Investment Services Regulatory Update

October, 2015

In This Issue

New Rules, Proposed Rules and Guidance

Public Statements, Speeches and Testimony

Litigation and Enforcement Actions

Other News and Developments

VEDDER PRICE®

New Rules, Proposed Rules and Guidance

SEC Proposes New Liquidity Risk Management Rules for Mutual Funds and ETFs

On September 22, 2015, the SEC unanimously approved a proposal that is intended to promote effective liquidity risk management by open-end investment companies, reduce the risk that funds will be unable to meet redemption obligations and mitigate the dilution of shareholder interests.

Under the proposal, mutual funds and exchange-traded funds (ETFs), but not money market funds, would be required to establish a liquidity risk management program and disclose fund liquidity and redemption practices, such as the methods that a fund uses to meet redemption requests and the number of days in which a fund will pay redemption proceeds to redeeming shareholders. If the number of days in which a fund will pay redemption proceeds differs by distribution channel (e.g., broker-dealer channel, omnibus account channel, retirement plan channel, etc.), a fund also would be required to disclose the number of days for each distribution channel. Additionally, the proposal would provide a framework in which funds could elect to use “swing pricing” to reflect in their net asset value costs associated with shareholder trading activity during periods of heavy redemptions or purchases.

In connection with the proposed disclosure and reporting reforms, the SEC is re-opening the comment period for the proposed investment company reporting reforms announced earlier this year because the new proposal includes amendments to the previously proposed Form N-PORT and Form N-CEN.

Liquidity Risk Management Programs

Proposed Rule 22e-4 under the 1940 Act would require funds to adopt and implement written liquidity risk management programs, including the following elements:

- *Liquidity Classification of Portfolio Investments:* Funds would be required to indicate the liquidity classification of each of the fund’s positions in a portfolio asset using the following specified categories: (1) convertible to cash within 1 business day; (2) convertible to cash within 2-3 business days; (3) convertible to cash within 4-7 calendar days; (4) convertible to cash within 8-15 calendar days; (5) convertible to cash within 16-30 calendar days; and (6) convertible to cash in more than 30 calendar days. For portfolio assets with multiple liquidity classifications, the proposed rule would require funds to indicate the dollar amount attributable to each classification. Such information would be made available to the public quarterly on proposed Form N-PORT.
- *Determination of Three-Day Liquid Asset Minimum:* The proposed rule would require each fund to determine its “three-day liquid asset minimum,” which is the percentage of the fund’s net assets to be invested in three-day liquid assets. The proposed definition of three-day liquid asset is any cash held by a fund and any position of a fund in an asset (or portion of the fund’s position in an asset) that the fund believes is convertible into cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale. The three-day liquid asset minimum would be determined based on an assessment of short-term and long-term cash

flow projections, the investment strategy and liquidity of the fund's portfolio assets, the use of borrowings and derivatives for investment purposes, holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources. A fund's board would be required to approve the fund's three-day liquid asset minimum and a fund would be required to maintain a written record of how the fund's three-day liquid asset minimum was determined.

- *Assessment, Review and Management of Liquidity Risk:* The proposed rule would require a fund to assess and periodically review its liquidity risk and manage such risk based on this assessment. In this connection, a fund would be prohibited from acquiring any less liquid asset if the fund would have invested less than its three-day liquid asset minimum in three-day liquid assets. In addition, the proposal codifies current SEC guidance that limits a mutual fund's ability to invest in illiquid assets to 15% of the fund's net assets.
- *Reports to Fund Boards:* A fund's investment adviser or officers administering the fund's liquidity risk management program would be required to submit written reports to the fund's board concerning the adequacy of the fund's liquidity risk management program, including the fund's three-day liquid asset minimum, and the effectiveness of its implementation. Board approval would be required for any changes to the fund's three-day liquid asset minimum.

The requirements of proposed Rule 22e-4, including the liquidity risk assessment requirements, are applicable to each series of a registered open-end investment company, meaning that each series requires a liquidity risk management program tailored to its own liquidity risk. The proposing release acknowledges that it may be appropriate for multiple series to adopt the same or a similar liquidity risk management program to the extent that such series are "substantially similar in terms of cash flow patterns, investment strategy, portfolio liquidity, and the other factors a fund would be required to consider in assessing its liquidity risk."

Swing Pricing

The SEC also is proposing amendments to Rule 22c-1 under the 1940 Act that would allow, but not require, mutual funds (excluding ETFs and money market funds) to adjust their net asset value when the level of purchases or redemptions exceed certain pre-approved "swing thresholds." Under the proposal, a fund's board would be required to: (i) approve the methodologies for calculating the swing threshold and the adjustment factor and (ii) conduct an annual review of swing pricing policies and procedures. The SEC notes that the proposed amendments to Rule 22c-1 are designed to protect existing shareholders from dilution associated with shareholder purchases and redemptions.

Disclosure and Reporting Requirements

The SEC is proposing several amendments to Form N-1A and proposed Form N-PORT and Form N-CEN, including:

- Form N-1A: Funds would be required to disclose their liquidity risk management practices, including the methods used to meet shareholder redemptions and the use of "swing pricing," if applicable. In addition, the proposal would require a fund to file any agreements related to lines of credit for the benefit of the fund as exhibits to its registration statement. (The specific fees paid in connection with credit agreements need not be disclosed in the exhibit proposed to be filed with the SEC.)

- Form N-PORT: Funds would be required to report the liquidity classifications assigned to individual portfolio securities and the three-day liquid asset minimum.
- Form N-CEN: Funds would be required to disclose information regarding committed lines of credit, swing pricing and interfund borrowing and lending, to the extent applicable.

Comments on the proposed rules will be accepted by the SEC for a period of 90 days after publication in the Federal Register. The proposing release is available at: http://www.sec.gov/rules/proposed/2015/33-9922.pdf.

SEC Issues Final Rule for Removal of Certain References to Credit Ratings and Amends the Issuer Diversification Requirement in the Money Market Fund Rule

On September 16, 2015, the SEC adopted amendments to remove references to credit ratings from Rule 2a-7 and eliminate an exclusion from Rule 2a-7's issuer diversification provisions. The amendment removing credit rating references implements a requirement of the Dodd-Frank Act, which directed each federal agency, including the SEC, to review its rules and replace any reference to or requirement of reliance on credit ratings with a standard of credit-worthiness that the agency determines is appropriate for its regulations.

Determination of Eligible Securities

Currently, Rule 2a-7 requires money market funds to limit portfolio investments to securities that are "eligible securities," as defined generally by reference to credit ratings provided by "nationally recognized statistical rating organizations" (each, an "NRSRO"), and that have been determined by the fund's board (or its delegate) to pose "minimal credit risks" to the fund. Since minimal credit risk is not defined in Rule 2a-7, the money market fund industry has relied on SEC staff guidance regarding the credit quality factors that may be used to determine that a security presents minimal credit risks.

As amended, Rule 2a-7 codifies this guidance and adopts a revised standard for eligible securities requiring a single uniform minimal credit risk finding. Consequently, in making its minimal credit risk determinations, a money market fund's board (or its delegate) will be required to consider "the capacity of each security's issuer, guarantor, or provider of a demand feature, to meet its financial obligations, and in doing so, consider, to the extent appropriate, the following factors: (1) financial condition; (2) sources of liquidity; (3) ability to react to future market-wide and issuer- or guarantor-specific events, including ability to repay debt in a highly adverse situation; and (4) strength of the issuer or guarantor's industry within the economy and relative to economic trends, and issuer or guarantor's competitive position within its industry."

