Investment Services Regulatory Update

September, 2015

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New Rules, Proposed Rules and Guidance

FinCEN Proposes Anti-Money Laundering Rules for Registered Investment Advisers

On August 25, 2015, the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Department of the Treasury, issued a notice of proposed rulemaking that would require registered investment advisers to establish anti-money laundering ("AML") programs and to report suspicious activity to FinCEN pursuant to the Bank Secrecy Act ("BSA"). The proposed rule seeks to address money laundering vulnerabilities in the U.S. financial system, specifically to prevent illicit actors from using an investment adviser as a means to avoid detection of their activity, which might otherwise occur in dealing with financial institutions that have AML programs and suspicious activity reporting requirements. FinCEN is proposing three significant regulatory changes:

- The proposed rule would include all investment advisers that are registered with the SEC or required to be registered with the SEC under Section 203 of the Advisers Act (generally, investment advisers with assets under management of $100 million or more) within the scope of "financial institutions" for purposes of the BSA, thus subjecting such advisers to all BSA regulatory requirements generally applicable to other financial institutions (e.g., the requirement to file currency transaction reports and comply with recordkeeping requirements relating to the transmittal of funds).
- The proposed rule would require registered investment advisers to develop, implement and monitor a written AML program reasonably designed to prevent the adviser from being used as a conduit to facilitate money laundering or finance terrorist activities and to achieve compliance with the applicable provisions of the BSA and FinCEN implementing regulations. Specifically, a registered investment adviser would be required, among other things, to: (1) adopt and implement policies, procedures and internal controls based upon the adviser's assessment of the money laundering or terrorist financing risks posed by its clients, (2) provide for periodic independent testing of the AML program, (3) designate an AML compliance officer, and (4) provide ongoing AML training for appropriate firm personnel.
- The proposed rule would require registered investment advisers to report suspicious transactions that involve at least $5,000 in funds or other assets that are conducted or attempted "by, through or at" the adviser. An adviser would be permitted to delegate such responsibilities to an agent or third-party processor, but the adviser would remain liable for any violation by the third party for failure to comply with the suspicious activity reporting requirements.

FinCEN is proposing to delegate its authority to examine registered investment advisers for compliance with these requirements to the SEC. FinCEN notes that it is not proposing a customer identification program requirement at this time, but that it anticipates addressing this issue in a subsequent rulemaking. Comments on the proposed rule are due by November 2, 2015.

The FinCEN proposed rulemaking release is available at: http://www.fincen.gov/statutes_regs/frn/pdf/1506-AB10_FinCEN_IA_NPRM.pdf.

SEC Issues No-Action Letter Permitting a Fund-of-Funds to Invest in Assets that May Not Be Deemed Securities

On June 29, 2015, the staff of the SEC issued a no-action letter to Grant Park Multi Alternative Strategies Fund, which operates as a fund-of-funds, stating that it would not recommend enforcement action under Sections 12(d)(1)(A) and (B) of the 1940 Act if the Fund invests in assets that might not be considered securities under the 1940 Act, in addition to shares of underlying funds.

Funds are limited in their ability to acquire securities of other funds by Section 12(d)(1)(A) of the 1940 Act, which provides that no registered investment company ("acquiring company") may acquire securities of another investment company ("acquired company") if such securities represent more than 3% of the acquired company's outstanding voting stock or more than 5% of the acquiring company's total assets, or if such securities, together with the securities of other investment companies, represent more than 10% of the acquiring company's total assets. Section 12(d)(1)(G) of the 1940 Act provides that Section 12(d)(1)(A) will not apply to securities of an acquired company purchased by an acquiring company if, among other things, (i) the acquiring company and the acquired company are part of the same group of investment companies ("affiliated funds"), and (ii) the acquiring company holds only securities of affiliated funds, government securities and short-term paper. Rule 12d1-2, in turn, broadens the scope of permissible investments for a fund-of-funds relying on Section 12(d)(1)(G), enabling it to invest, among other things, in any types of securities (as defined by the 1940 Act) that are consistent with its investment policies; however, certain types of derivatives and other assets, including real estate, futures contracts and other financial instruments, may not fall within the 1940 Act's definition of "securities." Thus, the Grant Park Fund sought no-action assurance from the staff to have greater flexibility in meeting its investment objectives by investing in derivatives and other financial instruments that might not be securities as defined by the 1940 Act.

In granting the no-action relief, the staff referenced the amendments to Rule 12d1-2 proposed by the SEC in 2008, which were intended to permit, among other things, a fund-of-funds relying on Section 12(d)(1)(G) to invest in assets, such as real estate, futures contracts and other financial instruments, that might not qualify as securities under the 1940 Act. The staff noted that the SEC had issued, and has continued to issue, exemptive orders providing the relief that would have been codified in the proposed Rule 12d1-2 amendments and that such greater flexibility to invest in assets that might not be securities under the 1940 Act does not appear to present any additional concerns that Section 12(d)(1)(G) was intended to address. In the incoming letter, the Grant Park Fund also argued that its request was consistent with the rationale behind these exemptive orders.

