Investment Services Regulatory Update

February 1, 2011

NEW RULES, PROPOSED RULES AND GUIDANCE

SEC Proposes Reporting Obligations for Advisers to Private Funds

On January 26, 2011, the SEC proposed new Rule 204(b)-1 under the Advisers Act, to implement certain recordkeeping and filing requirements under the Dodd-Frank Act. Specifically, proposed Rule 204(b)-1 would require advisers to private investment funds, including advisers to hedge funds, private equity funds and "liquidity funds" (i.e., private money market funds), to file periodically new Form PF with the SEC. The content and frequency of an adviser's reporting obligations on Form PF would vary based on the types of private funds advised and the adviser's assets under management. For example, advisers to "hedge funds" and "liquidity funds" would generally be subject to more comprehensive reporting requirements than advisers to "private equity funds," with certain "large private fund advisers" subject to the most comprehensive and frequent reporting requirements. Large private fund advisers with $1 billion or more in assets under management would be required to file Form PF on a quarterly basis. All other private fund advisers would be required to file Form PF annually. Information collected by the SEC on Form PF would be made available to the CFTC (as it relates to commodity pools managed by CPOs and CTAs) and the Financial Stability Oversight Council. Under the proposed rule, information reported on Form PF would remain confidential.

Information to be reported on proposed Form PF would include, among other things:

- identifying information of the adviser, as well as the adviser's gross and net assets under management in total, and gross and net assets under management attributable to certain types of private funds, and

- fund-specific information such as the name of the fund, gross and net assets, aggregate notional value of the fund's derivative positions, information regarding creditors and outstanding debt, performance information and investor information.

The proposed Rule would require hedge funds to disclose information relating to investment strategies, use of trading algorithms, counterparty trading exposure and general trading and clearing practices. Large private fund advisers would also generally be required to disclose a greater range of information, including the market value of assets invested (on a short and long basis) in different types of securities and commodities, the duration of fixed income portfolio holdings, the turnover rate of the adviser's portfolios during the reporting period and the geographic breakdown of investments held. Depending on the type of fund and amount of assets under management, other information would also be required on Form PF.

Comments on the proposal are due 60 days after publication in the Federal Register.

SEC Proposes Net Worth Standard for Accredited Investors

On January 25, 2011, the SEC proposed an amendment to the definition of "accredited investor" to implement Section 413(a) of the Dodd-Frank Act. Specifically, the SEC proposed amendments to Rules 215 and 501(a)(5) under the Securities Act to exclude the value of a natural person's primary residence for purposes of determining whether a natural person is an "accredited investor" (i.e., has a net worth in excess of $1 million). While the provisions of Section 413(a) of the Dodd-Frank Act were effective upon enactment in July 2011, the Act required the SEC to amend these rules.

Comments on the proposal are due by March 11, 2011.

SEC Extends Compliance Date for Initial Delivery of Form ADV Brochure Supplements

On December 28, 2010, the SEC extended the compliance date for the initial delivery by registered investment advisers of brochure supplements required by Part 2B of Form ADV and Rule 204-3 of the Advisers Act. On July 28, 2010, the SEC adopted amendments to Part 2 of Form ADV, and related rules under the Advisers Act, to require advisers to deliver to clients and prospective clients a narrative brochure in plain English describing the adviser's business practices, fees, conflicts of interest and disciplinary history. The amendments also require advisers to deliver to clients and prospective clients brochure supplements which provide information on the educational background, business experience and disciplinary history of advisory personnel who provide or will provide investment advice to the client.

As originally adopted, the amendments became effective on October 12, 2010 with the following compliance dates:

- Advisers applying for registration with the SEC after January 1, 2011 must file a brochure that meets the amended requirements of Part 2A of Form ADV as part of their application for registration and deliver the brochure and brochure supplements to existing and prospective clients upon registering.

- Existing registered advisers must file a revised brochure that meets the amended requirements of Part 2A as part of their annual updating amendment to Form ADV for fiscal years ending on or after December 31, 2010. The revised brochure and brochure supplements must be delivered to new and prospective clients following the filing of the adviser's annual updating amendment and to existing clients within 60 days after the filing of the annual updating amendment.

