Investment Services Regulatory Update

February 1, 2012

NEW RULES, PROPOSED RULES AND GUIDANCE

OCIE Publishes Risk Alert Regarding the Use of Social Media by Investment Advisers

On January 4, 2012, the SEC's Office of Compliance Inspections and Examinations issued a National Examination Risk Alert to address the use of social media by investment advisory firms. In the Alert, the SEC staff noted that the use of social media by investment advisory firms is rapidly accelerating, and that such use must comply with various provisions of the federal securities laws, including antifraud, compliance and recordkeeping provisions. The SEC recommended that investment advisory firms evaluate their policies by first identifying conflicts and compliance risks in light of the firm's particular circumstances and then testing whether their existing policies and procedures effectively address those risks. To assist with this evaluation, the SEC staff provided the following non-exhaustive list of factors that investment advisory firms may want to consider:

- **Usage Guidelines**. Firms may want to consider whether to create firm usage guidelines that provide guidance on appropriate/inappropriate use of social media, including restrictions or prohibitions on specific sites or functionalities of sites.
- **Content Standards**. Firms may want to assess whether the content created by the firm, its representatives or solicitors creates risks related to fiduciary or other regulatory issues (e.g., content that contains investment recommendations, information on specific investment services or investment performance).
- **Monitoring/Frequency of Monitoring**. Firms may want to consider how to effectively monitor the firm's social media sites or the firm's use of third-party sites, including the frequency of such monitoring.
- **Approval of Content**. Firms may want to consider pre-approval requirements as opposed to after-the-fact review.
- **Firm Resources**. Firms may want to consider whether they have dedicated sufficient compliance resources to adequately monitor social media activity, including the ability to monitor the activity of numerous representatives or solicitors.
- **Criteria for Approving Participation**. Firms may want to consider the reputation of a site, a site's privacy policy, the ability to remove third-party posts from a site, a site's controls on anonymous posting and a site's advertising practices before the firm, its representatives or solicitors use the site to conduct business.

- **Training**. Firms may want to consider training related to social media to promote compliance and to prevent potential violations.

- **Certification**. Firms may want to consider obtaining certifications confirming that social media policies have been communicated clearly and are being followed.

- **Functionality**. Firms may want to consider the functionality of each social media site approved for use, including any continuing obligation to address upgrades or modifications to the site that affect the risk exposure of the firm or its clients.

- **Personal/Professional Sites**. Firms may want to consider whether to adopt policies to address an advisory representative or solicitor that conducts firm business on personal (non-business) or third-party social media sites.

- **Information Security**. Firms may want to consider whether any information security risks arise in connection with the use of social media and consider measures to create appropriate firewalls between permitted sites and sensitive information.

- **Enterprise-Wide Sites**. Investment advisory firms that are part of a larger financial services or other corporate enterprise may want to consider whether to create usage guidelines reasonably designed to prevent the advertising practices of firm-wide social media sites from violating the Advisers Act.

- **Third-Party Content**. The SEC staff noted that the policies and procedures governing third-party content vary considerably, and that firms should consider developing policies to review, monitor or even restrict such content.

- **Testimonials**. Determining whether a third-party statement is a testimonial under the Advisers Act depends on the particular facts and circumstances surrounding the statement. The SEC staff noted that it has interpreted the term “testimonial” to include a statement of a client’s experience with, or endorsement of, an investment adviser. As a result, the SEC staff noted that the use of “social plug-ins” such as a “like” button by a third party could be a testimonial under the Advisers Act if it is an explicit or implicit statement of a client’s experience with an investment adviser.

- **Recordkeeping.** The SEC staff noted that recordkeeping responsibilities under the Advisers Act do not differentiate between different types of media. In the SEC staff’s view, investment advisory firms that communicate through social media must retain records of those communications if they contain information covered by the Advisers Act. Firms should assess whether it is possible to retain and make available for inspection all required records for specific types of social media communications.

SEC Adopts New Net Worth Standard for Accredited Investors

On December 21, 2011, the SEC adopted an amendment to the definition of "accredited investor" in order to implement Section 413(a) of the Dodd-Frank Act. The SEC adopted the amendment substantially as proposed on January 25, 2011, with some changes made in response to comments. Specifically, the SEC adopted 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). The amended definition also includes a grandfathering provision to permit the application of the former definition in certain limited circumstances and a provision addressing the treatment of incremental debt secured by the primary residence that is incurred within 60 days of the sale of securities to the individual. The amended definition of "accredited investor" becomes effective on February 27, 2012.