The No-Action Letter is available at: http://www.sec.gov/divisions/investment/noaction/2015/northern-lights-fund-trust-063015.htm

Division of Investment Management Issues Guidance on Personal Trade Reporting of Accounts Over Which Access Persons Have No Influence or Control

On June 26, 2015, the staff of the Division of Investment Management of the SEC issued a Guidance Update addressing the staff's views on the application of the exception from personal securities and trading reporting under an adviser's code of ethics for its directors, officers, partners and other supervised persons with access to nonpublic information regarding securities transactions ("access persons") for securities held in an account over which the access person has "no direct or indirect influence or control" (the "reporting exception"). Specifically, the staff addressed the application of the reporting exception to an access person's trusts and third-party discretionary accounts. In this connection, the staff states that an access person may rely on the reporting exception with respect to a blind trust, in which a trustee manages funds for the benefit of such access person, who has no knowledge of the specific management actions taken by the trustee and no right to intervene in the trustee's management.

In the Guidance Update, the staff notes that some advisers have asserted that the reporting exception applies to (1) an access person's trusts when such person (i) is a grantor or beneficiary of a trust managed by a third-party trustee, and (ii) has limited involvement in trust affairs, and (2) an access person's personal account when a third-party manager has discretionary authority over the account. In this regard, the staff states its view that the fact that an access person provides a trustee with management authority over a trust for which he or she is grantor or beneficiary, or provides a third-party manager discretionary investment authority over his or her personal account, by itself, is insufficient for an adviser to reasonably believe that the access person had "no direct or indirect influence or control" for purposes of relying on the reporting exception. Although this would not, by itself, enable an adviser to rely on the reporting exception, the staff believes that the adviser may be able to implement additional controls to establish a reasonable belief regarding the absence of influence or control such that an access person could rely on the reporting exception. In the staff's view, such additional policies and procedures should be reasonably designed to determine whether the access person actually has direct or indirect influence or control over the trust or account, rather than whether the third-party manager has discretionary or non-discretionary investment authority. Advisers may consider, for example:

- obtaining information about a trustee or third-party manager's relationship to the access person (e.g., independent professional versus friend or relative; unaffiliated versus affiliated firm);
- periodically obtaining specific certifications by access persons and their trustees or discretionary third-party managers regarding the access persons' influence or control over trusts or accounts (e.g., "Did you suggest that the trustee or manager make any particular purchases or sales of securities for account X during time period Y?");
- providing access persons with the exact wording of the reporting exception and a clear definition of "no direct or indirect influence or control" that the adviser consistently applies to all access persons; and

- on a sample basis, requesting reports on holdings and/or transactions made in the trust or discretionary account to identify transactions that would have been prohibited pursuant to the adviser's code of ethics, absent reliance on the reporting exception.

The Guidance Update is available at: http://www.sec.gov/investment/im-guidance-2015-03.pdf.

SEC Requests Public Comment on the Listing, Trading and Selling of Exchange-Traded Products

On June 12, 2015, the SEC issued a release (the "Release") seeking public comment relating to the listing and trading of exchange-traded products ("ETPs"), which include exchange-traded funds (including open-end funds and unit investment trusts, in each case registered under the 1940 Act), pooled investment vehicles (including commodity trusts and partnerships that are registered under the Securities Act but not the 1940 Act) and exchange-traded notes (senior debt instruments issued by a financial institution that pay a return based on the performance of a reference asset), and the sale of these products by broker-dealers. Unlike the SEC's previous requests for public comment, the Release focuses on a broader group of ETPs—not just 1940 Act-registered exchange-traded funds (the largest category of ETPs)—and the oversight of the products under the Exchange Act. Citing the "enormous growth" in the number, aggregate market capitalization and variety of ETPs, including the increasing scope and complexity of ETP investment strategies in recent years, the SEC solicited public comment on 53 specific multi-part requests, divided into the following categories:

- **Arbitrage and Market Pricing***:* The SEC requested comment on all aspects of the ETP arbitrage mechanism, including the nature, extent and potential causes of premiums and discounts across the ETP spectrum. Specifically, the Release sets forth 18 multi-part requests for comment on the efficient and effective use of the ETP arbitrage mechanism. In the Release, the SEC noted its reliance upon ETP sponsor representations regarding the continued effectiveness and efficiency of arbitrage mechanisms when considering whether to grant exemptive relief under the Exchange Act. Issues identified for comment in this category include whether a listing exchange should have an obligation to monitor the effectiveness of an ETP's arbitrage mechanism on an ongoing basis and whether and ow arbitrage mechanisms may affect trading in underlying or reference assets (including whether this varies by underlying asset type).
- **Exemptive and No-Action Relief under the Exchange Act:** Rules 101 and 102 of Regulation M under the Exchange Act generally prohibit distribution participants, issuers, selling security holders and their affiliated purchasers from purchasing, bidding for or attempting to induce others to purchase or bid for covered securities during the restricted period of a distribution of securities. Because ETPs are in continuous distribution, they generally, on an ongoing basis, need to meet the conditions of the Regulation M relief that has been extended to them and to meet the representations made in seeking relief under Regulation M. The SEC requested comment on the application of Rules 101 and 102, noting the increased complexity of ETP investment strategies and the expanded types of underlying assets. Specifically, the SEC sets forth three multi-part requests for comment on approaches for preventing manipulation of ETP distributions by persons who may be incentivized to do so in light of the increasingly complex products and markets. The

SEC also invites comment through four multi-part requests on existing conditions pertaining to ETP exemptive and no-action relief.

