VEDDERPRICE®

Chicago • New York • Washington, DC • London • San Francisco • Los Angeles

July 1, 2014

Investment Services Regulatory Update

New Rules, Proposed Rules and Guidance

Division of Investment Management Issues Guidance Regarding Enhanced Mutual Fund Disclosure

In June 2014, the staff of the Division of Investment Management of the SEC published a Guidance Update related to the enhanced mutual fund disclosure amendments adopted in 2009, which require funds to include a summary section, written in plain English, containing certain information (i.e., investment objectives and strategies, risks, costs and performance) at the beginning of each mutual fund statutory prospectus.

According to the Guidance Update, since the adoption of these amendments, a significant number of summary sections still contain "complex, technical and duplicative" information. The Guidance Update highlights certain rule and form requirements, as well as comments the staff provided to funds related to these amendments, including:

- *Investment Strategies and Risks*: Form N-1A requires that a summary section include a summary of principal strategies and risks. Funds often repeat the principal investment strategies and risk disclosure contained elsewhere in the prospectus, rather than summarizing this information. Duplicative disclosure increases the length of a prospectus and undermines the purpose of the amendments. Additionally, Form N-1A provides that non-principal strategies and risks should be disclosed in the SAI. Many funds include the additional, non-principal strategies and risks elsewhere in their prospectuses and do not clearly indicate whether the strategies/risks are principal or non-principal.
- *Plain English Requirements*: Form N-1A requires that a summary section be written in plain English. Many funds still use technical terms, unnecessary defined terms and long, dense paragraphs in summary sections which undermine the stated goal of creating useable summaries for investors.
- *Inclusion of Required or Permitted Information*: Form N-1A requires that a summary section only include disclosures required or permitted by the Form. The Guidance Update highlights certain fee table footnotes and purchase and sale information as examples of disclosure that funds often incorrectly include in summary sections.
- *Cross-References*: Form N-1A provides that funds should avoid cross-references to the SAI or shareholder reports. Some funds have numerous cross-references in their summary sections, which unnecessarily add to summary section complexity.

The Guidance Update encourages funds to revisit their disclosure in light of the established framework of Form N-1A and the Guidance Update.

The Guidance Update is available at www.sec.gov/investment/im-guidance-2014-08.pdf.

SEC Divisions Issue Guidance Regarding Proxy Voting

In June 2014, the staff of the Divisions of Investment Management and Corporation Finance of the SEC jointly published Staff Legal Bulletin No. 20 (SLB 20) regarding (1) investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms and (2) the availability and requirements of two exemptions from the

Exchange Act proxy rules. SLB 20 consists of questions and answers regarding proxy voting responsibilities and exemptions in order to assist investment advisers and proxy advisory firms, respectively, in making changes to their current systems and processes in advance of next year's proxy season. In particular, SLB 20 notes the following:

- Investment advisers and their clients do not need to agree that the adviser will undertake all of the proxy voting responsibilities. Rule 206(4) 6 under the Advisers Act only requires investment advisers to vote in accordance with their client's wishes, including not voting at all, only voting on some matters, or voting in favor of management or certain proponents.
- Where the client gives the investment adviser the authority to vote, the investment adviser must take steps to demonstrate that proxy votes are cast in accordance with clients' best interests and the adviser's procedures. SLB 20 suggests periodically sampling proxy votes to review whether they comply with the investment adviser's proxy voting policies and review, at least annually, the adequacy of proxy voting policies and procedures.
- An investment adviser choosing to rely on recommendations of a proxy advisory firm should ascertain whether the proxy advisory firm has the capacity and competency to make voting recommendations based on materially accurate information. If an investment adviser finds that a proxy advisory firm's recommendation is based on a material factual error (for example, as a result of a supplemental proxy filing by the issuer), the adviser should take reasonable steps to investigate the error and seek to determine whether the proxy advisory firm is taking reasonable steps to reduce similar errors in the future.
- An investment adviser that retains a proxy advisory firm should adopt policies and procedures reasonably designed to provide sufficient oversight of the proxy advisory firm, and to identify and address the conflicts of the proxy advisory firm (which, as discussed below, will be disclosed by the proxy advisory firms), in order to ensure that the investment adviser, in acting based on the proxy advisory firm, continues to vote proxies in the best interests of its clients.
- A proxy advisory firm is subject to the Exchange Act proxy rules when it engages in "solicitation," which includes "the furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy."
- SLB 20 describes certain exemptions available to proxy advisory firms from the filing and disclosure requirements of the Exchange Act proxy rules. To rely on certain of these exemptions, a proxy advisory firm must disclose significant relationships or material interests. Where a significant relationship or material interest is found, the proxy advisory firm must disclose the conflict, including the scope of the relationship or interest and steps taken to mitigate the conflict. Rule 14a 2(b)(3) under the Exchange Act imposes an affirmative duty to disclose these significant relationships or material interests to the recipient of a proxy advisory firm's advice. Providing the information "upon request" will not satisfy the rule.

