The following summarizes recent legal developments of note affecting the mutual fund/investment management industry:

SEC to Reevaluate Rule 12b-1 Fees

In a speech given at the Mutual Fund Directors Forum's Annual Policy Conference on April 13, 2007, SEC Chairman Christopher Cox outlined the priorities of the SEC in 2007 regarding regulation of the investment management industry. At the top of the list is a reevaluation of Rule 12b-1. In explaining the importance of this effort, Mr. Cox expressed his view that, in today's market, the continuing validity of the SEC's original premises in adopting this rule is now very much in doubt. Mr. Cox noted that the SEC's rationale for approving rule 12b-1 in 1980 was that allowing a fund to subsidize the sale of its shares to new investors could be beneficial to its current investors. The premise had been that increased fund sales would allow the fund to obtain the benefits of "economies of scale" and spread the burden of administrative costs over a larger pool of assets. At that time the SEC was concerned about the doldrums then being experienced by the mutual fund industry. Mr. Cox believes that Rule 12b-1 plans were quickly allowed to stray from the original purpose, as Rule 12b-1 payments by funds began to support sales compensation structures that soon replaced front-end loads paid by new investors. Mr. Cox has called upon independent fund directors to help the SEC "tackle head-on the problem of brokers' sales commissions masquerading as fund marketing costs." In his Keynote Address at the Practicing Law Institute Investment Management Institute on April 12, 2007, the head of the SEC's Division of Investment Management, Andrew "Buddy" Donohue, also called for a review of Rule 12b-1 practices. In contrast to the statements made by Mr. Cox, Mr. Donohue appeared to adopt a more moderate approach with regard to the review of Rule 12b-1 practices, which he indicated are in need of a "tune-up." Other priorities of the SEC for 2007, as outlined by Mr. Cox, include re-proposing its fund governance rule, reviewing the adequacy of disclosures to investors by mutual funds and 401(k) plans, and considering whether fund boards can better assess soft dollar arrangements if they receive improved disclosure of the broker's unbundled execution-only commission rate as compared to its bundled execution and research rate.

D.C. Circuit Overturns Rule Exempting Certain Broker-Dealer Compensation from Advisers Act Requirements

In yet another setback to the SEC's rulemaking authority, the U.S. Court of Appeals for the District of Columbia Circuit, in Financial Planning Association v. SEC, invalidated Rule 202(a)(11)-1 under the Investment Advisers Act. This case arose when the Financial Planning Association, a nationwide organization representing the interests of financial planners, challenged Rule 202(a)(11)-1, which provided that a broker-dealer that received fee-based compensation (as opposed to commissions) for brokerage services would not be deemed an investment adviser for purposes of the Advisers Act. Brokers seeking to take advantage of this exception were required to meet various conditions set forth in the rule which were designed to ensure that any investment advisory services provided by a broker receiving fee-based compensation were "solely incidental to" the brokerage services provided to the customer. After discussing the specific exemption granted to broker-dealers under Section 202(a)(11)(F) of the Advisers Act, the Court of Appeals concluded that the SEC did not have statutory authority to exempt a broader category of broker-dealers than that specifically exempted by Congress in the Advisers Act.

Federal Financial Agencies Propose New Model Privacy Disclosure Notice under the Graham-Leach-Bliley Act ("GLB Act")

As required under the GLB Act, the SEC, various banking agencies and other financial regulatory agencies (the "Agencies") have adopted rules that require a financial institution to provide a notice of its privacy policies and practices to its customers who are consumers (the "Privacy Rules"). The notice must include, among other things, instructions on how a consumer can

"opt out" of giving the financial institution the ability to share the consumer's nonpublic personal information with non-affiliated third parties. Although the Privacy Rules do not prescribe any specific format on the wording for the notice, the Appendix to the Privacy Rules includes model language that institutions may use to satisfy the GLB Act notice requirements. Pursuant to legislation adopted on October 13, 2006, the Agencies were directed jointly to develop a new model form of notice that is clearer and easier for the consumer to understand. The Agencies are now preparing to replace their approved forms of privacy notice with the new model form contained in the recently published release. In order to ease the compliance burden on financial institutions, the Agencies are also proposing a transition period of one year from the date the final regulation adopting the new model form goes into effect. Comments on the new model form are due by May 29, 2007.

SEC Staff Provides Guidance on "Qualified Purchaser" Requirements For Charitable Entities

In a recent no-action letter, the SEC provided relief that clarifies certain aspects of the definition of "qualified purchaser" contained in section 2(a)(51) of the Investment Company Act. The term qualified purchaser is used to determine who may be eligible to invest in private funds excluded from the definition of an "investment company" under Section 3(c)(7) of the Act. Section 2(a)(51) sets forth four main categories of qualified purchasers: (i) natural persons who own not less than $5 million in qualifying "investments," (ii) a company owned by closely related family members that owns not less than $5 million in qualifying investments, (iii) trusts where the trustee and settlor otherwise fall within the definition of qualified purchaser, and (iv) other types of entities that own and invest on a discretionary basis not less than $25 million in investments. The Adviser sought no-action relief to allow it to treat certain charitable corporations that had at least $5 million in investments (but less than $25 million) as qualified purchasers, which is the same amount of investments as would be required if the charitable entity had been organized as a trust. As noted in the no-action letter, due to the special characteristics of non-profit IRC Section 501(c)(3) corporations, there is a question as to whether such a corporation would be able to meet the criteria for family-owned companies, since it is not clear that its shares are "owned" by the persons who contribute assets to the corporation. The SEC staff stated it would not recommend enforcement action if the applicant treated as a qualified purchaser (1) a charitable corporation having not less than $5 million in investments as to which all the persons who have contributed assets are related in the ways enumerated in 2(a)(51)(ii), or (2) a charitable corporation as to which each person who has authority to make investment decisions and each person who has contributed assets is a qualified purchaser under 2(a)(51)(i), (ii) or (iii). Goldman Sachs Asset Management, L.P., SEC Staff No-Action Letter (March 13, 2007).

Contact Information

For further information, please contact the Ropes & Gray attorney who normally advises you.

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