- **Exchange Listing Standards:** The SEC requested comment on the interplay between the national securities exchanges and the SEC in determining whether the proposed listing and trading of ETPs is consistent with the Exchange Act. The nine multi-part requests for comment generally relate to whether the SEC's and the exchanges' independent obligations complement each other or overlap, and if they overlap, how the responsibilities should be more appropriately allocated.
- **Broker-Dealer Sales Practices and Investor Use of, and Understanding of, ETPs:** The Release also requests comment on the practices of broker-dealers in recommending or selling ETPs to retail investors. The 15 multi-part requests for comment generally relate to how broker-dealers meet their obligations to customers and the extent to which investors' investment decisions are based on such broker-dealer recommendations. The Release also seeks comment on the extent to which individual investors understand the nature and operation of ETPs and on the ways ETPs are used by investors. For instance, the Release asks whether investors understand the arbitrage mechanisms of ETPs and whether there are aspects of such mechanisms that should be prominently disclosed to investors.

The comment period ended on August 17, 2015. The Release is available at: https://www.federalregister.gov/articles/2015/06/17/2015-14890/request-for-comment-on-exchange-traded-products.

Public Statements, Speeches and Testimony

SEC Commissioners Address Recent Commission Orders Against CCOs

On August 10, 2015, SEC Commissioner Luis Aguilar released a public statement concerning "the critical importance of clarity in Commission Orders for enforcement actions." Commissioner Aguilar stated that the Commission and its staff "should always be cognizant that there is a broad audience that carefully reads Commission Orders for guidance" as to what is, and what is not, acceptable behavior. More specifically, Commissioner Aguilar stated that when Commission Orders involve federal securities law violations by Chief Compliance Officers, "[t]he need for clear and transparent Orders is especially important." Noting that "CCOs, after all, exist in large part to implement and enforce policies and procedures to prevent federal securities law violations," Commissioner Aguilar emphasized that "the importance of clarity in Commission Orders, especially the ones involving CCOs, cannot be overstated."

Along the same lines, SEC Commissioner Daniel Gallagher, in a speech delivered to the U.S. Chamber of Commerce on August 4, 2015 in connection with the fifth anniversary of the enactment of the Dodd-Frank Act, warned that "[r]ecent enforcement actions holding compliance officers to a standard of strict liability will only serve to chill talented professionals from playing this vital role."

These comments come against a backdrop of other recent comments by SEC Commissioners regarding the appropriate treatment of CCOs in enforcement actions. For instance, on June 18,

2015, Commissioner Gallagher, in a public statement, commented on his vote against two settled SEC enforcement actions *(In the Matter of Blackrock Advisors, LLC and In the Matter of SFX Financial Advisory Management Enterprises, Inc.)* involving alleged violations by CCOs of Rule 206(4)-7 under the Advisers Act, which requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Act. He stated that "[b]oth settlements illustrate a Commission trend toward strict liability for CCOs under Rule 206(4)-7," suggesting that "[a]ctions like these are undoubtedly sending a troubling message that CCOs should not take ownership of the firm's compliance policies and procedures, lest they be held accountable for conduct that, under Rule 206(4)-7, is the responsibility of the adviser itself."

On June 29, 2015, in a public statement titled "The Role of Chief Compliance Officers Must be Supported," Commissioner Aguilar expressed "concern that the recent public dialogue may have unnecessarily created an environment of unwarranted fear in the CCO community" and that "the dissent [of Commissioner Gallagher] and the resulting publicity, has left the impression that the SEC is taking too harsh of an enforcement stance against CCOs, and that CCOs are needlessly under siege from the SEC." Commissioner Aguilar insisted that "the Commission does not bring enforcement actions against CCOs who take their jobs seriously and do their jobs competently, diligently, and in good faith to protect investors." On July 15, 2015, Chair Mary Jo White also weighed in on the public debate in her opening remarks at the SEC's Compliance Outreach Program for Broker-Dealers. She assured the audience that it is not the Commission's intention to use its enforcement program to target compliance professionals, stating that "[w]e do not bring cases based on second guessing compliance officers' good faith judgments, but rather when their actions or inactions cross a clear line that deserve sanction."

Litigation and Enforcement Actions

SEC Grants Petition for Review of Dismissal of Charges Against Investment Advisory Firm

In September 2014, the SEC issued an order instituting administrative proceedings against respondents The Robare Group, Ltd., a registered investment adviser ("Adviser") and its principals, Mark Robare and Jack Jones, Jr., alleging violations of the Advisers Act based on the Adviser's failure to disclose financial incentives it had in recommending particular mutual funds to its advisory clients. Specifically, the SEC alleged that the Adviser failed to disclose in its Form ADV compensation it received through a commission schedule and servicing fee agreement (the "Agreement") with a registered broker-dealer ("Broker") for client assets that were invested in certain mutual funds offered on the Broker's platform and the conflicts of interest to clients arising from that compensation arrangement. According to the SEC's allegations, from 2005 until the Adviser filed its December 2011 Form ADV, the Adviser failed to disclose the existence of the Agreement, which had been executed in 2004; beginning in December 2011, the SEC alleged, the Adviser inadequately disclosed the arrangement and "still failed to disclose that it had an incentive to prefer certain [mutual] funds as a result of the arrangement."

On June 4, 2015, an SEC administrative law judge issued an initial decision dismissing all charges against the respondents after finding, among other things, that the SEC failed to show that the respondents acted with scienter. Of note, the administrative law judge concluded that the respondents had prepared the Form ADV disclosure in question in reliance in good faith upon the advice of third-party compliance consultants, and that the consultants' advice was "facially valid."

