Investment Services Regulatory Update

October 1, 2009

NEW RULES, PROPOSED RULES AND GUIDANCE

SEC Adopts Rule Requiring Disclosure of Certain Money Market Fund Portfolio Information

On September 18, 2009, the SEC adopted a new rule – effective immediately – requiring money market funds whose net asset value ("NAV") per share falls below $0.9975 to provide portfolio and valuation information to the SEC on a weekly basis for as long as a fund's NAV per share remains below that level. Interim temporary final Rule 30b1-6T, issued in conjunction with the expiration of the Treasury Department's Temporary Guarantee Program for Money Market Funds ("Guarantee Program"), requires funds to provide substantially the same information as was required for funds participating in the Guarantee Program. Money market funds are required to provide detailed information about each security held by the fund no later than the next business day after a fund's NAV per share falls below $0.9975 and then must submit the same information as of the last business day of each week by no later than the second business day of the following week. Comments on the new rule, which expires on September 17, 2010, may be submitted to the SEC until October 26, 2009. Upon expiration of the rule, the SEC will consider whether to extend or amend the rule as part of its broader proposed money market reforms.

SEC Proposes Flash Order Ban

On September 17, 2009, the SEC proposed amendments to Regulation NMS that would eliminate the exception for use of flash orders by market participants. Flash orders, which are orders for immediate execution or withdrawal, are currently excepted from the requirement under Regulation NMS that exchanges publicly disseminate their best bids and offers in U.S.-listed equities. If adopted, the elimination of the exception for flash orders would require flash orders with non-marketable prices to be included in the publicly disseminated consolidated quotation data and would prohibit flashing orders with marketable prices only to certain market participants. The SEC's proposing release states that the benefits of flash orders for some market participants do not justify their costs to other market participants, the national market system and the public interest.

Comments on the proposals are due by November 23, 2009.

SEC Proposes Changes to NYSE Corporate Governance Standards

On September 11, 2009, the SEC published for comment proposed changes to certain of the corporate governance requirements in Section 303A of the NYSE's Listed Company Manual. The proposed changes clarify a number of provisions, including the time by which companies listing in conjunction with an initial public offering, spin-off or carve-out must comply with the audit committee requirements, that closed-end funds choosing to include a "Management's Discussion of Fund Performance" must have their

audit committee meet to review and discuss it, and that closed-end funds are subject to the provision regarding shareholder approval of equity compensation plans. The changes would eliminate the required annual certification by CEOs that they are not aware of any violations by the company of NYSE listing standards. Instead, revised Section 303A.12(b) would require listed companies to notify the NYSE in writing after an executive officer becomes aware of any non-compliance with Section 303A. Currently, notification is only required for material non-compliance. The changes are proposed to take effect January 1, 2010.

Massachusetts Proposes Amendments to Information Security Program Regulations and Compliance Deadline

On August 17, 2009, the Massachusetts Office of Consumer Affairs and Business Regulation published for comment proposed amendments to the regulations that require persons (including funds) who own or license personal information about a Massachusetts resident, such as a shareholder or employee, to develop, implement and maintain a comprehensive, written information security program, including a computer security system program. Under the amended regulations, "owns or licenses" is defined to include receiving, processing or otherwise accessing personal information. The revised regulations set forth a risk-based approach to information security, reflect that a number of the specific provisions previously required to be in the information security program were removed, apply technical feasibility to the computer security requirements and make the third-party vendor requirements consistent with federal law. A hearing on the proposed amendments is scheduled for September 22, 2009. The deadline for compliance with the proposed amended regulations is March 1, 2010.

SEC Makes Short Sale Rule Permanent

On July 27, 2009, the SEC made permanent temporary Rule 204T (now Rule 204), which requires short sellers and their broker-dealers to deliver securities by the close of business on the settlement date for short sale transactions, and imposes penalties for the failure to do so. In the fall of 2008, the SEC had issued a series of orders and rules designed to curb "naked" short selling and to temporarily prohibit the short selling of stocks of certain financial companies because such practices have the potential to exacerbate market price movements. In a short sale transaction, a seller borrows a stock and sells it, with the understanding that the loan will be repaid by the seller by buying the stock on the open market. In a "naked" short sale transaction, the seller does not actually borrow the stock and fails to deliver it to the buyer. Noting that its temporary actions have largely had the intended effect of preventing substantial disruptions in the securities markets, the SEC adopted a permanent rule.

