June 2, 2014

Investment Services Regulatory Update

New Rules, Proposed Rules and Guidance

SEC Reopens Comment Period on Proposed Target Date Retirement Fund Marketing Rules

On April 3, 2014, the SEC reopened the comment period for rule amendments originally proposed in 2010 that, if adopted, would amend rule 482 under the 1933 Act and Rule 34b-1 under the 1940 Act to require marketing materials for target date retirement funds to include a table, chart or graph depicting the fund's asset allocation over time. This illustration, referred to as the fund's asset allocation glide path, would show how the fund's asset allocation changes as it nears its target date. In 2013, the SEC's Investment Advisory Committee, which was established under the Dodd-Frank Act, recommended that the SEC develop a glide path illustration for target date retirement funds that is based on a standardized measure of fund risk as either a supplement or a replacement to the proposed asset allocation glide path illustration. The Committee recommended the risk-based glide path illustration because the choices of assets within the various asset classes and other risk management practices can have a significant impact on fund risk levels. The Committee also recommended that the SEC adopt a standard methodology or methodologies that target date retirement funds should use in the risk-based glide path illustration. The SEC is seeking comments on the risk-based glide path illustration and any other aspects of the recommendations submitted by the Committee.

Comments are due to the SEC by June 9, 2014.

Division of Investment Management Issues Guidance Regarding Fund Deregistrations

In April 2014, the staff of the Division of Investment Management of the SEC published a Guidance Update regarding deregistration of investment companies. The Guidance Update states that a fund seeking an order from the SEC declaring that it is no longer an investment company may file an application with the SEC on Form N-8F if the fund falls within one of four enumerated categories (described in Form N-8F as "Merger," "Liquidation," "Abandonment of Registration" and "Business Development Company").

The Guidance Update reviews the staff's process for reviewing and commenting on Form N-8F filings, noting that the staff generally will issue comments requesting revisions or additional information if it identifies any deficiencies. In the Guidance Update, the staff identifies six items from the Form that have generated a significant number of comments and, in order to assist applicants in completing the Form, provides guidance for responding to these items. In particular, the Guidance Update notes the following:

- Item 2 requests the fund's name and should be the name of the registrant as it appears on EDGAR. The name should not include the name of any particular series of the registrant.
- Item 6 requests information regarding the fund's contact person. The fund may include an email address for purposes of receiving staff comments, if any, electronically.
- Item 11 requests information regarding the fund's adviser. If the fund is a unit investment trust (UIT), the response to this item should be "not applicable" or otherwise explain that, as a UIT, the fund does not have an adviser.

- Item 15(a) requests information regarding whether the fund's board of directors has approved the action leading to deregistration. UITs, including insurance company separate accounts organized as UITs, should respond "not applicable" or otherwise explain that, as a UIT, the fund does not have a board. In addition, if a UIT is liquidating in accordance with its terms, the response may include a statement to that effect.
- Item 25 relates to "Abandonment of Registration." The Guidance Update states that a fund filing on the basis of "Abandonment of Registration" may either be (1) a fund that registered but determined to wind up prior to offering securities publicly or (2) a fund that will continue to operate but qualifies for an exclusion from the definition of "investment company" under Sections 3(c)(1) or 3(c)(7) of the 1940 Act. The staff notes that many funds fail to clearly identify which of these categories applies and offers guidance for properly completing the item.
- The name of the fund in the verification at the end of the Form should match exactly the name provided in response to Item 2.

The Guidance Update is available at www.sec.gov/investment/im-guidance-2014-05.pdf

Division of Investment Management Issues Guidance Regarding the Testimonial Rule and Social Media

In March 2014, the staff of the Division of Investment Management of the SEC published a Guidance Update regarding a registered investment adviser's use of social media and its publication of advertisements that feature public commentary about the adviser that appears on independent, third-party social media sites. Rule 206(4)-1(a)(1) under the Advisers Act prohibits the publication, circulation or distribution of any advertisement containing a testimonial. Although the term "testimonial" is not defined in the Advisers Act or the rules thereunder, the Guidance Update notes that the staff has consistently interpreted the term to include a statement of a client's experience with, or an endorsement of, an investment adviser. The Guidance Update states that, in certain circumstances, an investment adviser representative's or investment adviser's publication of *all* of the testimonials from an independent social media site on its own website would not implicate the concerns underlying the testimonial rule. The Guidance Update also states that in order not to violate the testimonial rule, the publication of all of the testimonials from an independent social media site also would have to meet two conditions: (1) the independent social media site must provide content that is independent of the investment adviser, and (2) there must be no material connection between the independent social media site and the investment adviser that would call into question the independence of the independent social media site or the testimonials. The Guidance Update provides additional information in a question and answer format about the conditions, other issues related to third party commentary, the inclusion of investment adviser advertisements on independent social media sites, references to independent social media site testimonials in print advertisements, client lists and fan/community pages. The Guidance Update also notes that the staff no longer takes the position that an advertisement that contains certain non-investment related commentary (e.g., religious affiliation or service to the community) regarding an investment adviser representative may be considered a testimonial.