On June 25, 2015, the SEC Division of Enforcement filed a petition for review of the initial decision, seeking reversal of the administrative law judge's decision to dismiss, a finding of liability and the imposition of sanctions. The Division of Enforcement's petition took issue with the judge's decision as a matter of public policy, claiming that the decision "shifts the burden of fully disclosing a conflict of interest from an investment adviser, who has a fiduciary duty to and a relationship with clients, to a compliance consultant (who has no such connection)." The Division asserted that the administrative law judge's decision, if allowed to stand, could "significantly weaken the long-standing fiduciary standards applicable to investment advisers." On July 10, 2015, the respondents moved for summary affirmance of the administrative law judge's decision.

On August 12, 2015, the SEC issued an order denying the respondents' petition for summary affirmance and granting the Division of Enforcement's petition for review. In granting the petition for review, the SEC noted the "potentially important matters of public interest this case presents . . . ." The Division has until September 11, 2015 to file a brief in support of the petition for review. The respondents' brief in opposition must be filed by October 12, 2015, and any reply brief must be filed by October 26, 2015.

Seventh Circuit Affirms District Court on Remand in *Jones v. Harris Associates*

On August 6, 2015, on remand from the U.S. Supreme Court, the Court of Appeals for the Seventh Circuit affirmed the 2007 decision by the District Court granting summary judgment to defendant Harris Associates in *Jones v. Harris Associates*, which had found that investors in the Oakmark mutual funds failed to establish that they had been charged excessive advisory fees. In a four-page order (including an acknowledgment that the Seventh Circuit's opinion was delayed following the Supreme Court's remand due to misplaced papers and a tracking system gap), the Seventh Circuit applied the *Gartenberg* standard embraced by the Supreme Court in a unanimous decision issued in March 2010: to face liability under §36(b) of the 1940 Act, an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining. In this connection, the Seventh Circuit turned aside the plaintiffs' contention that Harris's fees should be deemed excessive because they were not approved through proper procedures, explaining that a process-based failure alone does not constitute an independent violation of §36(b). Instead, Circuit Judges Frank Easterbrook and Michael Kanne stated in the opinion, "we have been instructed that §36(b) is sharply focused on the question of whether the fees themselves were excessive" (citing *Gallus v. Ameriprise Financial*). The Seventh Circuit's decision further states that although the district court applied a legal standard similar to the one eventually adopted by the Supreme Court, the standards are "not identical, because the Supreme Court's approach does not allow a court to assess the fairness or reasonableness of advisers' fees; the goal is to identify the outer bounds of arm's

length bargaining and not engage in rate regulation. This means that the Supreme Court's standard is less favorable to plaintiffs than the one the district court used- yet plaintiffs lost even under the district court's approach." Turning to the District Court's findings, the Seventh Circuit noted that there was no material dispute about four propositions, "which collectively require a decision for Harris": (1) Harris's fees were in line with those charged by advisers for other comparable funds; (2) Harris provided accurate information to the funds' boards, whose disinterested members approved the fees; (3) the fee schedules included breakpoints; and (4) the fees could not be called disproportionate in relation to the value of Harris's work because the funds' returns (net of fees) "exceeded the norm for comparable investment vehicles." The Seventh Circuit added that the plaintiffs "seek to avoid the implications of [the foregoing] facts" by comparing the fees that Harris charged the Oakmark funds with the fees that Harris charged some of its other clients, such as pension funds. However, the Circuit Judges stated that their initial opinion rejected this contention and the "Supreme Court did not disagree with us," noting the Supreme Court's position that "courts may give such comparisons the weight that they merit in light of the similarities and differences between the services that the clients in question require," but courts must be "wary of inapt comparisons" between fees charged to different types of clients. The Seventh Circuit concluded that because the plaintiffs did not provide any evidence that "would tend to show that Harris provided pension funds (and other non-public clients) with the same sort of services that it provided to the Oakmark funds, or that it incurred the same costs when serving different types of clients," it had no basis to justify "a further inquiry" of these comparisons under the Supreme Court's approach.

U.S. District Court Denies Motion to Dismiss Excessive Fee Case Against SEI Investments

On July 13, 2015, the United States District Court for the Eastern District of Pennsylvania issued a decision on the defendants' motion to dismiss in the case of *Curd v. SEI Investments Management Corp.*, Civ. Action No. 13-7219. In 2013, plaintiffs Steven and Rebel Curd filed suit in the District Court on behalf of five mutual funds (the "Funds") managed by SEI Investments Management Corporation (the "Investment Adviser"), alleging that the Investment Adviser and SEI Investments Global Funds Services (the "Administrator"), the Funds' administrator, violated Section 36(b) of the 1940 Act by charging excessive management and administrative fees.

The defendants submitted a motion to dismiss the plaintiffs' claims against the Investment Adviser on the grounds that the plaintiffs failed to allege sufficient facts to satisfy the requirements of the multi-factor *Gartenberg* test used to evaluate Section 36(b) claims and that the plaintiffs' allegations were untimely because they did not allege facts occurring during the relevant damages period. The defendants also moved to dismiss the plaintiffs' claims against the Administrator, claiming that the plaintiffs failed to establish that the Administrator was a party against which a Section 36(b) claim could be brought.