SLB 20 is available at www.sec.gov/interps/legal/cfslb20.htm.

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.

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.

Other News

SEC Commissioner Confirms Cybersecurity as a Board-Level Concern

In a June 10, 2014 speech delivered at the New York Stock Exchange, SEC Commissioner Luis Aguilar addressed the important role of boards in overseeing cyber risk management. In his speech, Mr. Aguilar focused on what boards can do and should be doing to ensure that their organizations are appropriately considering and addressing cyber risks. Mr. Aguilar emphasized the duties of boards, highlighting business interruption and the potential for reputational harm as posing serious threats to a company's bottom line. According to Mr. Aguilar, boards have assumed greater responsibility for overseeing risk management efforts, and these efforts should include cybersecurity. Mr. Aguilar stated that, although the primary responsibility for risk management has historically belonged to management, a board is responsible for ensuring that a company has established appropriate risk management programs and for overseeing how management implements these programs.

Mr. Aguilar also addressed the risk of shareholder lawsuits if boards choose to minimize or ignore their cybersecurity oversight responsibilities. Mr. Aguilar urged boards to take a proactive approach to mitigating liability exposure. In discussing what boards can do and should be doing on cybersecurity issues, Mr. Aguilar cited a February 2014 report from the National Institute of Standards and Technology, entitled "Framework for Improving Critical Infrastructure Cybersecurity" (NITS Framework) stating that it is a place for a board to begin in assessing a company's cybersecurity readiness. He stated that the NITS Framework is intended to provide companies with a set of industry standards and best practices for managing cybersecurity.

The NITS Framework is available at www.nist.gov/cyberframework/upload/cybersecurity-framework-021214-final.pdf.

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.

Litigation and Enforcement Actions

SEC Settles Charges Against Hedge Fund Adviser for Conducting Prohibited Transactions and Retaliating Against Whistleblower

On June 16, 2014, the SEC settled charges against a hedge fund advisory firm, Paradigm Capital Management, Inc., for engaging in principal transactions with an affiliated broker-dealer without providing effective disclosure to, or obtaining effective consent from, a hedge fund client. The SEC also settled charges against the firm's owner, Candace

Weir, for causing the improper principal transactions. According to the SEC's order, Paradigm's former head trader made a whistleblower submission to the SEC that revealed the principal transactions between Paradigm and the affiliated broker-dealer. The SEC found that, after learning that its head trader had reported potential violations to the SEC, Paradigm engaged in a series of retaliatory actions that ultimately resulted in the head trader's resignation. This is the first time the SEC has filed a case under its new authority to bring anti-retaliation enforcement actions.

According to the SEC, Ms. Weir conducted transactions between Paradigm and an affiliated broker-dealer while trading on behalf of a hedge fund client. The SEC's order also found that Paradigm failed to provide effective written disclosure to the hedge fund and did not obtain its consent as required prior to the completion of each principal transaction. The SEC's order stated that Paradigm attempted to satisfy the written disclosure and consent requirements by establishing a conflicts committee to review and approve each of the principal transactions on behalf of the hedge fund. The SEC's order found that the conflicts committee itself, however, was conflicted, because its two members, Paradigm's chief financial officer and chief compliance officer, each reported to Ms. Weir and Paradigm's CFO also served as CFO of the affiliated broker-dealer. The SEC also found that Paradigm's Form ADV was materially misleading for failing to disclose its CFO's conflict as a member of the conflicts committee.

The SEC's order found that Paradigm violated, among other things, Sections 206(3) and 207 of the Advisers Act. The SEC's order also found that Ms. Weir caused Paradigm's violations of Section 206(3) of the Advisers Act. Paradigm and Ms. Weir agreed to jointly and severally pay disgorgement of $1.7 million for distribution to current and former investors in the hedge fund, and pay prejudgment interest of $181,771 and a penalty of $300,000. Paradigm also agreed to retain an independent compliance consultant.