The SEC is maintaining the original compliance dates for the filing and delivery of the brochure required by Part 2A of Form ADV, but is extending the compliance dates for initially delivering brochure supplements required by Part 2B of Form ADV. The new compliance dates for delivering brochure supplements are:

- Advisers applying for registration with the SEC from January 1, 2011 through April 30, 2011 have until May 1, 2011 to begin delivering brochure supplements to new and prospective clients and until July 1, 2011 to deliver brochure supplements to existing clients.

- Existing registered advisers having a fiscal year ending on December 31, 2010 through April 30, 2011 have until July 31, 2011 to begin delivering brochure supplements to new and prospective clients and until September 30, 2011 to deliver brochure supplements to existing clients.

SEC Extends Temporary Rule Regarding Adviser Principal Trades

On December 28, 2010, the SEC extended by two years the temporary rule that provides an alternative method for investment advisers who are also broker-dealers to comply with Section 206(3) of the Advisers Act, which requires an adviser to obtain client consent prior to engaging in a principal transaction with the client. Temporary Rule 206(3)-3T was initially adopted on September 24, 2007 in response to a federal appeals court decision that vacated Rule 202(a)(11)-1 of the Advisers Act, which allowed registered broker-dealers to offer fee-based accounts without being regulated as investment advisers. Pursuant to Rule 206(3)-3T, which will now expire on December 31, 2012, if an adviser enters into a principal trade with a client, the adviser will be deemed to comply with Section 206(3) if the adviser, among other things: (1) obtains written, revocable consent from the client prospectively authorizing principal trades; (2) provides certain disclosures, either oral or written, and obtains client consent prior to each principal trade; and (3) provides the client with an annual report on all principal transactions. The Rule applies only to non-discretionary accounts of investment advisers who are also registered as broker-dealers and the accounts also must be brokerage accounts subject to the Exchange Act. The Rule applies to all accounts meeting the above requirements, whether or not they were previously fee-based brokerage accounts.

The SEC made no changes to Rule 206(3)-3T other than the extension of its expiration date. The SEC stated that the extension was necessary to provide sufficient protection to advisory clients while the SEC conducts its study of the standards of care applicable to broker-dealers and investment advisers as required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and also as it considers more broadly the regulatory requirements applicable to broker-dealers and investment advisers, including principal trading by advisers.

SEC Proposes Rules Relating to Investment Adviser Registration

On November 19, 2010, the SEC proposed new rules and rule amendments under the Advisers Act to implement certain provisions of the Dodd-Frank Act. Specifically, the SEC's proposed rules and rule amendments would:

- facilitate the de-registration and registration of so-called “mid-sized advisers”—investment advisers with assets under management between $25 million and $100 million,

- require advisers to provide additional information about certain areas of their operations on Form ADV, including information about the private funds they manage and information about use of affiliated brokers, soft dollar arrangements and compensation for client referrals,

- require “exempt reporting advisers” (venture capital fund advisers, private fund advisers and foreign private advisers, which qualify for an exemption from registration under the Advisers Act but may be subject to certain reporting requirements) to complete certain portions of Form ADV, which would be filed through the IARD system and made available to the public,

- amend Rule 206(4)-5 under the Advisers Act (the “pay to play” rule) to expand its application to exempt reporting advisers and allow an adviser to pay a “regulated municipal advisor” to solicit business on behalf of the adviser from a state or local government entity,

- define a “venture capital fund” for purposes of the exemption from registration under the Advisers Act for advisers that exclusively advise venture capital funds,

- clarify which private fund assets an adviser must count towards the $150 million limit for purposes of the exemption from registration under the Advisers Act for advisers acting solely as investment adviser to one or more qualifying private funds with aggregate assets totaling no more than $150 million in the United States, and

- provide interpretive guidance as to many of the terms used in the Dodd-Frank Act within the definition of “foreign private adviser” for purposes of the exemption from registration under the Advisers Act for foreign private advisers.