The adopting release advises that the financial condition factor generally should include examination of recent financial statements, including consideration of trends relating to cash flow, revenue, expenses, profitability, short-term and total debt service coverage, and leverage. As to sources of liquidity, bank lines of credit and alternative sources of liquidity should be considered. The third factor, involving market-wide events, generally should include analysis of risk from "various scenarios, including changes to the yield curve or spreads, especially in a changing interest rate environment." The fourth factor, the competitive position of the firm and its industry, generally should include "consideration of diversification of sources of revenue, if applicable." Finally, the adopting release adds that a minimal credit risk evaluation also may include "consideration of whether the price and/or yield of the security itself is similar to that of other securities in the fund's portfolio."

Monitoring Minimal Credit Risks

Rule 2a-7 currently requires a money market fund board (or its delegate) to promptly reassess whether a security that has been downgraded by an NRSRO continues to present minimal credit risks. As amended, Rule 2a-7 will require a money market fund to adopt written procedures requiring the fund's adviser to provide ongoing review of each portfolio security to determine that the issuer continues to present minimal credit risks.

Recordkeeping

The SEC adopted a conforming change to the recordkeeping requirements under Rule 2a-7 to reflect that funds must retain a written record of the determination that a portfolio security is an eligible security, including the determination that it presents minimal credit risks, at the time the fund acquires the security, or at such later times (or upon such events) that the fund's board determines the investment adviser must reassess whether the security presents minimal credit risks.

Exclusion from the Issuer Diversification Requirement

Under current Rule 2a-7, a money market fund's portfolio must be diversified both as to the issuers of the securities it acquires and providers of guarantees (and demand features) related to those securities. Generally, money market funds must limit their investments in the securities of any one issuer of a "first tier security" to no more than 5% of total assets, other than with respect to government securities and securities subject to a guarantee by a non-controlled person. Thus, Rule 2a-7 currently does not require a money market fund to be diversified with respect to issuers of securities that are subject to a guarantee by a non-controlled person. The Rule amendments adopted by the SEC eliminate the current exclusion to the issuer diversification requirement for such securities.

The effective date of the Rule amendments is October 26, 2015. The compliance date is October 14, 2016. The adopting release is available at: http://www.sec.gov/rules/final/2015/ic-31828.pdf.

OCIE Identifies Focus Areas for Second Round of Cybersecurity Sweep Exams

On September 15, 2015, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a Risk Alert to provide additional information on the focus areas for OCIE's second round of cybersecurity examinations of registered broker-dealers and investment advisers. The Risk Alert is the latest publication by the SEC staff concerning cybersecurity compliance and controls, which OCIE included among its 2015 examination priorities.

In April 2014, OCIE announced the first round of sweep examinations intended to identify cybersecurity risks and assess cybersecurity preparedness in the securities industry. In February 2015, OCIE issued a Risk Alert providing summary observations derived from the first round of examinations, which included interviews with key personnel and evaluation of materials from 57 registered broker-dealers and 49 registered investment advisers relating to the firms' practices for: identifying cybersecurity-related risks; establishing cybersecurity governance, including policies, procedures and oversight processes; identifying and responding to risks relating to service providers, vendors and other third parties; safeguarding network infrastructure and information; identifying and managing risks associated with remote access to client information and funds transfer requests; and uncovering unauthorized activity.

In the recently released Risk Alert, OCIE indicated that the second round of sweep examinations will involve more testing to assess implementation of firm procedures and controls. In this connection, OCIE identified several key focus areas, including:

- **Governance and Risk Assessment:** Examiners may assess whether firms: (i) have cybersecurity governance and risk assessment processes related to the other key areas of focus described below; (ii) are periodically evaluating cybersecurity risks and whether their controls and risk assessment processes are tailored to their business; and (iii) are involving senior management/boards of directors and to what extent.
- **Access Rights and Controls:** Examiners may review how firms control access to various systems and data via management of user credentials, authentication, and authorization methods. This review may include a review of controls associated with remote access, customer logins, passwords, firm protocols to address customer login problems, network segmentation, and tiered access.
- **Data Loss Prevention:** Examiners may assess how firms: (i) monitor the volume of content transferred outside of the firm by their employees or through third parties (e.g., by email attachments or uploads); (ii) monitor for potentially unauthorized data transfers; and (iii) verify the authenticity of a customer request to transfer funds.
- **Vendor Management:** Examiners may assess: (i) firm practices and controls related to vendor management (e.g., due diligence with regard to vendor selection, monitoring and oversight of vendors, and contract terms); (ii) how vendor relationships are considered as part of the firm's ongoing risk assessment process; and (iii) how the firm determines the appropriate level of due diligence to conduct on a vendor.

- **Training:** Examiners may assess how: (i) training is tailored to specific job functions and how training is designed to encourage responsible employee and vendor behavior; and (ii) procedures for responding to cyber incidents under an incident response plan are integrated into regular personnel and vendor training.
- **Incident Response:** Examiners may assess whether firms have established policies, assigned roles, assessed system vulnerabilities, and developed plans to address possible future events (including determining which firm data, assets, and services warrant the most protection to help prevent attacks from causing significant harm).

In connection with "OCIE's efforts to promote compliance and to share with the industry where it sees cybersecurity-related risks," OCIE included with the Risk Alert a sample request for information and documents to be used in the second round of sweep examinations. The Risk Alert, including the sample information request, is available at: http://www.sec.gov/ocie/announcement/ocie-2015-cybersecurity-examination-initiative.pdf.

FinCEN Proposes Anti-Money Laundering Rules for Registered Investment Advisers

On August 25, 2015, the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Department of the Treasury, issued a notice of proposed rulemaking that would require registered investment advisers to establish anti-money laundering ("AML") programs and to report suspicious activity to FinCEN pursuant to the Bank Secrecy Act ("BSA"). The proposed rule seeks to address money laundering vulnerabilities in the U.S. financial system, specifically to prevent illicit actors from using an investment adviser as a means to avoid detection of their activity, which might otherwise occur in dealing with financial institutions that have AML programs and suspicious activity reporting requirements. FinCEN is proposing three significant regulatory changes:

- The proposed rule would include all investment advisers that are registered with the SEC or required to be registered with the SEC under Section 203 of the Advisers Act (generally, investment advisers with assets under management of $100 million or more) within the scope of "financial institutions" for purposes of the BSA, thus subjecting such advisers to all BSA regulatory requirements generally applicable to other financial institutions (e.g., the requirement to file currency transaction reports and comply with recordkeeping requirements relating to the transmittal of funds).
- The proposed rule would require registered investment advisers to develop, implement and monitor a written AML program reasonably designed to prevent the adviser from being used as a conduit to facilitate money laundering or finance terrorist activities and to achieve compliance with the applicable provisions of the BSA and FinCEN implementing regulations. Specifically, a registered investment adviser would be required, among other things, to: (1) adopt and implement policies, procedures and internal controls based upon the adviser's assessment of the money laundering or terrorist financing risks posed by its clients, (2) provide for periodic

independent testing of the AML program, (3) designate an AML compliance officer, and (4) provide ongoing AML training for appropriate firm personnel.

- The proposed rule would require registered investment advisers to report suspicious transactions that involve at least $5,000 in funds or other assets that are conducted or attempted "by, through or at" the adviser. An adviser would be permitted to delegate such responsibilities to an agent or third-party processor, but the adviser would remain liable for any violation by the third party for failure to comply with the suspicious activity reporting requirements.