The Guidance Update is available at www.sec.gov/investment/im-guidance-2014-04.pdf.

Other News

CFTC Staff Announces Expedited No-Action Relief for CPO Delegation

On May 12, 2014, the staff of the Commodity Futures Trading Commission (CFTC) issued a letter setting forth the criteria for seeking streamlined registration no-action relief for commodity pool operators (CPOs) who delegate their status and responsibility as a CPO to another party. The letter clarified that no-action relief is required if a CPO seeks to delegate its responsibilities to another party. While an investment adviser is deemed to be the CPO of a registered investment company (RIC) that also is a commodity pool (and therefore delegation is not necessary), the same does not apply to a wholly-owned subsidiary of a RIC. Each director of the wholly-owned subsidiary will likely have to seek no-action relief to delegate their CPO status and responsibilities to the investment adviser to the wholly-owned subsidiary. The CFTC staff's letter details the criteria which must be satisfied in order for a delegating CPO to use the streamlined process for relief. The relief is not self-executing and the delegating CPO (e.g., the directors) must complete a form of no-action request and file such request with the CFTC, which the CFTC staff will review on an expedited basis. If a delegating CPO does not qualify for the streamlined no-action relief, the CFTC staff will continue to evaluate requests for CPO registration no-action relief on a non-expedited basis.

The CFTC staff letter is available at www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-69.pdf

OCIE Issues Cybersecurity Risk Alert

On April 15, 2014, the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a National Exam Program Risk Alert entitled "OCIE Cybersecurity Initiative." In the Risk Alert, OCIE states that it will conduct an initial set of examinations of more than 50 registered broker-dealers and registered investment advisers to gain information about the industry's recent experiences with certain cybersecurity threats and the level of the industry's cybersecurity preparedness. Specifically, OCIE indicates that the examinations will focus on cybersecurity governance, identification and assessment of cybersecurity risks, protection of networks and information, risks associated with remote customer access and funds transfer requests, risks associated with vendors and other third parties, detection of unauthorized activity and experiences with certain cybersecurity threats. The Risk Alert includes a seven-page appendix of sample requests for information and documents that may be used by OCIE in the conduct of the examinations and encourages compliance professionals to use the appendix as a tool to help "assess their firms' level of preparedness, regardless of whether they are included in OCIE's examinations."

The Risk Alert is available at
www.sec.gov/ocie/announcement/Cybersecurity+Risk+Alert++%2526+Appendix+-+4.15.14.pdf

SEC Staff Member Discusses Planned Sweep Examination of Alternative Funds

At an industry conference held in March 2014, Jane Jarcho, National Associate Director of the Investment Adviser/ Investment Company Examination Program in the Office of Compliance Inspections and Examinations, stated that the SEC will conduct a national sweep examination of retail alternative funds beginning in 2014. Ms. Jarcho indicated that the sweep examination is intended to gather information for the Division of Investment Management and the SEC commissioners and could potentially lead to guidance regarding alternative funds. Ms. Jarcho stated that the initial examinations will cover 15-20 fund complexes and will focus mainly on liquidity, leverage, compliance and board oversight of alternative funds.

Litigation and Enforcement Actions

SEC Charges Investment Advisory Firm and its President for Fraudulently Hiding Account Shortfall

On May 5, 2014, the SEC announced fraud charges and an asset freeze against an investment advisory firm and its president for repeatedly hiding a shortfall of more than $700,000 in client assets. According to the SEC's complaint filed in U.S. District Court for the Southern District of Ohio, Professional Investment Management (PIM) reported to clients that the firm held approximately $7.7 million of client money in a money market fund account when the actual amount held was less than $7 million. The account shortfall was discovered when the SEC conducted an examination of the firm to verify the existence of client assets. The SEC alleges that Douglas Cowgill, the president and chief compliance officer of PIM, attempted to disguise the money market fund account shortfall from SEC examiners by entering a fake trade in PIM's account records and also transferring funds from a separate client cash account to the money market fund account.

The SEC's complaint alleges that: (1) PIM and Mr. Cowgill violated the antifraud provisions of the federal securities laws; (2) PIM violated the registration and custody provisions of the Advisers Act; and (3) Mr. Cowgill aided and abetted and caused PIM's Advisers Act violations.

SEC Charges Investment Adviser for Undisclosed Revenue Sharing Agreements

On April 15, 2014, the SEC announced charges against an investment advisory firm, its chief executive officer, its chief compliance officer, and another employee for misleading investors and breaching their fiduciary duties to clients. The SEC alleges that Total Wealth Management (Total Wealth) and its owner and CEO, Jacob Cooper, entered into undisclosed revenue sharing agreements through which they paid themselves kickbacks or so-called "revenue sharing fees." The SEC states that Total Wealth and Mr. Cooper failed to disclose to clients the conflicts of interest created by these agreements. The SEC alleges that Total Wealth and Mr. Cooper also materially misrepresented the extent of the due diligence conducted on the investments they recommended. The SEC also charged Total Wealth's CCO, Nathan McNamee, and investment adviser representative, Douglas Shoemaker, with breaching their fiduciary duties and defrauding clients by failing to disclose conflicts of interest and concealing the kickbacks they received from the investments they recommended.