SEC Extends Compliance Date for New Short-Selling Restrictions

On November 4, 2010, the SEC extended the date for complying with the amendments to Regulation SHO adopted in February 2010 from November 10, 2010 to February 28, 2011. On February 24, 2010, the SEC adopted changes to the rules regarding short-selling under the Exchange Act, by imposing a restriction on the prices at which securities traded on a national securities exchange (other than options) may be sold short. Pursuant to the amendments to Regulation SHO, a trading center must implement written policies and procedures reasonably designed to prevent the execution or display of a short sale order for a particular security at a price that is less than or equal to the current national best bid, if the price of that security has decreased by 10% or more from the prior day’s closing price. Once the “circuit breaker” is triggered, this price test will remain in effect for the remainder of the trading day and the following day. The amendments also facilitate the ability of long sellers of the affected security to sell their shares before short sellers may do so, and further short sales are permitted only when the price of the security is above the current national best bid.

SEC Proposes Whistleblower Rules Under the Dodd-Frank Act

On November 3, 2010, the SEC proposed rules to implement the whistleblower provisions of the Dodd-Frank Act. Proposed Regulation 21F under the Exchange Act would expand the SEC's ability to reward whistleblowers who alert the SEC to federal securities law violations. Among other things, proposed Regulation 21F would require the SEC to pay awards of between 10% and 30% of the monetary sanctions that the SEC and other authorities are able to collect to whistleblowers who voluntarily provide the SEC with original information about a violation of federal securities laws that leads to a successful enforcement action with monetary sanctions exceeding $1 million.

Under proposed Regulation 21F, only a natural person, either alone or jointly with others, is eligible to be a whistleblower. Proposed Regulation 21F generally allows for whistleblower anonymity and otherwise provides that the SEC will not reveal a whistleblower's identity, except under certain circumstances. However, anonymous whistleblowers must be represented by an attorney who is required to provide certification as to the whistleblower's identity and the completeness and accuracy of the whistleblower's submission. In order to receive an award as a whistleblower, the following requirements apply:

- the whistleblower must voluntarily provide the SEC with the information,
- the whistleblower must provide original information based on their independent knowledge or analysis, and
- the whistleblower's information must lead to successful enforcement by the SEC of an injunctive action in federal court or an administrative proceeding, which could be satisfied: (1) if the information results in a new examination or investigation being opened and significantly contributes to the success of a resulting enforcement action, or (2) if the conduct was already under investigation when the information was submitted, but the information is essential to the success of the action and would not have otherwise been obtained.

Under the proposal, whistleblowers are not required to report potential securities law violations through a company's internal reporting system before submission to the SEC. However, proposed Regulation 21F would not disqualify an individual who reports a potential securities law violation internally prior to submitting such information to the SEC, provided that the individual provides such information to the SEC within 90 days of the internal reporting.

Proposed Regulation 21F provides that culpable whistleblowers may not recover awards and are not given amnesty. Additionally, individuals whose job descriptions require them to investigate and uncover corporate wrongdoing generally may not receive an award.

OTHER NEWS

SEC Staff Submits Study on Investment Adviser and Broker-Dealer Regulatory Standards

On January 21, 2011, the SEC staff submitted to Congress its study, as required by the Dodd-Frank Act, which evaluates the effectiveness of the existing standards of care for broker-dealers and investment advisers when providing personalized investment advice to retail customers. The study also examines the existence of any gaps or overlaps in the standards of care. The study recommends implementing a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice to retail customers.

Currently, broker-dealers and investment advisers are each regulated extensively, but under different regimes with differing standards. Despite the differing standards, broker-dealers and investment advisers provide many of the same services, including providing personalized investment advice to retail investors. The SEC staff's study found evidence that retail investors generally do not understand the difference between investment advisers and broker-dealers or the standards of care applicable to each. The study noted that many retail investors expect any investment advice they receive to be in their best interest.

In order to decrease investor confusion and increase investor protection, the SEC staff recommends that the SEC adopt a rule, with appropriate interpretive guidance, to establish a uniform fiduciary standard to regulate all investment advisers and broker-dealers when providing personalized investment advice to retail investors, which should be no less stringent than the standard currently applied to investment advisers, i.e., "act in the best interest of the client." The SEC staff noted that the SEC should provide guidance regarding how broker-dealers should fulfill the uniform fiduciary standard when engaging in principal trading.