FinCEN is proposing to delegate its authority to examine registered investment advisers for compliance with these requirements to the SEC. FinCEN notes that it is not proposing a customer identification program requirement at this time, but that it anticipates addressing this issue in a subsequent rulemaking. Comments on the proposed rule are due by November 2, 2015.

The FinCEN proposed rulemaking release is available at: http://www.fincen.gov/statutes_regs/frn/pdf/1506-AB10_FinCEN_IA_NPRM.pdf.

Public Statements, Speeches and Testimony

SEC Commissioners Address Recent Commission Orders Against CCOs

On August 10, 2015, SEC Commissioner Luis Aguilar released a public statement concerning "the critical importance of clarity in Commission Orders for enforcement actions." Commissioner Aguilar stated that the Commission and its staff "should always be cognizant that there is a broad audience that carefully reads Commission Orders for guidance" as to what is, and what is not, acceptable behavior. More specifically, Commissioner Aguilar stated that when Commission Orders involve federal securities law violations by Chief Compliance Officers, "[t]he need for clear and transparent Orders is especially important." Noting that "CCOs, after all, exist in large part to implement and enforce policies and procedures to prevent federal securities law violations," Commissioner Aguilar emphasized that "the importance of clarity in Commission Orders, especially the ones involving CCOs, cannot be overstated."

Along the same lines, SEC Commissioner Daniel Gallagher, in a speech delivered to the U.S. Chamber of Commerce on August 4, 2015 in connection with the fifth anniversary of the enactment of the Dodd-Frank Act, warned that "[r]ecent enforcement actions holding compliance officers to a standard of strict liability will only serve to chill talented professionals from playing this vital role."

These comments come against a backdrop of other recent comments by SEC Commissioners regarding the appropriate treatment of CCOs in enforcement actions. For instance, on June 18, 2015, Commissioner Gallagher, in a public statement, commented on his vote against two settled SEC enforcement actions *(In the Matter of Blackrock Advisors, LLC and In the Matter of SFX Financial Advisory Management Enterprises, Inc.)* involving alleged violations by CCOs of Rule 206(4)-7 under the Advisers Act, which requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Act. He stated that "[b]oth settlements illustrate a Commission trend toward strict liability for CCOs under Rule 206(4)-7," suggesting that "[a] ctions like these are undoubtedly sending a troubling message that CCOs should not take ownership of the firm's compliance policies and procedures, lest they be held accountable for conduct that, under Rule 206(4)-7, is the responsibility of the adviser itself."

On June 29, 2015, in a public statement titled "The Role of Chief Compliance Officers Must be Supported," Commissioner Aguilar expressed "concern that the recent public dialogue may have unnecessarily created an environment of unwarranted fear in the CCO community" and that "the dissent [of Commissioner Gallagher] and the resulting publicity, has left the impression that the SEC is taking too harsh of an enforcement stance against CCOs, and that CCOs are needlessly under siege from the SEC." Commissioner Aguilar insisted that "the Commission does not bring enforcement actions against CCOs who take their jobs seriously and do their jobs competently, diligently, and in good faith to protect investors." On July 15, 2015, Chair Mary Jo White also weighed in on the public debate in her opening remarks at the SEC's Compliance Outreach Program for Broker-Dealers. She assured the audience that it is not the Commission's intention to use its enforcement program to target compliance professionals, stating that "[w]e do not bring cases based on second guessing compliance officers' good faith judgments, but rather when their actions or inactions cross a clear line that deserve sanction."

Litigation and Enforcement Actions

U.S. Supreme Court Denies Defendants' Petition for Certiorari in Schwab Case Relating to Violation of Fundamental Investment Policies

On October 5, 2015, the U.S. Supreme Court announced that it had denied the defendants' petition for a writ of certiorari in the shareholder class action originally brought in August 2008 by Northstar Financial Advisors, Inc., on behalf of its clients, against Schwab Investments, a Massachusetts business trust, the board of trustees of Schwab Investments and Charles Schwab Investment Management, Inc. (CSIM). In denying the defendants' petition, the Supreme Court declined to review the earlier decision of the U.S. Court of Appeals for the Ninth Circuit in the case, effectively allowing the Ninth Circuit's decision to stand.

The following is a summary of the litigation to date:

In August 2008, Northstar Financial Advisors, Inc. filed a shareholder class action lawsuit setting forth a number of claims based on allegations that the Schwab Total Return Bond Fund, a series of Schwab Investments for which CSIM serves as investment adviser, deviated from its fundamental investment policies. Specifically, between September 2007 and February 2009, the Fund is alleged to have (1) deviated from its fundamental investment objective to track the Lehman Brothers U.S. Aggregate Bond Index, the Fund's benchmark, by investing in non-U.S. agency collateralized mortgage obligations that were not included in the Index, and (2) invested in non-agency mortgage-backed securities and collateralized mortgage obligations in excess of fundamental investment policies prohibiting the Fund from investing more than 25% of its total assets in any industry and investing more than 25% of its total assets in U.S. agency and non-agency mortgage-backed securities and CMOs. As a result of these investments, the Fund significantly underperformed its benchmark during the relevant period.

The plaintiffs' initial complaint asserted a number of claims relating to this activity, including: a violation of Section 13(a) of the 1940 Act, which prohibits a fund from, among other things, deviating from a fundamental investment policy without shareholder approval; a breach of fiduciary duty by the Fund's board of trustees relating to a denial of voting rights; a breach of a purported contract between Fund shareholders and Schwab Investments created when shareholders voted in 1997 to change the Fund's fundamental investment policies to those alleged to have been violated; and a breach of the implied covenant of good faith and fair dealing. The defendants initially moved to dismiss the suit, claiming that Northstar, the lead plaintiff, had no standing to sue because it never itself invested in the Fund, and that there is no private right of action under Section 13(a). The U.S. District Court for the Northern District of California agreed that Northstar had no standing to sue but allowed a shareholder's claim to be assigned to Northstar to cure the deficiency. While the District Court initially ruled against the defendants on the Section 13(a) claim, the defendants ultimately prevailed on appeal, where the U.S. Court of Appeals for the Ninth Circuit determined that there was no private right of action under that section.

In September 2010, the plaintiffs amended their complaint to re move the Section 13(a) claim and add a claim for breach of the investment advisory contract between Schwab Investments and CSIM, which required CSIM to manage the Fund in accordance with the Fund's fundamental investment objectives and policies, on a theory that plaintiffs were third-party beneficiaries of the contract.

The defendants again moved to dismiss the suit, arguing that all of the plaintiffs' claims should be precluded by the Securities Litigation Uniform Standards Act (SLUSA), which prohibits class actions brought by more than 50 plaintiffs if the action is based on state law claims and alleges either a material misrepresentation or omission or the use of manipulation or deception in connection with the purchase or sale of a security. On this point, the District Court agreed that all of the plaintiffs' claims, with the exception of the fiduciary duty claim to the extent it was based purely on Massachusetts law, should be precluded by SLUSA because such claims all related essentially to misrepresentations by the defendants, in the Fund's prospectuses and other documents, relating to how the Fund would be managed. The District Court granted the defendants' motion to dismiss the breach of contract and implied covenant of good faith and fair dealing claims, determining that the plaintiffs had failed to show that the 1997 proxy vote created a contract between Schwab Investments and Fund shareholders. The District Court also determined that the harm from the purported breach of fiduciary duty affected all shareholders equally and therefore was properly viewed as being inflicted on the Fund; accordingly, the District Court determined that the claim must be brought in a derivative suit rather than individually by Fund shareholders. The District Court granted the plaintiffs leave to amend their complaint to re-assert the fiduciary duty claim in a manner so as not to be derivative or to implicate SLUSA. Finally, while the District Court was not fully persuaded by the defendants' arguments that Fund shareholders were not third-party beneficiaries of the investment advisory contract, the District Court noted that this claim, as previously presented, was precluded by SLUSA. The District Court granted the plaintiffs leave to amend their complaint to re-assert the third-party beneficiary claim in a manner that did not trigger SLUSA preclusion.