On July 13, 2015, the District Court denied the defendants' motion to dismiss with respect to the claims against the Investment Adviser but granted the defendants' motion to dismiss the claims against the Administrator.

In denying the defendants' motion to dismiss the claims against the Investment Adviser, the court, citing prior case law under Section 36(b), indicated that a plaintiff's excessive fee claim may survive a motion to dismiss even if it does not specifically address all of the *Gartenberg* factors, provided that, "when taken as a whole, the complaint demonstrates a plausible claim for relief under [Section] 36(b)." The court noted that the plaintiffs did allege facts relevant to all of the *Gartenberg* factors, noting in particular the plaintiffs' claims regarding the nature and quality of the services provided by the Investment Adviser and the Investment Adviser's failure to share cost savings resulting from realized economies of scale.

Regarding the nature and quality of the services provided by the Investment Adviser, the court noted that the plaintiffs alleged the following facts: The Funds are managed under a "manager-of-managers" arrangement whereby the Investment Adviser subcontracts portfolio management responsibilities for the Funds to outside sub-advisers but retains 40% of the investment advisory fees even though the Investment Adviser is left "largely without any asset management responsibilities." The Funds pay the Investment Adviser a monthly investment advisory fee based on a percentage of the Funds' average daily net assets. Accordingly, the fees are not based on the Investment Adviser's quality of services nor on the cost of providing such services. The Funds have also demonstrated poor performance. For the 2013 fiscal year, each of the Funds underperformed its primary benchmark for the five- and ten-year periods, and three of the Funds underperformed their primary benchmark for the one-year period. The court concluded that these facts raised a plausible claim that the Investment Adviser charges investment advisory fees "that are disproportionately large in comparison to the services it provides . . . and could not have been the product of arm's length bargaining."

Regarding the failure of the Investment Adviser to share cost savings resulting from realized economies of scale, the court noted that the plaintiffs alleged the following facts: Although the Funds' assets had grown significantly (e.g., the assets of one Fund increased from $640 million in 1997 to $2.3 billion in 2015), the Funds' investment advisory fees remained set at a constant percentage of average daily net assets. In addition, the Funds' investment advisory fee schedules did not contain breakpoints, which would allow for cost savings resulting from realized economies of scale to be passed along to Fund shareholders. Accordingly, the plaintiffs claimed, "[the Investment Adviser] profits from economies of scale without sharing the benefits with the [Funds] and, in turn, investors." The court concluded that these facts supported a plausible claim for relief under Section 36(b).

On the defendants' claim that the plaintiffs' suit was time barred, the Court noted that Section 36(b) provides that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted." The Court determined that the plaintiffs' suit was instituted on December 11, 2013 when the plaintiffs filed their initial complaint. Accordingly, the Court determined that the plaintiffs could not recover any damages for excessive fees charged before December 11, 2012. Because the plaintiffs' claims relied on financial and performance information from the Funds' fiscal years ended August 31, 2013 (for one Fund) and September 30, 2013 (for the other four Funds), the Court determined that the plaintiffs alleged facts relating to fees charged during the appropriate damages period and that the suit was not time barred.

While the Court denied the motion to dismiss the claims against the Investment Adviser, the Court was not particularly sanguine about the plaintiffs' overall case, noting that additional facts would be necessary for the Court to evaluate the strength of the plaintiffs' Section 36(b) claims under a fact-

intensive review of the *Gartenberg* factors. The Court stated that while the plaintiffs' allegations were sufficient to survive a motion to dismiss, they "may well not survive summary judgment."

In granting the defendants' motion to dismiss the claims against the Administrator, the court noted that Section 36(b) authorizes an action against three categories of persons: a fund's investment adviser; an affiliated person of a fund's investment adviser; and certain persons enumerated in Section 36(a), which include a fund's officers, directors, advisory board members, depositor and principal underwriter. The Court concluded that (1) the Administrator was not the Funds' investment adviser, (2) the plaintiffs failed to allege facts indicating that the Administrator was an affiliated person of the Funds' investment adviser under the 1940 Act's definition of that term, and (3) the Administrator was not otherwise one of the enumerated persons in Section 36(a).

FINRA Sanctions Wells Fargo, Raymond James and LPL Financial for Failing to Identify and Apply Mutual Fund Sales Charge Waivers Available for Certain Retirement Accounts and Charitable Organizations

On July 6, 2015, each of Wells Fargo Advisors, LLC and Wells Fargo Advisors Financial Network, LLC (together, "Wells Fargo"), Raymond James & Associates, Inc. and Raymond James Financial Services, Inc. (together, "Raymond James") and LPL Financial LLC ("LPL") entered into a Letter of Acceptance, Waiver and Consent with the Financial Industry Regulatory Authority ("FINRA") to settle alleged rule violations in connection with each firm's failure to apply mutual fund sales charge waivers for certain retirement plan and charitable organization customers (together, "Eligible Customers").

As to each firm, FINRA alleged that, since at least July 1, 2009, the firms failed to reasonably supervise the application of sales charge waivers for eligible mutual fund sales to Eligible Customers. Although some of the funds available on each firm's platform offered waivers of up-front sales charges associated with Class A shares for Eligible Customers and disclosed those waivers in their prospectuses, FINRA alleged that the firms treated the Eligible Customers in the same manner as ordinary retail customers and, as a result, the Eligible Customers either unnecessarily paid sales charges when purchasing Class A shares or purchased other share classes that subjected them to higher ongoing fees and expenses. In each case, the firm began a review to determine whether the firm had provided available sales charge waivers to Eligible Customers. Thereafter, each firm self-reported to FINRA that Eligible Customers had not received available sales charge waivers and thus were overcharged for mutual fund purchases during the relevant periods.