The SEC also allowed an interim final temporary rule requiring institutional investment managers (i.e., those who file or are required to file reports on Form 13-F) to report short sales of publicly-traded equity securities to expire on August 1, 2009. The rule required the filing of a Form SH on every Monday (or the first business day of the week if Monday is a federal holiday) with respect to any new short positions the manager had entered

into during the prior seven-day period. The SEC indicated that it is working with self-regulatory organizations to make short sale volume and transaction data available through the organizations' websites.

SEC Proposes New Rule to Curtail Adviser "Pay to Play" Practices

On July 22, 2009, the SEC proposed a new rule intended to restrict "pay to play" practices by investment advisers seeking to manage money for state and local government public programs. The proposed rule is designed to prevent investment advisers from using direct political contributions and other pay to play arrangements to attempt to influence their selection by government officials.

Specifically, the proposed rule would:

- Subject to a de minimis provision for executives and employees of the adviser, bar an adviser who makes a political contribution to an elected official in a position to influence the selection of the adviser for two years from providing advisory services for compensation, either directly or through a fund;

- Prohibit an adviser from soliciting others to make contributions to an elected official or candidate who can influence the selection of the adviser or to a political party of a state or locality where the adviser is seeking to provide advisory services to the government;

- Prohibit an adviser from paying third party solicitors to solicit government clients on behalf of the adviser; and

- Prohibit an adviser from engaging in pay to play practices indirectly, for example, through affiliated companies, lawyers or spouses, if the conduct would violate the rule if the adviser did it directly.

Comments on the proposed rule are due by October 6, 2009.

Implementation of Identity Theft Prevention Programs Further Delayed Until November 1, 2009

On July 29, 2009, the Federal Trade Commission announced that it would suspend enforcement of the red flags rule under the Fair and Accurate Credit Transactions Act of 2003, which imposes identity theft-related requirements on "financial institutions" and other specified entities, until November 1, 2009. This is the third time the FTC has delayed implementation of the rule.

Under the red flags rule, a "financial institution" includes any institution, including an investment company, that directly or indirectly holds a transaction account belonging to a consumer, and a "transaction account" is an account in which the account holder is

permitted to make withdrawals payable to third persons by check, transferable or negotiable instruments or similar items (e.g., debit cards).

The rule requires funds that hold transaction accounts to develop and obtain board approval of a written Identity Theft Prevention Program by November 1, 2009. The Program must be designed to detect, prevent and mitigate identity theft in connection with covered accounts. The Program must be able to detect patterns, practices and certain "red flag" activities that potentially signify identity theft. Specifically, the Program must include "reasonable policies and procedures" to: (1) identify red flag activities for covered accounts and incorporate any newly identified red flag activities into the Program; (2) detect red flag activities; (3) respond to red flag activities that have been detected; and (4) update the Program periodically to reflect changes in risks. For each of these items, the rule requires the financial institution to consider specific guidelines and include in its Program those guidelines that are appropriate given the size and complexity of the institution and the nature and scope of its activities.

The new rule also imposes certain requirements related to the administration of the Program, including: (1) obtaining approval of the Program by the institution's board or a committee thereof, (2) involving the board, committee or designated senior management person in the oversight, development, implementation and administration of the Program, (3) training staff to effectively implement the Program, and (4) exercising appropriate and effective oversight of service provider arrangements.

PROPOSED LEGISLATION

Legislation Proposed to Require Private Fund Advisers to Register with the SEC

On July 15, 2009, the U.S. Department of the Treasury proposed legislation entitled the "Private Fund Investment Advisers Registration Act of 2009" that would require all investment advisers to hedge funds and other private pools of capital, including private equity and venture capital funds, with more than $30 million of assets under management to register with the SEC. Currently, under the Advisers Act, an investment adviser is exempt from registration if during the preceding 12 months the adviser has fewer than 15 clients (with each fund being considered one client) and does not hold itself out generally to the public or act as an investment adviser.