The study also recommends that the SEC consider harmonizing other regulatory requirements in order to provide investors with similar protections when broker-dealers and investment advisers are performing the same or substantially similar functions, including regulatory requirements regarding:

- content of advertising and other customer communications,
- the use of and disclosure requirements of finders and solicitors,
- supervisory requirements including examination and oversight,
- licensing and registration of firms, including disclosure requirements of Form ADV and Form BD, and

- books and records requirements.

The SEC staff recommends that the SEC take into account the best elements of each regime when considering the harmonization of regulations.

Two SEC commissioners issued a separate statement to express their view that the study does not adequately document retail investors' confusion regarding the differing standards and does not address the possibility that the recommended uniform fiduciary standard may not solve the confusion. The two SEC commissioners also expressed concern that the overall cost of the recommended regulatory actions is not appropriately considered by the study, but noted that with further research and analysis, they could ultimately support the recommendations of the study. Because the Dodd-Frank Act does not impose a deadline for rulemaking, the two SEC commissioners suggested further research and analysis.

ICI Issues Comment Letter on President's Working Group Report on Money Market Funds

In October 2010, the President's Working Group on Financial Markets released its report, Money Market Fund Reform Options, which sets forth options for additional money market reform to be considered by the Financial Stability Oversight Council. The Council is charged with identifying and pursuing those options that are most likely to reduce money market funds' susceptibility to runs, with the primary goal of mitigating systemic risk and containing the effect an individual money market fund can have on other money market funds or the broad financial system.

In accordance with the report, the SEC issued a request for comments on the options, which include: (1) requiring floating NAVs; (2) establishing private emergency liquidity facilities for money market funds (the facility described in the report would not assist funds that take on excessive capital risks or have isolated credit losses); (3) requiring mandatory redemptions-in-kind for large redemptions by institutional investors; (4) implementing an insurance program for money market funds; (5) creating a two-tier system of money market funds with enhanced protection, and more stringent requirements, for stable NAV funds; (6) creating a two-tier system of money market funds with stable NAV funds reserved for retail investors; and (7) regulating stable NAV money market funds as special purpose banks.

On January 11, 2011, the ICI issued a comment letter on the proposed options. The ICI letter discusses each option in detail, noting the potential issues and detrimental effects each could have on money market funds, investors and the market, including that certain of the proposed options could increase, rather than decrease, systemic risk. The ICI letter states that while each option has drawbacks, a private emergency liquidity facility for prime money market funds has the most promise for achieving the policymakers' objective with the least negative impact. The ICI letter then addresses the concerns enumerated in the report regarding a private emergency liquidity facility.

In particular, the proposed model liquidity facility described in the ICI letter would require all prime money market funds, or, alternatively, all prime money market funds that continue to use amortized cost pricing, to participate in the liquidity facility. The liquidity facility would be a state-chartered bank or trust company funded by initial contributions from prime money market fund sponsors and ongoing commitment fees from member funds, as well as additional capacity eventually being gained from the issuance of time deposits to third parties. The liquidity facility would be structured to enable participating money market funds to meet redemptions while maintaining a stable NAV during times of unusual market stress by purchasing such funds' high-quality, short-term assets. To protect against money market funds attempting to sell low-yielding securities to the liquidity facility, the funds would be required to present their entire portfolio to the facility for review and to pay an access fee. The liquidity facility would further limit the prime money market funds that may participate to those demonstrating a liquidity need and excluding those that have already broken the dollar. The ICI letter states that the liquidity facility would help protect the broad money market by allowing prime money market funds to sell portfolio holdings in a challenging market environment and could also provide reassurance to investors.

In addition to reviewing the seven options proposed in the report, the ICI letter proposes an additional reform for consideration. The letter recommends that the SEC consider a rule that would require intermediaries, upon the request of a money market fund, to provide information about underlying fund investors to facilitate the fund's compliance with the "know your investor" requirements.