In March 2011, the plaintiffs filed another amended complaint, which contained revised breach of fiduciary duty claims against Schwab Investments' board of trustees and CSIM as well as updated breach of contract claims against CSIM under the third-party beneficiary theory.

The defendants again moved to dismiss all claims. The District Court was not persuaded by the plaintiffs' additional pleading on the fiduciary duty claims and dismissed with prejudice all of the claims, determining that such claims failed to allege a breach of duty owed directly to shareholders, and that these claims would need to be brought derivatively. The District Court also dismissed the third-party beneficiary claims with prejudice, having not been persuaded by additional pleading that shareholders should be considered third-party beneficiaries of an investment advisory contract under California law.

The plaintiffs thereafter appealed a number of the claims previously dismissed by the District Court, including the breach of contract claim relating to the 1997 proxy vote, the fiduciary duty claims and the third-party beneficiary claim relating to the Fund's investment advisory contract.

On March 9, 2015, the U.S. Court of Appeals for the Ninth Circuit reversed the prior dismissal of these claims and remanded the case for further deliberation. In reversing the prior dismissal of the breach of contract claim relating to the 1997 proxy vote, the Ninth Circuit concluded that "the mailing of the proxy statement and the adoption of the two fundamental investment policies after the shareholders voted to approve them, and the annual representations by the Fund that it would follow these policies are sufficient to form a contract between the shareholders on the one hand and [Schwab Investments] on the other." The Ninth Circuit concluded that the Fund offered investors the right to invest on the terms set forth in its proxy statement and prospectuses, that shareholders accepted the offer by so investing, that the investment or continued investment by shareholders was the consideration and that the parties' object was lawful, thereby satisfying the requirements for a contract.

The Ninth Circuit also vacated the prior dismissal of the plaintiffs' fiduciary duty claims, disagreeing with the District Court's determination that the plaintiffs "failed to successfully allege a breach of any duty owed directly to Fund investors." The Ninth Circuit pointed to the Fund's declaration of trust, which states that "the Trustees hereby declare that they will hold all cash, securities and other assets, which they may from time to time acquire as Trustees hereunder IN TRUST to manage and dispose of the same . . . for the pro rata benefit of the holders from time to time of Shares of the Trust." In addition, citing cases under Massachusetts law and various secondary sources, the Ninth Circuit determined that trustees of a Massachusetts business trust owe a fiduciary relationship to all trust shareholders, and that "there is no logical basis for the argument that the trustees of a mutual fund organized as a Massachusetts business trust owe a fiduciary duty to the trust, rather than the shareholders, and that for this reason they are limited to a derivative action on behalf of the trust." The Ninth Circuit further identified general differences between when a derivative action should be required in the case of an operating corporation, where share prices rise and fall as a by-product of business success and share price declines may result from either unsuccessful decisions or fiduciary misconduct, and in the case of a mutual fund, where there is no business other than investing and any decrease in share price flows directly and immediately to shareholders, which would especially be true when such a decrease results from the violation of a fundamental investment policy.

Finally, the Ninth Circuit reversed the decision below to dismiss the third-party beneficiary claim relating to the Fund's investment advisory contract, concluding that plaintiffs adequately alleged that the investment advisory contract was entered into with the intention to benefit Fund shareholders.

Among other things, the Ninth Circuit cited as evidence that shareholders should be considered third-party beneficiaries of the investment advisory contract the requirement of the 1940 Act that investment advisory contracts be approved by fund shareholders.

The Ninth Circuit declined to address the effect of SLUSA on the various common law causes of action in the case and remanded the case to the District Court to determine the applicability of SLUSA to the plaintiffs' various claims. As noted, following the issuance of the Ninth Circuit's opinion in March, the defendants immediately petitioned for a rehearing.

On April 28, 2015, in a two-to-one decision, a three-judge panel of the Ninth Circuit rejected the defendants' petition for a rehearing.

On July 27, 2015, the defendants filed a petition for a writ of certiorari with the U.S. Supreme Court, requesting that the Supreme Court review certain of the Ninth Circuit's holdings. Specifically, the defendants requested that the Supreme Court review the Ninth Circuit's holding that Northstar could cure its lack of standing after the date of the original pleading by having a shareholder assign to Northstar its claim. The defendants argued that this ruling directly conflicted with decisions of at least two other U.S. circuit courts of appeals, was contrary to Supreme Court jurisprudence establishing that standing must exist at the time a complaint is filed, presented "a vitally important question" and caused confusion among lower courts. The defendants also requested that the Supreme Court review the Ninth Circuit's holding that disclosures in documents filed with the SEC create contracts that can be enforced through common law breach-of-contract claims. The defendants argued that this ruling was unworkable, misconstrued and improperly sidestepped the federal securities laws, created a means to penalize mutual funds for compliance with the federal securities laws, impaired the uniform regulation of nationally traded securities in conflict with federal law and established an unprecedented theory that is inconsistent with previous decisions of the Supreme Court and other federal courts.

The plaintiffs filed a brief in opposition on August 26, 2015.

On August 28, 2015, the Investment Company Institute (ICI) and the Independent Directors Council (IDC) filed a joint amicus brief supporting the defendants' petition, arguing that granting certiorari in this case was warranted because of the "immediate and far-reaching threat to mutual funds and their investors" presented by the Ninth Circuit's decision. The ICI and IDC further argued that the Ninth Circuit's ruling that SEC disclosures may create enforceable contracts improperly turns a federally mandated disclosure document into a privately enforceable contract in a manner that conflicts with the comprehensive federal regulatory framework applicable to mutual funds. Also on August 28, 2015, a second amicus brief in support of the defendants was filed by the Mutual Fund Directors Forum, and a third amicus brief in support of the defendants was filed jointly by Pacific Life Fund Advisors, LLC, Capital Research and Management Co., AssetMark Inc., Wells Fargo Fund Management, LLC and Russell Investments.

As stated above, on October 5, 2015, the U.S. Supreme Court announced that it had denied the defendants' petition for a writ of certiorari.