Also, on July 15, 2009, before the Subcommittee on Securities, Insurance and Investment of the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Andrew "Buddy" Donohue testified that the SEC supports the registration of private fund advisers under the Advisers Act. He also discussed other legislative options, such as the registration of private funds under the 1940 Act and/or providing the SEC with rulemaking authority in the 1940 Act exemptions on which private funds rely, that he recommended be considered by the Subcommittee.

OTHER NEWS

IDC Issues Task Force Report on Board Oversight of Fund Compliance

On September 10, 2009, the Independent Directors Council issued a task force report entitled "Board Oversight of Fund Compliance." The report discusses the variety of ways in which funds have implemented their compliance programs, as required by Rule 38a-1 under the 1940 Act, and suggests certain core characteristics of a successful compliance function. The goal of the report is to provide a comparative tool, by highlighting various alternatives and practices, that will assist boards in evaluating fund compliance programs.

The report discusses the following common themes amongst fund groups regarding the mission and philosophy of compliance: (1) a fund board can have a significant and immediate influence in defining the goals and priorities of the fund's compliance function; (2) compliance responsibility should be allocated to each business unit that makes up the fund's or adviser's compliance operation; (3) compliance should be structured as a collaborative function that enhances operations and controls, and not structured to punish outliers; and (4) compliance should be proactive, anticipatory and seek to educate all personnel who contribute to its effectiveness.

The report also discusses matters relating to the fund CCO, including considerations regarding the employment of the CCO (e.g., whether the fund CCO should be the same as the adviser's CCO), as well as the CCO's relationship with management and the fund board.

Finally, the report lists the following characteristics that the task force believes support a strong compliance regime: (1) a strong "tone from the top" (i.e., management and the fund's board); (2) the CCO operating in a collaborative manner allows the CCO to undertake his or her role and responsibilities professionally and effectively; (3) a continuous and thoughtful risk-based program; (4) transparency and candor in compliance disclosure between the CCO, the board and management; and (5) effective compliance personnel (including the CCO), armed with appropriate resources.

SEC Provides No-Action Relief Permitting Foreign Funds to Invest in U.S. Funds in Excess of 1940 Act Limitations

On August 4, 2009, the SEC staff issued a no-action letter stating that it would not recommend enforcement action against a foreign fund that acquires shares of a registered U.S. fund in excess of the 5% and 10% anti-pyramiding limitations of Section 12(d)(1)(A) of the 1940 Act.

In granting the relief, the SEC staff relied on the following representations:

- each foreign fund will comply with the 3% restrictions of Section 12(d)(1)(A) of the 1940 Act;

- each foreign fund will not offer or sell securities in the U.S. or to any U.S. person;
- each foreign fund's transactions with its shareholders will be consistent with the definition of "offshore transactions" in Regulation S under the 1933 Act; and
- each U.S. fund will comply with the restrictions of Section 12(d)(1)(B) of the 1940 Act.

SEC Issues No-Action Letter Related to Mixed and Shared Funding Orders

On July 31, 2009, the SEC's Division of Investment Management issued a no-action letter relating to "mixed and shared funding" exemptive orders for variable insurance products funds. Specifically, the no-action letter states that a fund would not have to comply with the terms and conditions of an existing mixed and shared funding order if the fund is not relying on the exemptions in the order. The terms and conditions of the existing order that the fund did not intend to comply with included restrictions regarding who can hold fund shares, in particular, college savings plans.

ENFORCEMENT ACTIONS

FINRA Settles Auction Rate Securities Violations with Three Firms

On September 2, 2009, FINRA announced that it had entered into final settlement agreements with Northwestern Mutual Investment Services, LLC, City Securities Corporation and Fifth Third Securities to settle charges relating to the sale of Auction Rate Securities ("ARS"). Each of the firms agreed to initiate or complete offers to repurchase ARS sold to their customers in connection with failed ARS auctions.

According to FINRA, its investigation of the firms uncovered evidence that each firm employed the use of unfair and unbalanced advertising, marketing materials or other communications in its efforts to sell ARS, and did not provide investors with a sound basis on which to evaluate the benefits and risks of investing in ARS. Moreover, FINRA's investigation of the firms revealed that each firm failed to maintain adequate supervisory systems reasonably designed to achieve compliance with the securities laws and FINRA rules with respect to the marketing and sale of ARS.