By failing to reasonably supervise mutual fund sales to ensure that Eligible Customers that purchased mutual fund shares received the benefit of applicable sales charge waivers, FINRA found that each firm violated NASD Conduct Rule 3010 (for misconduct before December 1, 2014) and FINRA Rule 2010 and, with respect to Raymond James and LPL only, FINRA Rule 3110 (for misconduct on or after December 1, 2014). As part of the settlements, each firm agreed to a censure and to pay restitution to Eligible Customers of the amount estimated to have been overcharged, including interest, totaling approximately $15 million in the case of Wells Fargo, $4.5 million for Raymond James and $6.3 million with respect to LPL. LPL also agreed to pay restitution to Eligible Customers that purchased fund shares

or that purchase mutual funds without an appropriate sales charge waiver during the period January 1, 2015 through the date that the firm establishes and fully implements training, systems and procedures reasonably designed to achieve compliance with the supervision of mutual fund sales waivers.

In resolving the matters, FINRA cited each firm's "extraordinary cooperation" for having: (i) initiated, prior to detection or intervention by a regulator, an investigation to identify whether Eligible Customers received sales charge waivers during the relevant period; (ii) promptly established a plan of remediation for Eligible Customers that did not receive appropriate sales charge waivers; (iii) promptly self-reported to FINRA; (iv) promptly taken action and remedial steps to correct the violative conduct; and (v) employed subsequent corrective measures, prior to detection or intervention by a regulator, to revise its procedures to avoid recurrence of the misconduct.

FINRA's announcement of the enforcement settlements with each firm is available at: https://www.finra.org/newsroom/2015/finra-sanctions-wells-fargo-raymond-james-and-lpl-30-million.

SEC Settles Charges Against Auditor, Fund Administrator and Trustee In Connection with Auditor-Trustee Relationship

On July 1, 2015, the SEC announced settled administrative proceedings against Deloitte & Touche LLP ("Deloitte"), the outside auditor of three closed-end funds (the "Funds"); ALPS Fund Services, Inc. ("ALPS"), an administrator of the Funds that provided compliance services; and Andrew C. Boynton, a former member of the Funds' board of trustees and the audit committee.

Deloitte

From 2006 to 2011, Deloitte Consulting LLP ("Deloitte Consulting"), an affiliate of Deloitte, maintained a business relationship with Mr. Boynton, who served as a member of the Funds' board of trustees and of the audit committee throughout that period. This relationship involved Deloitte Consulting acquiring from Mr. Boynton, among others, a brainstorming business methodology and later retaining Mr. Boynton as an outside consultant to assist in the implementation of the methodology for Deloitte Consulting clients. For his services, Deloitte Consulting paid Mr. Boynton consulting fees. During the entirety of the relationship, Deloitte served as the Funds' outside auditor, claiming independence from the Funds.

The internal policies of the parent company of Deloitte and Deloitte Consulting required that an independence consultation be performed before entering into a new business relationship with an outside consultant; however, this consultation was not performed before Deloitte Consulting entered into its arrangement with Mr. Boynton. In addition, Deloitte did not discover that the independence consultation was not performed until almost five years had passed after Deloitte Consulting's relationship with Mr. Boynton was established.

Deloitte was found to have (i) violated Rule 2-02(b) of Regulation S-X, which requires an outside auditor to maintain independence from audit clients, (ii) violated applicable standards of professional conduct under Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(ii) of the SEC's Rules of Practice and (iii) caused the Funds to have violated Sections 30(a) and 20(a) of and Rule 20a-1 under the 1940 Act, which require funds to file reports of independent auditors with their annual reports and otherwise to disclose certain information regarding independent auditors and audits in SEC filings.

In settlement of these charges, Deloitte agreed to be censured and to pay disgorgement of $497,438 plus prejudgment interest of $116,478 and a civil penalty of $500,000.

ALPS

As administrator to the Funds, ALPS agreed to assist the Funds in fulfilling their responsibilities under Rule 38a-1 under the 1940 Act. Specifically, ALPS provided the Funds with a set of written Rule 38a-1 compliance policies and procedures and a Chief Compliance Officer to administer the compliance program. The Funds' policies and procedures regarding the selection, retention and engagement of an independent auditor were found to be inadequate at all relevant times. Accordingly, ALPS was found to have caused the Funds to violate Rule 38a-1. In settlement of these charges, ALPS agreed to pay a civil penalty of $45,000.

Trustee and Audit Committee Member

As a Fund trustee and audit committee member, Mr. Boynton was required to complete an annual questionnaire indicating, among other things, his principal occupation and other positions held as well as any direct or indirect business relationship with Deloitte. Mr. Boynton never identified his relationship with Deloitte Consulting as a principal occupation or other position. Moreover, understanding that Deloitte and Deloitte Consulting were separate legal entities, Mr. Boynton did not disclose his relationship with Deloitte Consulting as an indirect business relationship with Deloitte, and Mr. Boynton did not otherwise inquire whether Deloitte Consulting's affiliation with Deloitte had any implications under conflict-of-interest or auditor independence rules. Mr. Boynton was found to have caused the Funds to violate Sections 30(a) and 20(a) of and Rule 20a-1 under the 1940 Act. In settlement of these charges, Mr. Boynton agreed to pay disgorgement of $30,000 plus prejudgment interest of $5,329 and a civil penalty of $25,000.