SEC Settles Charges Against Investment Adviser for Failing to Adopt Adequate Cybersecurity Policies and Procedures in Advance of Data Breach

On September 22, 2015, the SEC announced settled administrative proceedings against R.T. Jones Capital Equities Management, Inc. ("RTJ"), a registered investment adviser, for failing to adopt written policies and procedures regarding the security and confidentiality of sensitive client information and the protection of that information from anticipated threats or unauthorized access pursuant to Rule 30(a) of Regulation S-P under the Securities Act (the "Safeguards Rule"). As noted in the order, the Safeguards Rule, which the SEC adopted in 2000, requires SEC-registered brokers/dealers, investment companies and investment advisers to adopt policies and procedures reasonably designed to: (1) insure the security and confidentiality of customer records and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

According to the SEC, RTJ provided portfolio allocation models and recommendations to retirement plan participants through a program that participants could access on RTJ's public website. The SEC found that from September 2009 through July 2013, in order to verify eligibility to enroll in the program, RTJ required prospective clients to log on to its website by providing certain personal information, which RTJ compared against sensitive "personally identifiable information" ("PII") of eligible plan participants provided to RTJ by its plan sponsor partners. According to the order, to facilitate the verification process, the plan sponsors provided RTJ with PII of all of their plan participants, which RTJ stored, without modification or encryption, on its third party-hosted web server. Consequently, the order states that "even though [RTJ] had fewer than 8000 plan participant clients, its web server contained the PII of over 100,000 individuals."

According to the SEC, in July 2013, RTJ discovered a potential cybersecurity breach on its third party-hosted web server, rendering the PII vulnerable to theft. The order states that RTJ promptly hired multiple cybersecurity firms to review the breach, but, ultimately, the cybersecurity firms could not determine the full nature or extent of the breach or whether the PII stored on the server had been accessed or compromised. The SEC noted that RTJ notified the affected individuals and offered them free identity theft monitoring.

The SEC ordered that RTJ cease and desist from committing or causing future violations of the Safeguards Rule, censured the firm and required RTJ to pay a $75,000 civil penalty. In determining to accept RTJ's settlement offer, the SEC considered RTJ's remedial efforts, including the appointment of an information security manager to oversee data security and protection of PII, adoption and implementation of a written information security policy, installation of a new firewall and logging system to prevent and detect malicious incursions and the retention of a cybersecurity firm to provide ongoing reports and advice on the firm's information technology security.

The SEC order in the matter of RTJ is available at: http://www.sec.gov/litigation/admin/2015/ia-4204.pdf.

SEC Settles First Charges Brought Under Distribution-in-Guise Initiative

On September 21, 2015, the SEC issued an order instituting a settled administrative proceeding against First Eagle Investment Management, LLC, a registered investment adviser ("First Eagle"), and its wholly-owned broker-dealer subsidiary, FEF Distributors, LLC ("FEF"), for improper use of mutual fund assets to pay for the distribution and marketing of fund shares. An SEC press release announcing the order noted that "[t]he case is the first arising out of a recent SEC initiative to protect mutual fund shareholders from bearing the costs when firms improperly use fund assets to pay for distribution-related services."

As stated in the order, Section 12(b) of the 1940 Act and Rule 12b-1 thereunder make it unlawful for any registered open-end management investment company to engage "directly or indirectly in financing any activity which is primarily intended to result in the sale of shares issued by such company" unless such financing is made pursuant to a written plan that meets the requirements of Rule 12b-1.

According to the SEC, in an effort to expand the distribution of the shares of the First Eagle Funds, FEF, the Funds' the principal underwriter and distributor, entered into distribution relationships with various financial intermediaries, including two firms identified in the order as "Intermediary One" and "Intermediary Two."

Intermediary One

The SEC found that in June 2000, FEF entered into two agreements with Intermediary One: a Financial Services Agreement and a Selected Dealer Agreement. Pursuant to the Financial Services Agreement, Intermediary One agreed to provide a variety of sub-transfer agency ("sub-TA") services, for which it charged fees ranging between $16-$19 per account. The Funds paid these fees. Pursuant to the Selected Dealer Agreement, Intermediary One agreed to become a selected dealer to "distribute shares" of the Funds and to provide services which included due diligence, legal review, training and "marketing." According to the SEC, for these services, the Selected Dealer Agreement stated that Intermediary One would receive, in addition to Rule 12b-1 plan fees paid by the Funds: (1) a one-time fee of $50,000; (2) 25 basis points of total new gross sales of shares of any class sold by Intermediary One; and (3) 10 basis points of the value of Fund shares sold by Intermediary One that are held for more than one year.

As stated in the SEC's order, under the terms of the Selected Dealer Agreement, during the period from January 1, 2008 through March 31, 2014, First Eagle and FEF caused the Funds to pay approximately $25 million to Intermediary One for services that the SEC found were "generally marketing and distribution" and not made pursuant to the Funds' Rule 12b-1 plan.

Intermediary Two

According to the SEC, in December 2007, FEF entered into a Correspondent Marketing Program Participation Agreement (the "Correspondent Agreement") with Intermediary Two; however, the SEC found that the Funds had essentially been paying for the same services since 2005. As stated in the SEC's order, pursuant to the Correspondent Agreement, Intermediary Two agreed, among other things, to provide email distribution lists of correspondent broker-dealers that request "sales and marketing concepts" from Intermediary Two, market the Funds on its internal website, invite the Funds to participate in special marketing promotions and offerings to correspondent broker-dealers and provide quarterly statements detailing which correspondent broker-dealers were selling the Funds. In exchange for these services, Intermediary Two received fees based upon the net asset value of outstanding shares of the Funds it sold.

The SEC found that First Eagle and FEF caused the Funds to pay approximately $290,000 to Intermediary Two pursuant to the Correspondent Agreement during the relevant time period. As with the Selected Dealer Agreement with Intermediary One, the SEC found that the services provided by Intermediary Two under the Correspondent Agreement were generally marketing and distribution and not sub-TA services. Consequently, the SEC found that First Eagle and FEF were prohibited from using the Funds' assets to pay Intermediary Two under the Correspondent Agreement outside of a written, approved 12b-1 plan.

The SEC order stated that First Eagle periodically reported to the Funds' board of trustees regarding payments for distribution and sub-TA services and consulted with its outside counsel regarding such payments, including in connection with a review by outside counsel of First Eagle's practices with respect to payments for sub-TA services. According to the SEC, the results of the foregoing review—which First Eagle shared with the board—indicated that all of the fees paid to Intermediary One and Intermediary Two under the Financial Services Agreement, Selected Dealer Agreement and Correspondent Agreement, respectively, were for sub-TA services.

As a result of the foregoing conduct, the SEC found that, among other things, First Eagle and FEF violated Section 12(b) of the 1940 Act and Rule 12b-1 thereunder. Pursuant to the terms of the order, First Eagle was censured and ordered to cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act, and Sections 12(b) and 34(b) of the 1940 Act and Rule 12b-1 thereunder. FEF also was subjected to a cease and desist order with respect to Section 12(b) of the 1940 Act and Rule 12b-1. In addition, First Eagle and FEF agreed to certain undertakings to enhance their compliance program and were ordered to pay disgorgement, prejudgment interest and a civil monetary penalty totaling approximately $40 million, a portion of which will be used to reimburse Fund shareholders.

The SEC order in the matter of First Eagle and FEF is available at: http://www.sec.gov/litigation/admin/2015/ia-4199.pdf.

SEC Grants Petition for Review of Dismissal of Charges Against Investment Advisory Firm

In September 2014, the SEC issued an order instituting administrative proceedings against respondents The Robare Group, Ltd., a registered investment adviser ("Adviser") and its principals, Mark Robare and Jack Jones, Jr., alleging violations of the Advisers Act based on the Adviser's failure to disclose financial incentives it had in recommending particular mutual funds to its advisory clients. Specifically, the SEC alleged that the Adviser failed to disclose in its Form ADV compensation it received through a commission schedule and servicing fee agreement (the "Agreement") with a registered broker-dealer ("Broker") for client assets that were invested in certain mutual funds offered on the Broker's platform and the conflicts of interest to clients arising from that compensation arrangement. According to the SEC's allegations, from 2005 until the Adviser filed its December 2011 Form ADV, the Adviser failed to disclose the existence of the Agreement, which had been executed in 2004; beginning in December 2011, the SEC alleged, the Adviser inadequately disclosed the arrangement and "still failed to disclose that it had an incentive to prefer certain [mutual] funds as a result of the arrangement."