Under the terms of the agreements, each firm will offer to repurchase at par value certain outstanding ARS purchased by investors between May 31, 2006, and February 28, 2008. As a result, a total of approximately $128 million of ARS are eligible for repurchase. Additionally, the firms have agreed to compensate individual investors who sold ARS below par after February 28, 2008 and pay fines totaling $600,000. Going forward, any additional claims against the firms for consequential damages resulting from investors' inability to access funds invested in ARS will be resolved by an independent, non-industry arbitrator.

SEC Charges Adviser and Its CEO for Fraudulently Overstating Assets

On August 13, 2009, the SEC charged Brantley Capital Management ("BCM"), investment adviser to Brantley Capital Corporation (a business development company) ("BCC"), and Robert Pinkas, chief executive officer of BCM, with securities fraud for overvaluing assets held by BCC in order to generate higher investment advisory fees.

According to the SEC, Mr. Pinkas and Tab Keplinger, BCM and BCC's part-time chief financial officer, substantially overstated the value of equity and debt investments in two failing private companies that represented more than half the investment portfolio of BCC, including equity of a private airline. The SEC alleged that Mr. Pinkas and Mr. Keplinger understood that the airline faced severe financial difficulties, and Mr. Pinkas knew that it was able to remain in business only because another investor repeatedly loaned the company money, yet Mr. Pinkas and Mr. Keplinger failed to disclose these financial difficulties to BCC's board and investors. The two also allegedly misrepresented the financial performance of the airline to BCC's board and its independent auditors, cited various false rationales to support their $32.5 million valuation, and concealed third-party valuations that indicated BCC's investment was worth substantially less than what was being represented.

The SEC also alleged that the value of debt investments in another company was overstated. According to the SEC, Mr. Pinkas and Mr. Keplinger repeatedly advised BCC's board that the company would repay most of the loans provided by BCC, when in fact the company could not repay the loans. In addition, the company consistently missed its financial targets by large margins, remained in business only because BCC continued to loan it money, and lacked sufficient assets to cover BCC's loans in the event of liquidation. Despite knowing these facts and that the BCC's loans to the company were essentially worthless, Mr. Pinkas and Mr. Keplinger allegedly advised BCC's board that only relatively minor write-downs were required.

Mr. Keplinger agreed to settle the SEC's charges without admitting or denying the allegations and agreed to a $50,000 penalty and certain industry and professional bars. Mr. Pinkas and BCM are contesting the SEC's charges.

FINRA Fines Merrill Lynch and UBS for Supervisory Failures in Sales of Closed-End Funds

On July 28, 2009, FINRA announced that it fined Merrill Lynch, Pierce, Fenner & Smith, Inc. $150,000 and UBS Financial Services, Inc. $100,000 for alleged supervisory failures relating to unsuitable short-term sales of shares of closed-end funds ("CEFs") purchased in such funds' initial public offerings ("IPOs"). According to FINRA, Merrill and UBS failed to provide supervisors with guidance or warning about the potential abuses and disadvantages relating to short-term trading of CEF shares purchased during an IPO and failed to provide their registered persons with adequate guidance or training with respect to the impact of sales charges relating to short-term sales of CEF shares purchased in an IPO. Furthermore, FINRA found that neither Merrill nor UBS had

adequate supervisory systems and procedures designed to detect and prevent unsuitable short-term trading of CEF shares.

FINRA Fines Bank Broker-Dealers $1.65 Million for Supervisory Failures in Variable Annuity, Mutual Fund and UIT Transactions

On July 23, 2009, FINRA announced that it fined McDonald Investments (now KeyBanc Capital Markets, Inc.), IFMG Securities, Wells Fargo Investments, LLC, PNC Investments and WM Financial Services, Inc. (now Chase Investment Services Corp.) $1.65 million for inadequate sales procedures and deficient supervision of sales activities relating to variable annuity, mutual fund and UIT transactions. According to FINRA, between 2004 and 2006 the firms engaged in a pattern of selling to elderly bank customers investment products which were either ineligible or inappropriate based on the customers' age. FINRA also found that the firms' supervisory procedures with respect to suitability were inadequate. For example, in some cases, the firms' procedures failed to provide sales representatives with guidance on how to determine suitability in variable annuity transactions.

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This Regulatory Update is only a summary of recent information and should not be construed as legal advice.