SEC Settles Charges Against Portfolio Manager for Improperly Benefiting Hedge Fund Client at Expense of U.S. Fund Investors

On June 2, 2014, the SEC settled charges against Christopher Ruffle, a portfolio manager and head of China operations for the UK-based Martin Currie group of institutional money managers, for structuring a prohibited joint transaction between a U.S.-registered investment company client and a hedge fund client.

According to the SEC's order, in April 2009, in the midst of the financial crisis, Martin Currie used its U.S.-registered investment company client, The China Fund, Inc., to invest in a convertible bond transaction which directly benefited a Martin Currie hedge fund client. The SEC's order states that the hedge fund client, an affiliated person of the China Fund, had previously acquired significant amounts of illiquid bonds of a single Chinese company and needed liquidity to meet increasing redemption requests from its investors.

According to the SEC's order, Mr. Ruffle negotiated a convertible bond transaction and, together with others at Martin Currie, caused the China Fund to invest in convertible bonds issued by a subsidiary of the Chinese company in which the hedge fund client was invested. The SEC's order states that the Chinese company used 44% of the investment proceeds to redeem a significant portion of the pre-existing bonds held by the hedge fund client, which alleviated the hedge fund's liquidity concerns. Nevertheless, according to the SEC order, the China Fund's board wrote down the value of the convertible bonds to zero in November 2010 and the China Fund sold the bonds for 55% of their face value in April 2011.

The SEC's order found that Mr. Ruffle willfully aided and abetted and caused violations of Section 17(d) of the 1940 Act and Rule 17d 1 thereunder. Mr. Ruffle agreed to a one-year industry bar and to pay a $150,000 penalty.

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.

* * *

Investment Services Group Members

Chicago

David A. Sturms, *Chair* .... +1 (312) 609 7589
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 .... +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
Jennifer M. Goodman .... +1 (312) 609 7732
Nicole M. Kuchera .... +1 (312) 609 7763
Michael J. Murphy .... +1 (312) 609 7738
Abigail J. Murray.................... +1 (312) 609 7796
Maren E. Pedersen................ +1 (312) 609 7554
Nathaniel Segal .... +1 (312) 609 7747
Jacob C. Tiedt........................ +1 (312) 609 7697
Ellen Yiadom Hoover .... +1 (312) 609 7707

New York

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

Washington, DC

Bruce A. Rosenblum...............+1 (202) 312 3379
Linda M. French......................+1 (202) 312 3345

London

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

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. Clients can expect to work with a highly experienced team with deep knowledge in structural, operational and regulatory matters, coupled with a dedication to quality, responsive service. Our attorneys provide a full range of services to diverse financial services organizations, including mutual fund (investment company) complexes, ETFs (exchange traded funds), investment advisers, hedge and other private funds, broker-dealers and independent directors of investment companies. Our clients include hundreds of separate open- and closed-end 1940 Act registered funds, ranging in size from less than $100 million to the multibillion-dollar level.

About Vedder Price

Vedder Price is a thriving general-practice law firm with a proud tradition of maintaining long-term relationships with our clients, many of whom have been with us since our founding in 1952. With approximately 300 attorneys and growing, we serve clients of all sizes and in virtually all industries from our offices in Chicago, New York, Washington, DC, London, San Francisco and Los Angeles.

VEDDER PRICE®

Chicago

222 North LaSalle Street
Chicago, IL 60601
T: +1 (312) 609 7500
F: +1 (312) 609 5005

Washington, DC

1401 I Street NW, Suite 1100
Washington, DC 20005
T: +1 (202) 312 3320
F: +1 (202) 312 3322

San Francisco

275 Battery Street, Suite 2464
San Francisco, CA 94111
T: +1 (415) 749 9500
F: +1 (415) 749 9502

New York

1633 Broadway, 47th Floor
New York, NY 10019
T: +1 (212) 407 7700
F: +1 (212) 407 7799

London

4 Coleman Street
London EC2R 5AR
T: +44 (0)20 3667 2900
F: +44 (0)20 3667 2901

Los Angeles

10250 Constellation Boulevard, Suite 2300
Los Angeles, CA 90067
T: +1 (424) 204 7700
F: +1 (424) 204 7702