On June 4, 2015, an SEC administrative law judge issued an initial decision dismissing all charges against the respondents after finding, among other things, that the SEC failed to show that the respondents acted with scienter. Of note, the administrative law judge concluded that the respondents had prepared the Form ADV disclosure in question in reliance in good faith upon the advice of third-party compliance consultants, and that the consultants' advice was "facially valid."

On June 25, 2015, the SEC Division of Enforcement filed a petition for review of the initial decision, seeking reversal of the administrative law judge's decision to dismiss, a finding of liability and the imposition of sanctions. The Division of Enforcement's petition took issue with the judge's decision as a matter of public policy, claiming that the decision "shifts the burden of fully disclosing a conflict of interest from an investment adviser, who has a fiduciary duty to and a relationship with clients, to a compliance consultant (who has no such connection)." The Division asserted that the administrative law judge's decision, if allowed to stand, could "significantly weaken the long-standing fiduciary standards applicable to investment advisers." On July 10, 2015, the respondents moved for summary affirmance of the administrative law judge's decision.

On August 12, 2015, the SEC issued an order denying the respondents' petition for summary affirmance and granting the Division of Enforcement's petition for review. In granting the petition for review, the SEC noted the "potentially important matters of public interest this case presents . . . ." The Division has until September 11, 2015 to file a brief in support of the petition for review. The respondents' brief in opposition must be filed by October 12, 2015, and any reply brief must be filed by October 26, 2015.

Seventh Circuit Affirms District Court on Remand in *Jones v. Harris Associates*

On August 6, 2015, on remand from the U.S. Supreme Court, the Court of Appeals for the Seventh Circuit affirmed the 2007 decision by the District Court granting summary judgment to defendant Harris Associates in *Jones v. Harris Associates*, which had found that investors in the Oakmark mutual funds failed to establish that they had been charged excessive advisory fees. In a four-page order (including an acknowledgment that the Seventh Circuit's opinion was delayed following the Supreme Court's remand due to misplaced papers and a tracking system gap), the Seventh Circuit applied the *Gartenberg* standard embraced by the Supreme Court in a unanimous decision issued in March 2010: to face liability under §36(b) of the 1940 Act, an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining. In this connection, the Seventh Circuit turned aside the plaintiffs' contention that Harris's fees should be deemed excessive because they were not approved through proper procedures, explaining that a process-based failure alone does not constitute an independent violation of §36(b). Instead, Circuit Judges Frank Easterbrook and Michael Kanne stated in the opinion, "we have been instructed that §36(b) is sharply focused on the question of whether the fees themselves were excessive" (citing *Gallus v. Ameriprise Financial*). The Seventh Circuit's decision further states that although the district court applied a legal standard similar to the one eventually adopted by the Supreme Court, the standards are "not identical, because the Supreme Court's approach does not allow a court to assess the fairness or reasonableness of advisers' fees; the goal is to identify the outer bounds of arm's length bargaining and not engage in rate regulation. This means that the Supreme Court's standard is less favorable to plaintiffs than the one the district court used- yet plaintiffs lost even under the district court's approach." Turning to the District Court's findings, the Seventh Circuit noted that there was no material dispute about four propositions, "which collectively require a decision for Harris": (1) Harris's fees were in line with those charged by advisers for other comparable funds; (2) Harris provided accurate information to the funds' boards, whose disinterested members approved the fees; (3) the fee schedules included breakpoints; and (4) the fees could not be called disproportionate in relation to the value of Harris's work because the funds' returns (net of fees) "exceeded the norm for comparable investment vehicles." The Seventh Circuit added that the plaintiffs "seek to avoid the implications of [the foregoing] facts" by comparing the fees that Harris charged the Oakmark funds with the fees that Harris charged some of its other clients, such as pension funds. However, the Circuit Judges stated that their initial opinion rejected this contention and the "Supreme Court did not disagree with us," noting the Supreme Court's position that "courts may give such comparisons the weight that they merit in light of the similarities and differences between the services that the clients in question require," but courts must be "wary of inapt comparisons" between fees charged to different types of clients. The Seventh Circuit concluded that because the plaintiffs did not provide any evidence that "would tend to show that Harris provided pension funds (and other non-public clients) with the same sort of services that it provided to the Oakmark funds, or that it incurred the same costs when serving different types of clients," it had no basis to justify "a further inquiry" of these comparisons under the Supreme Court's approach.

U.S. District Court Denies Motion to Dismiss Excessive Fee Case Against SEI Investments

On July 13, 2015, the United States District Court for the Eastern District of Pennsylvania issued a decision on the defendants' motion to dismiss in the case of *Curd v. SEI Investments Management Corp*., Civ. Action No. 13-7219. In 2013, plaintiffs Steven and Rebel Curd filed suit in the District Court on behalf of five mutual funds (the "Funds") managed by SEI Investments Management Corporation (the "Investment Adviser"), alleging that the Investment Adviser and SEI Investments Global Funds Services (the "Administrator"), the Funds' administrator, violated Section 36(b) of the 1940 Act by charging excessive management and administrative fees.

The defendants submitted a motion to dismiss the plaintiffs' claims against the Investment Adviser on the grounds that the plaintiffs failed to allege sufficient facts to satisfy the requirements of the multi-factor *Gartenberg* test used to evaluate Section 36(b) claims and that the plaintiffs' allegations were untimely because they did not allege facts occurring during the relevant damages period. The defendants also moved to dismiss the plaintiffs' claims against the Administrator, claiming that the plaintiffs failed to establish that the Administrator was a party against which a Section 36(b) claim could be brought.

On July 13, 2015, the District Court denied the defendants' motion to dismiss with respect to the claims against the Investment Adviser but granted the defendants' motion to dismiss the claims against the Administrator.

In denying the defendants' motion to dismiss the claims against the Investment Adviser, the court, citing prior case law under Section 36(b), indicated that a plaintiff's excessive fee claim may survive a motion to dismiss even if it does not specifically address all of the *Gartenberg* factors, provided that, "when taken as a whole, the complaint demonstrates a plausible claim for relief under [Section] 36(b)." The court noted that the plaintiffs did allege facts relevant to all of the *Gartenberg* factors, noting in particular the plaintiffs' claims regarding the nature and quality of the services provided by the Investment Adviser and the Investment Adviser's failure to share cost savings resulting from realized economies of scale.

Regarding the nature and quality of the services provided by the Investment Adviser, the court noted that the plaintiffs alleged the following facts: The Funds are managed under a "manager-of-managers" arrangement whereby the Investment Adviser subcontracts portfolio management responsibilities for the Funds to outside sub-advisers but retains 40% of the investment advisory fees even though the Investment Adviser is left "largely without any asset management responsibilities." The Funds pay the Investment Adviser a monthly investment advisory fee based on a percentage of the Funds' average daily net assets. Accordingly, the fees are not based on the Investment Adviser's quality of services nor on the cost of providing such services. The Funds have also demonstrated poor performance. For the 2013 fiscal year, each of the Funds underperformed its primary benchmark for the five- and ten-year periods, and three of the Funds underperformed their primary benchmark for the one-year period. The court concluded that these facts raised a plausible claim that the Investment Adviser charges investment advisory fees "that are disproportionately large in comparison to the services it provides . . . and could not have been the product of arm's length bargaining."

