

July 2006

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

SEC Issues New Fund of Funds and Cash Sweep Rules

The SEC adopted three new rules that codify the relief granted in its previous exemptive orders allowing registered investment companies to invest in other unaffiliated registered funds - transactions which would otherwise be prohibited under Section 12(d)(1) of the Investment Company Act. The scope of the new rules, which include provisions addressing cash sweep investments into affiliated registered and unregistered vehicles, and amendments to various SEC disclosure requirements, will be described in more detail in an upcoming **Ropes & Gray Client Alert**.

SEC Hedge Fund Adviser Registration Rule Vacated

On June 23, 2006, in the case Goldstein v. Securities and Exchange Commission, the D.C. Circuit Court of Appeals vacated SEC Rule 203(b)(3)-1 (the "Hedge Fund Adviser Rule"). Section 203(b)(3) of the Investment Advisers Act provides that an adviser is not required to register unless it has more than 15 "clients." Under the Hedge Fund Adviser Rule, which became effective on February 10, 2006, the SEC defined the term "client" for purposes of Section 203(b)(3), to include investors in the typical type of hedge fund (which allows investors to withdraw from the fund within two years after making an investment), in addition to the hedge fund itself. This new approach to counting the total number of clients of a hedge fund adviser required numerous advisers to register for the first time under the Investment Advisers Act. As the basis for striking down the rule, the court determined that the SEC acted arbitrarily in defining the term "client" for purposes of Section 203(b)(3) differently than it had in other sections in which the term is used in the Advisers Act. Further information about this decision is available in a recent **Ropes & Gray Client Alert** published on this topic.

SEC Approves Release of Soft Dollar Final Interpretative Guidance

The SEC has issued final interpretative guidance regarding client commission practices under Section 28(e) of the Securities and Exchange Act of 1934 (the "Soft Dollar Guidance"). The Soft Dollar Guidance clarifies that certain types of advice, analysis and reports are eligible for the safe harbor as "soft dollar research" but that computer hardware is not. The Soft Dollar Guidance also states that eligible brokerage services include those products and services that relate to the execution of a trade from the point in time that the trade is communicated to the broker-dealer until the time the securities are delivered or credited to an account. This time frame has been a source of concern on the part of suppliers of so-called "trade order management systems" which may include analysis of trade data falling outside of this time period. The Soft Dollar Guidance will be discussed in greater depth in an upcoming **Ropes & Gray Client Alert**.

UK FSA will not make changes to its Soft Dollar Disclosure Rules before 2008

The Financial Services Authority ("FSA"), recently published Policy Statement PS 06/05, reporting on the results of comments it received in response to the Consultation Paper it published last year entitled "Bundled Brokerage and Soft Commission Arrangements for Retail Investment Funds" ("CP 05/13"). In CP 05/13, the FSA proposed that an "investors representative" be designated by a fund to receive and consider any commission related disclosures about a retail fund. Based on the "consultation feedback" the FSA received from industry participants, the FSA concluded that it would not be "proportionate" for it to introduce new rules and guidance on this topic now. In its recent announcement, the FSA stated that it will continue to monitor developments in industry practices over the next 18 months and will

review the effectiveness of such industry-led efforts as part of the FSA's previously announced review of soft dollar practices, which is scheduled to occur in 2008.

IDC Publishes Task Force Report Regarding Board Consideration of Fund Mergers

In response to the recent increase in fund merger activity, the Independent Directors Council convened a task force of investment company directors to focus on this area and provide guidance to fund boards that are being called upon to approve such transactions. The report of this task force is now available and contains a checklist of issues fund boards may want to consider in evaluating proposed fund mergers.

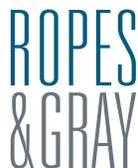
SEC Staff Member Comments Indicate 4:00 P.M. Hard Close Rule may be Dropped

In 2003, in the wake of the issues arising from late trading, the SEC proposed a rule which would prohibit fund firms from accepting trades after a fund's NAV had been struck. Because most firms calculate NAV based on the market closing price set at 4:00 p.m. Eastern Time, the rule in effect would place a 4:00 p.m. hard closing deadline on mutual fund trades. However, recent comments by a senior staff member of the SEC's Division of Investment Management, indicate that the SEC may be abandoning the effort to enact such a rule. According to participants at a conference at which the staff member spoke, the SEC staff apparently no longer believes that a 4:00 p.m. hard close rule is necessary to prevent late trading.

Evidence Regarding Sub-Advised and Institutional Account Fees Excluded in Mutual Fund Fee Case

A recent ruling by a United States District Court in a case challenging the fees paid to the adviser of various American Century mutual funds, places significant limitations on the evidence that will be admissible at trial. In granting the defendant's *motion in limine*, the court precluded the plaintiffs from presenting any evidence relating to the defendants' management of non-mutual fund accounts, because such evidence is irrelevant to fees charged for mutual fund accounts.

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



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