SEC Staff Opposes Closed-End Fund Use of Maryland Takeover Statute

On November 15, 2010, the SEC staff took the position in a no-action letter with respect to the Boulder Total Return Fund, Inc., that a registered closed-end fund may not opt in to the Maryland Control Share Acquisition Act. The SEC's position effectively removes an important anti-takeover device for closed-end funds. The no-action letter was issued under Section 18(i) of the 1940 Act, which generally provides that every share of stock issued by a registered fund shall be voting stock and have equal voting rights with every other outstanding voting stock. The Maryland Act provides that, when an investor crosses certain threshold percentages of stock ownership, the investor's shares lose their voting rights, unless the voting rights are restored by a shareholder vote in which the investor may not participate. The SEC staff stated that nullifying the voting rights of an acquiring person as contemplated by the Maryland Act would be inconsistent with Section 18(i) because the acquiring person would no longer presently be entitled to vote such shares for the election of directors—which is, the staff noted, precisely the aim of the Maryland Act. Because many closed-end funds are organized in Maryland, the no-action letter will likely have broad applicability. The no-action letter also lists 25 other states with control share acquisition statutes and notes that the same analysis may be applicable to them.

SEC Staff Issues Letter on Director Responsibilities under Affiliated Transaction Rules

On November 2, 2010, the SEC staff issued a letter to the Chairs of the Independent Directors Council and Mutual Fund Directors Forum regarding the responsibilities of fund directors with respect to affiliated transactions under Rules 10f-3, 17a-7 and 17e-1 under the 1940 Act. These rules permit funds to engage in otherwise prohibited affiliated transactions provided that fund directors fulfill certain responsibilities, including making a determination at least quarterly that all such affiliated transactions made during the preceding period were effected in compliance with the procedures adopted by the board under the applicable rule. The letter was issued in response to the SEC staff's observations that some boards believe that they can delegate their responsibilities to make such determinations under the rules. The letter notes that, while the rules do not specify how boards should make such determinations, boards retain the ultimate responsibility for making the determinations required by the rules and cannot delegate such responsibilities.

LEGISLATION

President Obama Signs Regulated Investment Company Modernization Act of 2010

On December 22, 2010, President Obama signed into law the Regulated Investment Company Modernization Act of 2010, which amends the Internal Revenue Code to modify certain rules governing the taxation of regulated investment companies ("RICs"). Among other provisions, the Act:

- permits RICs an unlimited carryforward of their net capital losses;
- adds savings provisions for failures of RICs to satisfy the RIC gross income and asset tests;
- modifies the rules for designating and allocating RIC capital gain dividends;
- permits certain nondeductible items of income to be included in a RIC's earnings and profits calculations;
- allows qualified funds-of-funds to pass through to their shareholders tax-exempt interest and foreign tax credits, without regard to certain investment limitations;
- modifies the rules relating to spillover dividends, return of capital distributions and stock redemptions;
- repeals the preferential dividend rule for publicly offered RICs;
- permits RICs to defer certain late-year losses; and

- modifies certain excise tax and penalty rules applicable to RICs, including increasing a RIC's required capital gain distribution to avoid excise tax from 98% to 98.2%.

The Act does not include a provision that was included in the original bill that would have allowed income from commodities to be treated as qualifying income for purposes of the RIC gross income test.

The provisions of the Act are generally effective for taxable years of a RIC beginning after December 22, 2010.

ENFORCEMENT ACTIONS

SEC Charges Merrill Lynch for Misusing Customer Order Information and Charging Undisclosed Trading Fees

On January 25, 2011, the SEC charged Merrill Lynch, Pierce, Fenner & Smith Incorporated with securities fraud for misusing customer order information to place proprietary trades for the firm and for charging customers undisclosed trading fees. According to the SEC, between 2003 and 2005, Merrill Lynch had an Equity Strategy Desk ("ESD") whose traders used information about institutional customer orders from trades on the market making desk to place trades on Merrill Lynch's behalf after executing customer trades, which was contrary to Merrill Lynch's representations to customers. The ESD traded securities solely for the firm's own benefit and had no role in executing customer orders.

