TOPICS IN THIS ISSUE:

The following is a summary of select developments in investment management regulation during the third quarter of 2014.

SEC Extends Expiration Date for Temporary Rule Relaxing Requirements for Principal Trades

On August 12, 2014, the Securities and Exchange Commission (the "SEC") published a Proposed Rule that would amend Rule 206(3)-3T under the Investment Advisers Act of 1940 (the "Rule") to extend the expiration date by two years until December 31, 2016. The Rule gives investment advisers, who are also broker-dealers, an alternative method to comply with Section 206(3) of the Advisers Act ("Section 206(3)"), which requires an adviser to obtain client consent prior to engaging in a principal transaction with the client.

Advisers who comply with the Rule would not be required to obtain trade-by-trade consent for any transactions as a principal as required by Section 206(3). Instead, under the Rule, if an adviser enters into a principal trade with a client, the adviser will be deemed to comply with Section 206(3) if the adviser, among other things:

- Obtains written, revocable consent from the client prospectively authorizing principal trades;
- Provides written prospective disclosure regarding the conflicts arising from principal trades; (3) provides certain disclosures, either oral or written, and obtains client consent prior to each principal trade;
- Provides the client with an annual report on all principal transactions with that client; and
- Sends confirmation statements disclosing the capacity in which the adviser has acted and disclosing that the adviser informed the client that it may act in a principal capacity and that the client authorized the transaction.

The Rule applies only to certain non-discretionary advisory accounts.

The SEC initially adopted the Rule on September 24, 2007 and its expiration date was most recently extended on December 20, 2012 until December 31, 2014.

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SEC Alleges Auditor Violated Independence Requirements

On July 14, 2014, the SEC announced a settlement order in an administrative proceeding (the "Order") against Ernst & Young LLP ("E&Y"). The Order alleged violations of auditor independence requirements under the Securities Exchange Act of 1934, as amended ("Exchange Act") and SEC regulations. Among other things, the SEC alleged that E&Y represented that it was "independent" in audit reports for certain E&Y clients for which it E&Y served as independent auditors, despite the fact that an E&Y subsidiary provided legislative advisory services for those same clients.

The SEC alleged that E&Y's actions violated SEC rules, including Rule 2-02(b)(1) of

Regulation S-X, which requires an accountant's report to state that an audit was conducted "in accordance with generally accepted accounting standards" and that E&Y caused its clients to violate Section 13(a) of the Exchange Act and SEC regulations thereunder, which require financial statements filed with the SEC to be certified by independent public accountants.

To settle the matter, E&Y agreed to pay a civil penalty of approximately $4 million, without admitting or denying the SEC's allegations.

FSOC Shifts Focus of Enhanced SIFI Designation Analysis

On July 31, 2014, the Financial Stability Oversight Council ("FSOC") announced that it will shift its focus from designation of individual asset managers as Systemically Important Financial Institutions ("SIFIs"), to focus on industry-wide products and activities. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") tasked the FSOC with assessing the vulnerability of asset management funds to financial shocks and consider enhanced standards and supervision of such firms.

SEC Revisits Amendments to Remove References to Credit Ratings from Money Market Fund Rule

On July 23, 2014, the SEC published a Proposed Rule that included previously proposed amendments to Rule 2a-7 under the 1940 Act and Form N-MFP. The amendments were initially proposed in March 2011 in accordance with a Dodd-Frank requirement that any references to credit ratings in the SEC's regulations be removed and replaced with other standards of creditworthiness. The SEC also proposed a new amendment to the diversification requirements under Rule 2a-7 which would eliminate an exclusion that is currently available for securities subject to guarantees issued by a non-controlled person (i.e., a person not controlling, controlled by or under common control with the issuer of the security subject to the guarantee.

The re-proposed amendments would require that money market funds:

- Adopt written procedures requiring the fund's adviser to provide ongoing review of the credit quality of each portfolio security to determine that the security continues to present minimal credit risks;
- Stress test for an event indicating or evidencing credit deterioration of particular portfolio security positions, each representing various exposures in a fund's portfolio.

The Proposed Rule also re-proposed amendments to Form N-MFP requiring money market funds disclose, for each portfolio security: (1) each rating assigned by any NRSRO if the fund or its adviser subscribes to that NRSRO's services, as well as the name of the agency providing the rating; and (2) any other NRSRO rating that the fund's board of directors (or its delegate) considered in making its minimal credit risk determination, as well as the name of the agency providing the rating.

Comments on the proposed rule amendments are due 60 days after publication in the Federal Register.

Northern Trust

Northern Trust is a best-in-class provider of middle and back office fund services to investment managers worldwide. Our unique expertise extends across products, fund vehicles and domiciles, delivering the flexibility associated with a boutique administrator but with all the advantages of being one of the world's leading financial institutions.

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Regulatory Administration Digest is compiled by our Regulatory Administration Group.

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