The SEC's order instituting administrative and cease-and-desist proceedings is available at: http://www.sec.gov/litigation/admin/2015/34-75343.pdf.

SEC Settles Charges Against Mutual Fund Board Members, Investment Adviser and Administrator in connection with Advisory Contract Approval and Disclosure Process

On June 17, 2015, the SEC announced settled administrative proceedings against Commonwealth Capital Management, LLC (the "Adviser"), the investment adviser to several series ("funds") of two open-end management investment companies, one organized as a Delaware statutory trust ("World Funds Trust" or the "Trust") and the other as a Maryland corporation ("World Funds, Inc." or the "Corporation"), and members of the board of trustees of the Trust (the "Trust Board" and the members individually, "Trustees"), involving the alleged failure to satisfy specific duties imposed upon them by Section 15(c) of the 1940 Act in connection with the advisory contract approval process. In the same action, the SEC alleged that Commonwealth Shareholder Services, Inc. (the "Administrator" and together with the Adviser, the "Affiliated Service Providers"), the funds' administrator and an affiliate of the Adviser, failed to include required disclosure concerning the 15(c) process in a shareholder report for a series of the

Corporation, causing the Corporation to violate Section 30(e) of the 1940 Act and Rule 30e-1 thereunder. The principal of the Affiliated Service Providers (the “Principal”), who also served as an interested member of the Trust Board and of the board of directors of the Corporation (the “Corporation Board”), is alleged to have caused the Adviser’s violations.

The Principal formed the Affiliated Service Providers and other related entities in order to offer small and mid-sized mutual funds “turnkey” fund services, including investment advisory, fund accounting, fund administration, transfer agent and distribution services. The Adviser did not make the day-to-day investment decisions for the funds; instead, it contracted out those services to an unaffiliated sub-adviser (a “Third-Party Sub-Adviser”).

The SEC alleges that, with respect to the Trust, the Adviser and the Principal did not furnish, and the Trustees did not have, and consequently did not evaluate, all the information they requested as reasonably necessary to evaluate the approval of the contracts with the Adviser. As to the Corporation, the SEC alleges that certain 15(c) information provided by the Adviser and the Principal in response to the Board’s request was inaccurate. In relevant part, the SEC’s order summarizes the alleged 15(c) process failures as follows:

World Funds Trust

As part of the 15(c) process, the Trust Board, with the assistance of independent counsel and the Administrator, requested that the Adviser and the Principal submit comparative fee information along with a completed 15(c) questionnaire concerning, among other things, the *Gartenberg* factors. In response, the Administrator compiled various documents, questionnaire responses and other relevant materials; the Principal reviewed and certified the questionnaire responses on behalf of the Adviser. However, the SEC found no documentary evidence that the Adviser furnished information regarding the fees paid by comparable funds. Nevertheless, the Trustees approved the advisory contracts because, as the SEC alleges, the Trustees considered the proposed advisory fees to be within an appropriate range.

In addition, the Trustees requested various information to evaluate the nature and quality of services provided by the Adviser. The SEC found that the Adviser “provided only limited disclosures that left unclear which services it intended to provide versus those that would be provided by others.” The SEC noted that the advisory and sub-advisory contracts described the Adviser’s and Third-Party Sub-Adviser’s proposed duties using nearly identical language, except that the Third-Party Sub-Adviser’s duties were subject to the Adviser’s supervision. The SEC alleges that after reviewing the Adviser’s written responses to the 15(c) questionnaire, the Trustees did not ask for, and the Adviser did not provide, any materials to clarify what services the Adviser would perform in exchange for its proposed fee. The questionnaire did indicate, however, that the Adviser would conduct oversight of the Third-Party Sub-Adviser through quarterly and annual due diligence reviews and would track the funds’ portfolios to ensure compliance with stated investment limitations, but the Adviser did not articulate which portfolio management compliance services it would perform itself, and the Trustees did not request additional materials to clarify the matter. Although during the relevant time period the funds did not pay any advisory fees as a result of a fee waiver provided for in an expense limitation agreement, and the Adviser

reimbursed the majority of operating expenses incurred by such funds, the Trustees "were obligated to evaluate [the Adviser's] services as compared to the fees provided for in the advisory contracts." In view of the foregoing, the SEC found that the Trustees approved the Trust's advisory contracts without having all the information they requested as reasonably necessary to evaluate such contracts.

World Funds, Inc.

As part of the 15(c) process with respect to a series of the Corporation (the "Fund"), the Adviser used a standard industry database to provide fee information for share classes that were comparable in size and with a similar investment strategy as the relevant share class of the Fund. The Adviser did not edit the tables to remove share classes that were not directly comparable to the Fund (an actively managed fund), causing the chart to contain various inapt comparisons, such as share classes with different distribution fee structures, assets at the share-class level rather than the total-fund level, different types of funds (e.g., index-based ETFs) and funds with different fee structures altogether. The Adviser provided two additional charts to the Corporation Board to use to compare the Fund's expense ratio and advisory fee, but these charts "provided only limited information." For instance, two of the four funds in the expense ratio chart had vastly different 12b-1 fees than the Fund (1.00% v. 0.25%), and two of the four funds in the advisory fee chart combined administration and advisory fees (yet the Fund, with separate administration and advisory fees, still had the highest advisory fee). The SEC alleges that the following year's 15(c) review utilized charts with the same comparisons and, consequently, the same deficiencies.