The SEC also found that, between 2002 and 2007, Merrill Lynch had agreements with certain institutional and high net worth customers providing that Merrill Lynch would only charge a commission equivalent for executing riskless principal trades, but that in some instances, Merrill Lynch also charged customers undisclosed mark-ups and mark-downs. The undisclosed trading fees were accomplished by filling customer orders at prices less favorable to the customer than the prices at which Merrill Lynch purchased or sold the securities in the market. Merrill Lynch agreed to pay a $10 million penalty and consent to a cease-and-desist order.

SEC Charges BNY Mellon and Order Desk Manager for Best Execution Failure

On January 14, 2011, the SEC charged BNY Mellon Securities LLC, a formerly registered broker-dealer, for its failure to reasonably supervise the order desk manager on its institutional order desk and traders under his supervision from November 1999 through March 2008. During the relevant period, the institutional order desk executed orders to purchase and sell securities on behalf of a BNY Mellon affiliate, Mellon Investor Services LLC, an administrator for various employee stock purchase plans, employee stock option plans, direct stock purchase and sale plans and similar plans (the "plan customers"). According to the SEC, BNY Mellon's order desk manager failed to meet his duty of best execution to certain plan customers by executing many of their orders at stale or inferior prices, which in many instances were outside of the national best bid and offer at the time of execution, in cross trades with a favored handful of accounts held by hedge funds and individuals and instructing traders under his supervision to do the same. BNY Mellon agreed to pay $19 million of disgorgement, plus prejudgment interest of approximately $4 million, and $1 million in civil penalties.

SEC Charges Schwab Advisers and Two Executives with Making Misleading Statements

On January 11, 2011, the SEC charged Charles Schwab Investment Management ("CSIM") and Charles Schwab & Co., Inc. ("CSC") with making misleading statements regarding the Schwab YieldPlus Fund and failing to establish, maintain and enforce policies and procedures to prevent the misuse of material, nonpublic information. The SEC also charged CSIM and Schwab Investments with deviating from the fund's concentration policy without obtaining the required shareholder approval. On the same day, FINRA settled with CSC regarding improper marketing of the fund. In addition, the SEC filed a complaint in federal court against CSIM's former fixed income chief investment officer, Kimon Daifotis, as well as Randall Merk, an executive vice president at CSC and formerly president of CSIM and a trustee of the fund, alleging that Mr. Daifotis and Mr. Merk committed fraud and other securities law violations in connection with the offer, sale and management of the fund.

According to the SEC, investors were not adequately informed about the risks of investing in the fund. For example, the fund was described in marketing materials as having only slightly higher risk than a money market fund. The SEC found that the statements were misleading because the fund was more than slightly riskier than money market funds, and CSIM, CSC and the executives did not adequately inform investors about the differences between the fund and money market funds. The SEC also found that the fund deviated from its concentration policy when it invested more than 25% of its assets in private-issuer mortgage-backed securities, contrary to its policy of not concentrating more than 25% of its assets in any one industry.

Furthermore, the SEC found that material misstatements and omissions concerning the fund were made. The fund suffered a significant decline during the credit crisis of 2007 and 2008 and its assets fell from $13.5 billion to $1.8 billion during an eight-month period due to redemptions and declining asset values. The fund's portfolio consisted of investments that were scheduled to mature within the next several months. However, when investors began pulling money out of the fund, the fund had to sell assets in a depressed market to raise cash. In response to market events and fund redemptions, CSIM, CSC, and the executives held conference calls, issued written materials, and had other communications with investors that contained a number of material misstatements and omissions concerning the fund, including misstatements by Mr. Daifotis regarding minimal investor redemptions and by Mr. Merk regarding the liquidity of the fund and its ability to avoid selling assets at depressed prices.

In addition, the SEC found that CSIM and CSC did not have policies and procedures reasonably designed to prevent the misuse of material, nonpublic information about the fund, including specific policies and procedures governing redemptions by fund portfolio managers, and did not have appropriate information barriers concerning nonpublic and potentially material information about the fund.