ENFORCEMENT ACTIONS

SEC Charges UBS Global Asset Management with Pricing Violations

On January 17, 2012, the SEC charged UBS Global Asset Management (Americas) Inc. with failing to properly price securities in three mutual funds it advised, resulting in violations of the 1940 Act. The pricing violations were discovered during the course of a routine SEC staff examination of UBS. The SEC found that, in June 2008, UBS improperly valued mortgage-backed securities that it purchased for the funds' portfolios by failing to follow the funds' valuation procedures. According to the SEC, in valuing the mortgage-backed securities, UBS used prices provided by third-party pricing sources that significantly exceeded the purchase price of the securities, in many cases by more than 100%. The SEC order stated that, pursuant to the funds' valuation procedures, because of the significant variation in prices, UBS should have issued price challenges to the third-party pricing sources and valued the mortgage-backed securities at their purchase prices for up to five business days, after which time UBS should have determined that the prices provided by the third-party pricing services were justified or else set fair value prices for the securities. The SEC found that, instead of following the valuation procedures, UBS valued the mortgage-backed securities at the higher prices provided by the third-party pricing sources for two weeks before issuing price challenges and setting fair value prices for the securities. According to the SEC, UBS' failure to follow the funds' valuation procedures with respect to the mortgage-backed securities caused the NAVs of the funds to be overstated, by between one and ten cents per share, for several days. The SEC found that, by selling and redeeming shares based on inaccurate NAVs, the funds violated Rule 22c-1 under the 1940 Act and that UBS willfully aided and abetted and caused the funds' violation of Rule 22c-1. In addition, the SEC found that, by not adequately implementing the valuation procedures, the funds violated Rule 38a-1 under the 1940 Act and that UBS willfully aided and abetted and caused the funds' violation of Rule 38a-1. UBS agreed to pay $300,000 to settle the SEC's charges.

SEC Files Complaint Against Former Evergreen Portfolio Manager

On January 17, 2012, the SEC issued an order instituting proceedings against Lisa Premo, a former portfolio manager of the Evergreen Ultra Short Opportunities Fund, alleging that her conduct resulted in the Fund's NAV being materially overstated from at least March 2008 to early June 2008. In 2009, Evergreen Investment Management Company LLC, the fund's investment adviser, agreed to pay $41 million to settle SEC charges stemming from the mispricing of the fund's shares in 2008. The SEC now alleges that Ms. Premo's actions in connection with the mispricing of the fund's shares violated and caused Evergreen to violate Sections 206(1) and 206(2) under the Advisers Act and also caused the fund to violate Rule 22c-1 under the 1940 Act.

According to the SEC, in early 2008, Ms. Premo learned that a collateralized debt obligation ("CDO") owned by the fund had defaulted and would no longer make payments to the fund. The SEC alleges that, under the fund's valuation procedures, Ms. Premo, as the fund's portfolio manager, was required to review on a daily basis the price being assigned to the CDO and to notify Evergreen's valuation committee of any price that she did not think reflected the holding's fair value. The SEC alleges that Ms. Premo failed to tell the valuation committee (of which she was a member) about the CDO's default and stoppage of payments to the fund. The SEC order states that, in June 2008, when the valuation committee became aware of the default and payment stoppage, it reduced the aggregate value assigned to the CDO from approximately $6.98 million to $0, resulting in a $0.10 per share drop in the fund's NAV. The SEC alleges that the drop in the fund's NAV set in motion a chain of events that ultimately led to the fund's liquidation in 2008.

SEC Settles Charges Against Morgan Stanley Investment Management for Improper Subadvisory Fee Arrangement

On November 16, 2011, the SEC charged Morgan Stanley Investment Management Inc. (MSIM) with violating federal securities laws in connection with subadvisory fees improperly charged to The Malaysia Fund, a closed-end fund for which MSIM served as investment adviser and administrator. The SEC alleged that MSIM entered into a subadvisory agreement with a Malaysian subadviser to provide advice, research and assistance to the fund, but that, in practice, the Malaysian subadviser merely provided two monthly reports based on publicly available information that MSIM neither requested nor used in its management of the fund. The SEC's order stated that, in renewing the subadvisory agreement each year, the fund's board relied on information provided by MSIM, including an annual report from the Malaysian subadviser representing that it provided: (1) research on Malaysian companies that MSIM used to identify investment opportunities; (2) statistical reports to assist MSIM's investment decisions; (3) market intelligence on Malaysian corporate developments; and (4) advice on changes in the economic and political conditions in Malaysia. According to the SEC, the fund paid more than $1.8 million in fees from 1996 to 2007 to the Malaysian subadviser.

The SEC alleged that MSIM violated (1) Section 15(c) of the 1940 Act by failing to provide the fund's board with information reasonably necessary to evaluate the nature, quality and cost of the Malaysian subadviser's services; (2) Section 206(2) of the Advisers Act by representing to the fund's board that the Malaysian subadviser was providing advisory services when it was not; (3) Section 206(4) of the Advisers Act by failing to adopt and implement procedures governing the oversight and review of the work performed by the Malaysian subadviser; and (4) Section 34(b) of the 1940 Act by preparing and distributing shareholder reports with materially false and misleading statements regarding the services provided by the Malaysian subadviser. MSIM agreed to repay the $1.8 million of subadvisory fees charged to the fund during the relevant period, as well as pay a $1.5 million penalty. MSIM further agreed to implement and maintain improved policies and procedures governing the 15(c) process and its oversight of subadvisers.

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