In the order instituting administrative proceedings, the SEC alleges that Total Wealth and Mr. Cooper willfully violated the antifraud provisions of the federal securities laws, and Messrs. McNamee and Shoemaker violated or aided and abetted violations of the antifraud provisions. The SEC also charged Total Wealth and Messrs. Cooper, McNamee and Shoemaker with violations of Form ADV disclosure rules and the custody rule. The SEC's order seeks return of allegedly ill-gotten gains plus interest, financial penalties, an accounting and remedial relief.

SEC Settles Charges Against Investment Adviser for Improperly Calculating Advisory Fees and Overcharging Clients

On April 3, 2014, the SEC settled charges against Transamerica Financial Advisors, Inc. for improperly calculating advisory fees and overcharging clients. According to the SEC's order, Transamerica offered breakpoint discounts designed to reduce the fees that clients owed to the firm when they increased their assets in certain investment programs and permitted clients to aggregate the values of related accounts in order to get the discounts. The SEC found that Transamerica failed to process aggregation requests by clients and also had conflicting policies on whether representatives were required to pass on to clients the savings from breakpoint discounts. The SEC's order stated that SEC examiners alerted Transamerica about aggregation problems in 2010 after an examination of a branch office. The SEC found that, while Transamerica provided refunds to clients of that branch office, Transamerica failed to undertake a firm-wide review of all client accounts as SEC examiners recommended and, during a subsequent examination of the firm in 2012, SEC examiners found that Transamerica was still failing to aggregate certain related client accounts. As a result, the SEC found that Transamerica overcharged certain clients by failing to apply the discounts and failed to have adequate policies and procedures in place to ensure that the firm was properly calculating its fees.

The SEC's order found that Transamerica willfully violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rule 206(4)-7 thereunder. As a result of the SEC investigation, Transamerica reviewed client records and reimbursed 2,304 current and former client accounts with refunds and credits totaling $553,624 including interest. Transamerica also agreed to pay an additional $553,624 penalty. In addition to the monetary reimbursements and sanctions, Transamerica agreed to retain an independent consultant to review its policies and procedures pertaining to its account opening forms, fee schedules and fee computation methodologies, as well as the firm's account aggregation process for breakpoints.

U.S. Supreme Court Extends Sarbanes-Oxley Whistleblower Protection

On March 4, 2014, the U.S. Supreme Court issued its decision in *Lawson v. FMR LLC, et al.*, holding that the whistleblower protections of the Sarbanes-Oxley Act (SOX) extend to employees of privately-held contractors and subcontractors serving public companies. The plaintiffs in *Lawson*, former employees of privately-held service providers to the Fidelity funds, brought separate actions claiming that they were discharged in retaliation for raising concerns about cost accounting practices used for the funds and supposed inaccuracies in a draft SEC registration statement concerning the funds. The plaintiffs argued that the SOX whistleblower provision protected them as employees of a contractor for the funds, which are public companies. The defendants argued that the plaintiffs did not have a claim under the SOX whistleblower provision, because that provision protects only employees of public companies.

SOX prohibits retaliation against employees of public companies who report to federal authorities or designated persons of authority at the employer, or otherwise assist in an investigation of, certain types of allegedly unlawful conduct. At issue in *Lawson* was whether SOX similarly protects employees of private contractors and subcontractors providing services to public companies, including, among others, fund advisers, lawyers and accountants. At the time in question, the applicable section of SOX read as follows:

> No [public] company ..., or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of [whistleblowing or other protected activity].

In the 6-3 decision, the majority, focusing on statutory construction and legislative history, found that the term "employee" includes employees of a contractor to a public company. The opinion notes that Congress had enacted SOX in the wake of Enron's collapse and that Congress had focused on the role played by Enron's outside contractors, including that the primary deterrent to the employees of Enron's contractors reporting fraud was fear of retaliation. The opinion also highlights that, since funds do not have their own employees, the majority's interpretation "avoids insulating the entire mutual fund industry" from the whistleblower provision. The opinion notes that a narrow reading of SOX's whistleblower provision would fail to protect the only firsthand witnesses to fraud in the fund industry.

The opinion acknowledges that the Dodd-Frank Act established a whistleblower reward program, which prohibits any employer from retaliating against a whistle¬blower for providing information to the SEC, participating in an SEC proceeding, or making disclosures required or protected under SOX and certain other securities laws. The opinion notes, however, that the Dodd-¬Frank whistleblower provision focuses primarily on reporting to federal authorities, whereas the SOX whistleblower protections extend to employees who provide information to any person with supervisory authority over the employee.

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

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