

May 2006

The following summarizes recent *Legal Developments of Note* affecting the mutual fund/investment management industry:

Anti-Money Laundering

The Financial Crimes Enforcement Network ("FinCEN") extended the compliance date under its AML rule concerning due diligence on "correspondent accounts" for "foreign financial institutions." The compliance date was extended from April 4, 2006 to July 5, 2006 for new accounts (opened on or after July 5th), and to October 2, 2006 for existing accounts.

Redemption Fees - SEC Rule 22c-2

The Investment Company Institute ("ICI") requested a six-month extension of the October 16, 2006 compliance date for the SEC's anti-market timing rule. The ICI cited delays in obtaining "shareholder information agreements," that must be signed by any financial intermediary wishing to purchase shares of a fund, as the basis for their request.

Shelf Space Arrangements

The United States District Court (S.D.N.Y.) dismissed *with* prejudice a class action brought against various mutual fund complexes, their advisers and distributors which alleged that improper payments were made to broker-dealers as a *quid pro quo* for increased fund sales. The alleged improper fees took a variety of forms including wrongful use of directed brokerage, soft dollars and 12b-1 fees. In dismissing the case, the District Court made the following significant rulings:

- Congress did not intend to create private rights of action under Investment Company Act sections 34(b) or 36(a).
- The claims based on Section 36(b) were required to allege that the defendants were recipients of the improper fees or were otherwise compensated in connection with the alleged improper conduct.
- The claims brought derivatively on behalf of the funds against the investment adviser were improper, due to the failure of the plaintiffs to make demand on the trustees of the funds as required by Delaware law.

The Tax Increase Prevention and Reconciliation Act of 2005.

Comprehensive new tax legislation, signed into law by President Bush on May 17, 2006, contains certain provisions of interest to investment management firms. These provisions narrow the application of the Foreign Investment in Real Property Tax Act ("FIRPTA") rules to regulated investment companies ("RICs"), while imposing withholding requirements on those RICs to which FIRPTA continues to apply. These changes are generally effective for distributions from RICs made on or after May 17, 2006.

SEC Independent Board Rule Vacated

The United States Court of Appeals ruled in favor of the U.S. Chamber of Commerce which had challenged the validity of process followed by the SEC in re-adopting certain amendments to its fund governance rule, following an earlier decision invalidating the amendments. These amendments required that a mutual fund must have (1) at least 75% independent directors and (2) an independent chair. The court found that the SEC failed to follow the

Administrative Procedures Act when it re-adopted the amendments because the SEC relied on materials that were not part of the public record and it did not provide opportunity for public comment. The ruling gives the SEC a period of 90 days to correct these deficiencies, which the SEC can do by re-opening the record and seeking comment on the costs of implementing the two new fund governance requirements.

ICI Conference Report

Our report on the ICI 2006 Mutual Funds and Investment Management Conference which took place on March 19th – 22nd is now available.

For further information, please contact your Ropes & Gray attorney.

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