Regarding the failure of the Investment Adviser to share cost savings resulting from realized economies of scale, the court noted that the plaintiffs alleged the following facts: Although the Funds' assets had grown significantly (e.g., the assets of one Fund increased from $640 million in 1997 to $2.3 billion in 2015), the Funds' investment advisory fees remained set at a constant percentage of average daily net assets. In addition, the Funds' investment advisory fee schedules did not contain breakpoints, which would allow for cost savings resulting from realized economies of scale to be passed along to Fund shareholders. Accordingly, the plaintiffs claimed, "[the Investment Adviser] profits from economies of scale without sharing the benefits with the [Funds] and, in turn, investors." The court concluded that these facts supported a plausible claim for relief under Section 36(b).

On the defendants' claim that the plaintiffs' suit was time barred, the Court noted that Section 36(b) provides that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted." The Court determined that the plaintiffs' suit was instituted on December 11, 2013 when the plaintiffs filed their initial complaint. Accordingly, the Court determined that the plaintiffs could not recover any damages for excessive fees charged before December 11, 2012. Because the plaintiffs' claims relied on financial and performance information from the Funds' fiscal years ended August 31, 2013 (for one Fund) and September 30, 2013 (for the other four Funds), the Court determined that the plaintiffs alleged facts relating to fees charged during the appropriate damages period and that the suit was not time barred.

While the Court denied the motion to dismiss the claims against the Investment Adviser, the Court was not particularly sanguine about the plaintiffs' overall case, noting that additional facts would be necessary for the Court to evaluate the strength of the plaintiffs' Section 36(b) claims under a fact-intensive review of the Gartenberg factors. The Court stated that while the plaintiffs' allegations were sufficient to survive a motion to dismiss, they "may well not survive summary judgment."

In granting the defendants' motion to dismiss the claims against the Administrator, the court noted that Section 36(b) authorizes an action against three categories of persons: a fund's investment adviser; an affiliated person of a fund's investment adviser; and certain persons enumerated in Section 36(a), which include a fund's officers, directors, advisory board members, depositor and principal underwriter. The Court concluded that (1) the Administrator was not the Funds' investment adviser, (2) the plaintiffs failed to allege facts indicating that the Administrator was an affiliated person of the Funds' investment adviser under the 1940 Act's definition of that term, and (3) the Administrator was not otherwise one of the enumerated persons in Section 36(a).

FINRA Sanctions Wells Fargo, Raymond James and LPL Financial for Failing to Identify and Apply Mutual Fund Sales Charge Waivers Available for Certain Retirement Accounts and Charitable Organizations

On July 6, 2015, each of Wells Fargo Advisors, LLC and Wells Fargo Advisors Financial Network, LLC (together, "Wells Fargo"), Raymond James & Associates, Inc. and Raymond James Financial Services, Inc. (together, "Raymond James") and LPL Financial LLC ("LPL") entered into a Letter of Acceptance, Waiver and Consent with the Financial Industry Regulatory Authority ("FINRA") to settle alleged rule violations in connection with each firm's failure to apply mutual fund sales charge waivers for certain retirement plan and charitable organization customers (together, "Eligible Customers").

As to each firm, FINRA alleged that, since at least July 1, 2009, the firms failed to reasonably supervise the application of sales charge waivers for eligible mutual fund sales to Eligible Customers. Although some of the funds available on each firm's platform offered waivers of up-front sales charges associated with Class A shares for Eligible Customers and disclosed those waivers in their prospectuses, FINRA alleged that the firms treated the Eligible Customers in the same manner as ordinary retail customers and, as a result, the Eligible Customers either unnecessarily paid sales charges when purchasing Class A shares or purchased other share classes that subjected them to higher ongoing fees and expenses. In each case, the firm began a review to determine whether the firm had provided available sales charge waivers to Eligible Customers. Thereafter, each firm self-reported to FINRA that Eligible Customers had not received available sales charge waivers and thus were overcharged for mutual fund purchases during the relevant periods.

By failing to reasonably supervise mutual fund sales to ensure that Eligible Customers that purchased mutual fund shares received the benefit of applicable sales charge waivers, FINRA found that each firm violated NASD Conduct Rule 3010 (for misconduct before December 1, 2014) and FINRA Rule 2010 and, with respect to Raymond James and LPL only, FINRA Rule 3110 (for misconduct on or after December 1, 2014). As part of the settlements, each firm agreed to a censure and to pay restitution to Eligible Customers of the amount estimated to have been overcharged, including interest, totaling approximately $15 million in the case of Wells Fargo, $4.5 million for Raymond James and $6.3 million with respect to LPL. LPL also agreed to pay restitution to Eligible Customers that purchased fund shares or that purchase mutual funds without an appropriate sales charge waiver during the period January 1, 2015 through the date that the firm establishes and fully implements training, systems and procedures reasonably designed to achieve compliance with the supervision of mutual fund sales waivers.

In resolving the matters, FINRA cited each firm's "extraordinary cooperation" for having: (i) initiated, prior to detection or intervention by a regulator, an investigation to identify whether Eligible Customers received sales charge waivers during the relevant period; (ii) promptly established a plan of remediation for Eligible Customers that did not receive appropriate sales charge waivers; (iii) promptly self-reported to FINRA; (iv) promptly taken action and remedial steps to correct the violative conduct; and (v) employed subsequent corrective measures, prior to detection or intervention by a regulator, to revise its procedures to avoid recurrence of the misconduct.

FINRA's announcement of the enforcement settlements with each firm is available at: https://www.finra.org/newsroom/2015/finra-sanctions-wells-fargo-raymond-james-and-lpl-30-million.

SEC Settles Charges Against Auditor, Fund Administrator and Trustee In Connection with Auditor-Trustee Relationship

On July 1, 2015, the SEC announced settled administrative proceedings against Deloitte & Touche LLP ("Deloitte"), the outside auditor of three closed-end funds (the "Funds"); ALPS Fund Services, Inc. ("ALPS"), an administrator of the Funds that provided compliance services; and Andrew C. Boynton, a former member of the Funds' board of trustees and the audit committee.

Deloitte

From 2006 to 2011, Deloitte Consulting LLP ("Deloitte Consulting"), an affiliate of Deloitte, maintained a business relationship with Mr. Boynton, who served as a member of the Funds' board of trustees and of the audit committee throughout that period. This relationship involved Deloitte Consulting acquiring from Mr. Boynton, among others, a brainstorming business methodology and later retaining Mr. Boynton as an outside consultant to assist in the implementation of the methodology for Deloitte Consulting clients. For his services, Deloitte Consulting paid Mr. Boynton consulting fees. During the entirety of the relationship, Deloitte served as the Funds' outside auditor, claiming independence from the Funds.

The internal policies of the parent company of Deloitte and Deloitte Consulting required that an independence consultation be performed before entering into a new business relationship with an outside consultant; however, this consultation was not performed before Deloitte Consulting entered into its arrangement with Mr. Boynton. In addition, Deloitte did not discover that the independence consultation was not performed until almost five years had passed after Deloitte Consulting's relationship with Mr. Boynton was established.