The SEC's order identified other deficiencies in its findings pertaining to the Corporation Board's 15(c) process: To assess the Adviser's profitability, the independent directors of the Corporation Board requested "all reasonably available financial information," including two years of financial statements and the basis and methodology for allocating indirect costs, overhead and other costs to the Fund. In response, the Adviser provided an income statement for only one year and a profitability chart that estimated overhead and other expenses for the same year and neither provided a written description of its allocation methodology nor included a balance sheet. In responses to questions in the 15(c) questionnaire regarding the expense limitation agreement and economies of scale, including the appropriateness of any Fund breakpoints, the Adviser erroneously claimed that no fees had been waived and that the advisory contract included appropriate breakpoints (breakpoints that all parties believed to have been in place were omitted from the contract).

The Administrator

The SEC's order also claims that the Administrator, which was contractually responsible for preparing shareholder reports for the Fund, failed to include the discussion of the material factors and conclusions that formed the basis for the Directors' approval of the advisory contracts in the Fund's 2010 shareholder report, thus causing the Corporation to violate Section 30(e) of the 1940 Act and Rule 30e-1 thereunder.

Settlement: Trustees, Adviser, Administrator and Principal

Without admitting or denying the findings, each Trustee, the Adviser and the Principal consented to the order and agreed to cease and desist from committing any further violations of Section 15(c), and the Administrator agreed to cease and desist from committing any further violations of Section 30(e) or

Rule 30e-1. Each of the Trustees agreed to pay a penalty of $3,250, while the Principal and the Affiliated Service Providers agreed to jointly and severally pay a $50,000 penalty.

The SEC's order instituting administrative and cease-and-desist proceedings is available at: http://www.sec.gov/litigation/admin/2015/ic-31678.pdf.

Other News and Developments

Technical Difficulties at BNY Mellon Impact Processing of Net Asset Values

Beginning on August 24, 2015, Bank of New York Mellon Corp. experienced what it described as "system performance issues" with a fund accounting platform, InvestOne, that processes net asset value (NAV) calculations for certain mutual fund and ETF clients. The malfunction, reportedly unrelated to the market volatility experienced around the same time, followed an operating system change implemented by SunGard Data Systems Inc., a third-party vendor which hosts and supports the InvestOne platform. On a conference call held on August 30, 2015, BNY Mellon Chairman and CEO Gerald Hassell reported that the platform failure impacted 66 fund accounting clients and approximately 1,200 funds. On September 1, 2015, BNY Mellon reported that it completed production of system-generated NAVs for all ETFs and mutual funds through August 31, 2015.

IRS Identifies Certain Basket Derivatives as Reportable Transactions

On July 8, 2015, the Internal Revenue Service (the "IRS") identified as reportable transactions certain derivative contracts that reference a basket of assets. The transactions identified by the IRS are referred to by the IRS as "basket option contracts" or "basket contracts." In these transactions, a purchaser enters into a contract that is denominated as an option, a notional principal contract (e.g., a swap), a forward contract or other derivative contract with a counterparty to receive a return based on the performance of a notional basket of referenced assets (the "reference basket"). The reference basket may include (1) "actively traded personal property" (e.g., publicly traded stock), (2) interests in hedge funds or other entities that trade securities, commodities, foreign currency or similar property, (3) securities, (4) commodities, (5) foreign currency or (6) similar property or positions in such property. The purchaser or a designee named by the purchaser will either determine the assets that comprise the reference basket or design or select a trading algorithm that determines the assets. While the contract remains open, the purchaser has the right to request changes in the assets in the reference basket or the specified trading algorithm.

The purchaser generally takes the position that short-term gains and interest, dividend and other ordinary periodic income from the performance of the reference basket is deferred until the instrument terminates and, if the instrument is held for more than one year, that the entire gain is treated as long-term capital gain. According to the IRS, the purchaser may be using the instrument to inappropriately defer income recognition, convert ordinary income and short-term capital gain into long-term capital gain and/or avoid U.S. withholding tax.

Anyone who has participated in a basket option contract, basket contract or substantially similar transaction is now subject to certain IRS reporting obligations. The following parties are generally considered participants by the IRS and are, therefore, subject to these reporting obligations: (1) the purchaser, (2) if the purchaser is a partnership, any general partner of the purchaser, (3) if the purchaser is a limited liability company, any managing member of the purchaser and (4) the counterparty.

Each participant in a basket option contract, basket contract or substantially similar transaction that was in effect on or after January 1, 2011 must report the transaction to the IRS, provided that the period of limitations did not end on or before July 8, 2015. If a participant has already filed its tax return for a year in which it participated in a basket option contract, basket contract or substantially similar transaction and the period of limitations has not ended, the participant needs to report the transaction to the IRS by November 5, 2015. Significant penalties and an extended statute of limitations may apply if a reportable transaction is not timely reported. In addition to the reporting obligations, a participant in a reportable transaction must also retain copies of all material documents and other records relating to the transaction.

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