CSIM and CSC agreed to pay the SEC a total of nearly $119 million, including $52 million in disgorgement of fees by CSIM, a $52 million penalty against CSIM, a $5 million penalty against CSC, and pre-judgment interest of $9 million. CSC agreed to pay FINRA $18 million, including a fine of $500,000 and $12.5 million to a fair fund to be established by the SEC to repay fund shareholders for fees paid to CSC. The SEC's case continues against the executives.

SEC Charges Managing Director of Securities Lending Program

On November 22, 2010, the SEC charged Emil Busse, Jr., the former managing director of the securities lending program at FAF Advisors, Inc., for willfully aiding and abetting and causing FAF's violations with respect to its securities lending program. The charges involve Mr. Busse's role in violations of the antifraud provisions of the federal securities laws as the result of his attempt to prevent a mutual fund from dropping below a net asset value of $1.00 per share.

The securities lending program managed by FAF provided customers of its parent, U.S. Bank, the option of loaning securities they held at U.S. Bank to certain approved broker-dealers in exchange for cash collateral. Customers who participated in the program could then invest the cash proceeds into either the Prime Portfolio or the Bond Portfolio. The Bond Portfolio was not required to maintain an NAV of $1.00 per share and the bank was prepared to notify customers that the NAV may drop below $1.00. However, according to the SEC, Mr. Busse caused the reallocation of numerous loans of securities from customers invested in the Prime Portfolio to customers invested in the Bond Portfolio in an effort to increase the assets in the Bond Portfolio and enable the fund to keep its NAV at $1.00 per share. Eventually, Mr. Busse's efforts failed and the NAV of the Bond Portfolio decreased to $0.99 per share. As a result of his actions, according to the SEC, certain customers in the inflated Bond Portfolio suffered losses of approximately $6 million. Mr. Busse agreed to pay a civil money penalty in the amount of $65,000.

SEC Charges Investment Adviser for Books and Records and Form ADV Violations

On November 16, 2010, the SEC charged Thrasher Capital Management, LLC and James Perkins, its chief executive officer, for failing to make Thrasher's books and records available to the staff of the SEC and for untrue statements of material facts in Thrasher's Form ADV.

According to the SEC's order, Mr. Perkins failed to make Thrasher's books and records available after the staff requested the items following an office visit. The books and records were not produced until a subpoena was issued. In addition, according to the SEC, Thrasher's Form ADV inaccurately disclosed that 40% of its clients were high net worth at a time when Thrasher did not have any high net worth clients and the Form

ADV failed to disclose an individual with a significant ownership interest. As a result, the SEC revoked Thrasher's registration as an investment adviser and suspended Mr. Perkins from any association with an investment adviser for a period of nine months.

SEC Charges Investment Adviser, Broker Dealer and CCO for Compliance Violations

On November 17, 2010, the SEC charged investment adviser Buckingham Capital Management Inc. ("BCM"), its broker-dealer parent company, The Buckingham Research Group Inc. ("BRG"), and Lloyd Karp, the firms' chief compliance officer, with failing to have adequate policies and procedures to prevent misuse of nonpublic information. BCM was also charged with supplementing and altering its records prior to turning them over to SEC examination staff.

The SEC found that BCM and BRG failed to establish, maintain, and enforce written policies and procedures reasonably designed to prevent misuse of material, nonpublic information, including forthcoming BRG research reports. According to the SEC's order, BRG's written policy required analysts to certify confidentiality of information whenever a material research event occurred. However, BRG only required a certification in instances where a BCM portfolio traded in the same direction and in many instances, analyst certifications were lacking, incomplete or dated long after the research event had occurred. With respect to BCM, the SEC found that when BCM began preparing for an SEC examination in 2006, the firm discovered that it was missing over 100 pre-approval trade forms. According to the SEC, BCM created the missing pre-approval forms and provided the forms to the examination staff of the SEC without disclosing what had been done. In addition, BCM replaced incomplete compliance logs and failed to follow its written policy regarding nonpublic information. As a result, BRG agreed to pay a $50,000 penalty, BCM agreed to pay a $75,000 penalty and Mr. Karp agreed to pay a $35,000 penalty.

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