Deloitte was found to have (i) violated Rule 2-02(b) of Regulation S-X, which requires an outside auditor to maintain independence from audit clients, (ii) violated applicable standards of professional conduct under Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(ii) of the SEC's Rules of Practice and (iii) caused the Funds to have violated Sections 30(a) and 20(a) of and Rule 20a-1 under the 1940 Act, which require funds to file reports of independent auditors with their annual reports and otherwise to disclose certain information regarding independent auditors and audits in SEC filings.

In settlement of these charges, Deloitte agreed to be censured and to pay disgorgement of $497,438 plus prejudgment interest of $116,478 and a civil penalty of $500,000.

ALPS

As administrator to the Funds, ALPS agreed to assist the Funds in fulfilling their responsibilities under Rule 38a-1 under the 1940 Act. Specifically, ALPS provided the Funds with a set of written Rule 38a-1 compliance policies and procedures and a Chief Compliance Officer to administer the compliance program. The Funds' policies and procedures regarding the selection, retention and engagement of an independent auditor were found to be inadequate at all relevant times. Accordingly, ALPS was found to have caused the Funds to violate Rule 38a-1. In settlement of these charges, ALPS agreed to pay a civil penalty of $45,000.

Trustee and Audit Committee Member

As a Fund trustee and audit committee member, Mr. Boynton was required to complete an annual questionnaire indicating, among other things, his principal occupation and other positions held as well as any direct or indirect business relationship with Deloitte. Mr. Boynton never identified his relationship with Deloitte Consulting as a principal occupation or other position. Moreover, understanding that Deloitte and Deloitte Consulting were separate legal entities, Mr. Boynton did not disclose his relationship with Deloitte Consulting as an indirect business relationship with Deloitte, and Mr. Boynton did not otherwise inquire whether Deloitte Consulting's affiliation with Deloitte had any implications under conflict-of-interest or auditor independence rules. Mr. Boynton was found to have caused the Funds to violate Sections 30(a) and 20(a) of and Rule 20a-1 under the 1940 Act. In settlement of these charges, Mr. Boynton agreed to pay disgorgement of $30,000 plus prejudgment interest of $5,329 and a civil penalty of $25,000.

The SEC's order instituting administrative and cease-and-desist proceedings is available at: http://www.sec.gov/litigation/admin/2015/34-75343.pdf.

Other News and Developments

Technical Difficulties at BNY Mellon Impact Processing of Net Asset Values

Beginning on August 24, 2015, Bank of New York Mellon Corp. experienced what it described as “system performance issues” with a fund accounting platform, InvestOne, that processes net asset value (NAV) calculations for certain mutual fund and ETF clients. The malfunction, reportedly unrelated to the market volatility experienced around the same time, followed an operating system change implemented by SunGard Data Systems Inc., a third-party vendor which hosts and supports the InvestOne platform. On a conference call held on August 30, 2015, BNY Mellon Chairman and CEO Gerald Hassell reported that the platform failure impacted 66 fund accounting clients and approximately 1,200 funds. On September 1, 2015, BNY Mellon reported that it completed production of system-generated NAVs for all ETFs and mutual funds through August 31, 2015.

IRS Identifies Certain Basket Derivatives as Reportable Transactions

On July 8, 2015, the Internal Revenue Service (the “IRS”) identified as reportable transactions certain derivative contracts that reference a basket of assets. The transactions identified by the IRS are referred to by the IRS as “basket option contracts” or “basket contracts.” In these transactions, a purchaser enters into a contract that is denominated as an option, a notional principal contract (e.g., a swap), a forward contract or other derivative contract with a counterparty to receive a return based on the performance of a notional basket of referenced assets (the “reference basket”). The reference basket may include (1) “actively traded personal property” (e.g., publicly traded stock), (2) interests in hedge funds or other entities that trade securities, commodities, foreign currency or similar property, (3) securities, (4) commodities, (5) foreign currency or (6) similar property or positions in such property. The purchaser or a designee named by the purchaser will either determine the assets that comprise the reference basket or design or select a trading algorithm that determines the assets. While the contract remains open, the purchaser has the right to request changes in the assets in the reference basket or the specified trading algorithm.

The purchaser generally takes the position that short-term gains and interest, dividend and other ordinary periodic income from the performance of the reference basket is deferred until the instrument terminates and, if the instrument is held for more than one year, that the entire gain is treated as long-term capital gain. According to the IRS, the purchaser may be using the instrument to inappropriately defer income recognition, convert ordinary income and short-term capital gain into long-term capital gain and/or avoid U.S. withholding tax.

Anyone who has participated in a basket option contract, basket contract or substantially similar transaction is now subject to certain IRS reporting obligations. The following parties are generally considered participants by the IRS and are, therefore, subject to these reporting obligations: (1) the purchaser, (2) if the purchaser is a partnership, any general partner of the purchaser, (3) if the purchaser is a limited liability company, any managing member of the purchaser and (4) the counterparty.

Each participant in a basket option contract, basket contract or substantially similar transaction that was in effect on or after January 1, 2011 must report the transaction to the IRS, provided that the period of limitations did not end on or before July 8, 2015. If a participant has already filed its tax return for a year in which it participated in a basket option contract, basket contract or substantially similar transaction and the period of limitations has not ended, the participant needs to report the transaction to the IRS by November 5, 2015. Significant penalties and an extended statute of limitations may apply if a reportable transaction is not timely reported. In addition to the reporting obligations, a participant in a reportable transaction must also retain copies of all material documents and other records relating to the transaction.

Investment Services Group Members

Chicago

David A. Sturms, *Chair* ...... +1 (312) 609 7589
Juan M. Arciniegas .... +1 (312) 609 7655
James A. Arpaia .... +1 (312) 609 7618
Deborah B. Eades .... +1 (312) 609 7661
Karin J. Flynn .... +1 (312) 609 7805
Renee M. Hardt .... +1 (312) 609 7616
Joseph M. Mannon .... +1 (312) 609 7883
John S. Marten, *Editor* ...... +1 (312) 609 7753
Maureen A. Miller .... +1 (312) 609 7699
Robert J. Moran .... +1 (312) 609 7517
Cathy G. O'Kelly .... +1 (312) 609 7657
Junaid A. Zubairi .... +1 (312) 609 7720
Heidemarie Gregoriev .... +1 (312) 609 7817
Matthew A. Brunmeier ...... +1 (312) 609 7506
Megan J. Claucherty .... +1 (312) 609 7863
Ellen Yiadom Hoover .... +1 (312) 609 7707
Nicole M. Kuchera .... +1 (312) 609 7763
Travis N. Moyer .... +1 (312) 609 7739
Nathaniel Segal, *Editor* ...... +1 (312) 609 7747
Jacob C. Tiedt .... +1 (312) 609 7697
Cody J. Vitello .... +1 (312) 609 7816

New York

Joel S. Forman .... +1 (212) 407 7775

Washington, DC

Bruce A. Rosenblum .... +1 (202) 312 3379
Brendan R. Hamill .... +1 (202) 312 3010

London

Richard Thomas .... +44 (0)20 3667 2930
Sam Tyfield .... +44 (0)20 3667 2940

VEDDER PRICE®

Investment Services Group

With deep experience in all matters related to design, organization and distribution of investment products, Vedder Price can assist with all aspects of investment company and investment adviser securities regulations, compliance matters, derivatives and financial product matters, and ERISA and tax matters. Our highly experienced team has deep knowledge in structural, operational and regulatory matters, coupled with a dedication to quality, responsive service.