying a REIT?"

FUND RESPONSE: "There are a lot of things to consider when choosing between the two options. The answer depends on your goals and risk tolerance and whether you want to invest in a REIT, a fund that invests in REITs, or real property. While we can't talk about specific funds on [social media] please give us a call at 1-800-***-**** and we'll be happy to talk to you in more detail about this."

The following are examples of interactive communications that the Division believes generally **should be filed** pursuant to Section 24(b) or Rule 482, as appropriate:

Communication Type	Sample Posts
A discussion of fund performance that provides specific mention of some or all of the elements of a fund's return (e.g., 1, 5 and 10 year performance) or promotes a fund's returns	"The fund slightly underperformed its benchmark, the S&P 500 Index, during the quarter that ended September 30, 2012."
A communication initiated by the issuer that discusses the investment merits of the fund.	"Our ABC Fund was included in the list of best new funds recently published by Morningstar. <website url>"

The guidance from the Division of Investment Management was the first in its new "IM Guidance Update" series, which is "intended to help firms strengthen their compliance efforts by providing meaningful real life examples in a format that is accessible to all on the SEC's website".

The IM Guidance Update is available [here](#).



Custody Rule Risk Alert and Investor Bulletin

On March 13, 2013, the SEC issued a Risk Alert and Investor Bulletin on compliance with its custody rule for investment advisers, which is designed to protect advisory clients from theft or misuse of their funds and securities. The Risk Alert by the SEC's Office of Compliance Inspections and Examinations (OCIE) lists recent findings of custody deficiencies during SEC examination, including:

- Failure to recognize that the adviser has custody, such as situations where the adviser serves as trustee, is authorized to write or sign checks for clients, or is authorized to make withdrawals from a client's account as part of bill-paying services
- Failure to meet the custody rule's surprise examination requirements
- Failure to satisfy the custody rule's qualified custodian requirements, for instance, by commingling client, proprietary, and employee assets in a single account, or by lacking a reasonable basis to believe that a qualified custodian is sending quarterly account statements to the client.

The Risk Alert notes that discovery of the deficiencies has resulted in a range of remedial measures by advisers, such as drafting, amending or enhancing their written compliance procedures, policies or processes, changing their business practices, or devoting more resources or attention to custody issues.

The Investor Bulletin by the SEC's Office of Investor Education and Advocacy (OIEA) describes the requirements imposed on registered investment advisers by the custody rule, including the requirement that, with limited exceptions, advisers must maintain client funds and securities with a "qualified custodian" and have a reasonable basis to believe that the qualified custodian sends account statements at least quarterly to the adviser's clients directly.

The Investor Bulletin notes that "the custody rule is designed to provide additional safeguards for investors against possible theft or misappropriation," but urges investors to "exercise care when making investment decisions and remain vigilant in monitoring . . . investments."

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The Risk Alert is available [here](#) and the Investor Bulletin is available [here](#).

2013 Rulemaking Priorities at the Division of Investment Management Outlines

The current initiatives of the SEC Division of Investment Management were outlined in recent speeches before investment management industry groups made by Norm Champ, Director of the Division of Investment Management, and David Grim, Deputy Director of the Division of Investment Management. The regulators stated that the initiatives fall into two categories: long-term priorities and short term priorities. In describing the status of the priorities, they stated that the SEC Staff is actively working on the short-term priorities, while the division is still in the process of scoping and allocating resources to the long-term priorities.

Below is a summary of the three short-term priorities and five long-term discussed and how the Division plans to focus on each:

Short-Term Priorities	IM Division Focus
Money Market Reform	<ul style="list-style-type: none"> Engagement with Commissioners to develop reform recommendations
Identity Theft Red Flag Rules	<ul style="list-style-type: none"> Adoption of final rules designed detect and prevent theft of the identities of mutual fund investors and clients of asset managers and give effect to the transfer of authority for overseeing identity theft and protection programs from the Federal Trade Commission to the SEC and CFTC
Valuation Guidance	<ul style="list-style-type: none"> Level set requirements for the valuation process Raise fund and director awareness of prudent practices
Long-Term Priorities	IM Division Focus
Enhancements to fund disclosures about operations and portfolio holdings	<ul style="list-style-type: none"> Develop methods for structured data reporting by all mutual funds (similar to monthly money market fund reporting on portfolio holdings) Enhance and streamline data collection and disclosure forms

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Exchange Traded Fund Rule

- Pursue implementation of an ETF rule that would basically codify the exemptive relief that the SEC routinely grants for exchange-traded funds that would allow "plain vanilla" ETFs to operate without obtaining individual exemptive relief

Analysis of 2011 Derivatives Concept Release

- Analyze public feedback on the Derivatives Concept Release, including on a variety of regulatory issues raised by funds' use of derivatives, including valuation, diversification and leverage limitations
- Assess whether, and if so how, the mutual fund and investment company regulatory regimes should be revised to adequately account for the role of derivatives and incorporate more targeted requirements

Review of Rules Applicable to Private Fund Advisers

- Identify and assess rules that should be updated to address investor protection concerns and the business models of private fund advisers

A transcript of Mr. Grim's speech is available [here](#).



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