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

Pension Protection Act of 2006 Eases ERISA Restrictions.

The Pension Protection Act of 2006 significantly changes the "prohibited transaction" rules applicable to financial services companies which provide services to employee benefit plans regulated by the Employee Retirement Income Security Act of 1974 ("ERISA"). These changes, which became effective for transactions occurring after August 17, 2006, will greatly enhance the ability of financial services companies to provide additional services to retirement plans and their participants. In addition, this new legislation makes it easier for hedge funds and other unregistered funds to accept investments from ERISA plans without causing the hedge fund to become subject to the requirements of ERISA. For more discussion of the various changes effected by this new legislation, please see the several Ropes & Gray Client Alerts on this topic.

Industry Groups Split Over SEC Mutual Fund Independence Rules.

As reported in an earlier Update, the United States Court of Appeals for the District of Columbia Circuit, in a suit brought by the U.S. Chamber of Commerce, ruled that the SEC failed to follow proper procedures when it adopted certain regulations intended to promote independence of mutual fund boards. Following the suggestion of the court, the SEC requested additional comments on these regulations, which require that a fund board must have an independent chairman and at least 75% of the board's directors must be independent in order to obtain the benefits afforded by a variety of exemptive rules under the Investment Company Act of 1940. The Investment Company Institute ("ICI") recently filed a comment letter opposing the independent chair requirement and also recommended that the required percentage of independent directors be reduced from 75% to 66-2/3%. The main thrust of the ICI's comments was that the cost of implementing the SEC's proposed requirements would not result in any corresponding benefit, and that the increased costs of complying with such requirements would impose an undue burden on smaller funds.

The Independent Directors Council ("IDC") submitted a comment letter expressing its support for the SEC's requirement that 75% of the directors be independent. However, the IDC did not support the independent chair requirement stating that "it continues to believe that the choice of a chairperson should be left to the members of the board."

The Mutual Fund Directors Forum also submitted a comment letter setting forth its Board of Directors' unanimous recommendation that the SEC reinstate both the independent chair and 75% independence rules, on the grounds that "fund shareholders obtain significant benefits when the board of their fund is comprised of a supermajority of independent directors and is headed by an independent chair," and that "the costs of converting to and maintaining a board structured in this manner are negligible in relation to fund assets or other far more significant operating expenses, such as fund advisory fees."

SEC Chairman Comments Regarding Goldstein Decision.

SEC Chairman Christopher Cox recently issued a statement confirming that the SEC would not seek *en banc* review of the recent decision of the U.S. Court of Appeals for the District of Columbia Circuit in Goldstein v. Securities and Exchange Commission (the "Goldstein decision"). As discussed in a previous Update, the Goldstein decision invalidated SEC Rule 203(b)(3)-2 promulgated under the Investment Adviser Act of 1940 (the "Hedge Fund Adviser Registration Rule"). However, Chairman Cox's statement indicates that the SEC will seek to further regulate hedge funds through

new anti-fraud rules which will include a "look through" to a hedge fund's investors. The Chairman has also directed the SEC staff to consider whether the SEC should increase the minimum asset and income requirements that an individual must meet to qualify to invest in hedge funds.

SEC Staff Provides Advisers Guidance in Aftermath of Goldstein Decision.

The ABA Subcommittee on Private Investment Funds filed a request with the SEC seeking clarification of a number of issues raised by the Goldstein decision. In Goldstein, the focus of the opinion was on the question of who is included in the definition "client" for purposes of determining whether an adviser has more than 15 "clients" and is thus required to register with the SEC. However, the Hedge Fund Adviser Registration Rule also contained provisions which required non-U.S. hedge fund advisers to register with the SEC if they served U.S. clients, and included transition rules designed to address the application of various SEC requirements to newly-registered advisers. Unfortunately, all of these other provisions of the Hedge Fund Adviser Registration Rule were invalidated by the Goldstein decision, leaving these newly-registered advisers in limbo. In a recent guidance letter, the SEC in effect re-validated these other provisions of the Hedge Fund Adviser Registration Rule, by stating it would not seek enforcement action if an adviser acted in accordance with the applicable provisions of the rule invalidated by Goldstein.

American Century Case Dismissed.

In the last Update we reported on a case involving American Century Funds in which the court ruled that evidence regarding fees charged in sub-advised and institutional accounts was not admissible in a case involving mutual funds. Shortly after this ruling the plaintiffs decided to drop the suit, and agreed to a dismissal of their case.

Upcoming Compliance Dates.

Under Investment Company Act Rule 22c-2, fund boards must either approve a redemption fee or determine that the imposition of such a fee is not necessary or appropriate by October 16, 2006. Rule 22c-2 also requires that all funds must execute shareholder information agreements with each of their "financial intermediaries." It is anticipated that the SEC will grant a six month extension of the effective date only with respect to the shareholder information agreement portion of the rule.

As noted in a previous Update, the regulations requiring funds to make SAR filings as part of their AML programs is presently scheduled to become effective on October 31, 2006.

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

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