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IM REGULATORY REVIEW
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IM Regulatory Review

Mutual Funds ♦ Hedge Funds ♦ Investment Advisers

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*If you have any questions regarding this issue of the IM Regulatory Review or past issues, please feel free to contact **Bibb L. Strench** at 202.383.0509 or bibb.strench@sutherland.com, or the Sutherland attorney with whom you regularly work. Bibb Strench is a partner at Sutherland Asbill & Brennan LLP. Attorney Myra C. Mormile, an associate at Sutherland Asbill & Brennan LLP, contributed to this issue.*

Legislation

Fiscal Year 2010 Fee Rate Advisory #4 (HF, IA & MF)

12.17.2009 President Obama signed H.R. 3288, the appropriations bill that includes funding for the Securities and Exchange Commission (SEC). Accordingly, effective December 21, 2009, the § 6(b) fee rate applicable to the registration of securities, the § 13(e) fee rate applicable to the repurchase of securities, and the § 14(g) fee rate applicable to proxy solicitations and statements in corporate control transactions will increase to $71.30 per million dollars. The § 6(b) rate is also the rate used to calculate the fees payable with the Annual Notice of Securities Sold Pursuant to Rule 24f-2 under the Investment Company Act of 1940.

All filings submitted to the SEC before 5:30 p.m., ET, and filings pursuant to Rule 462(b) (17 C.F.R. 230.462(b)) submitted to the SEC before 10 p.m., ET, on December 18, 2009, will be subject to the current fee rate of $55.80 per million dollars. Rule 462(b) filings submitted after 10 p.m., ET, and all other filings submitted after 5:30 p.m., ET, on December 18, 2009, shall be deemed filed as of the next business day, December 21, 2009, under § 232.13 of Regulation S-T (17 C.F.R. 232.13), and be subject to the new fee rate of $71.30 per million dollars. In addition, effective January 15, 2010, the § 31 fee rate applicable to securities transactions on the exchanges and over-the-counter markets will decrease to $12.70 per million dollars. Until that date, the current rate of $25.70 per million dollars will remain in effect. The § 31 assessment on security futures transactions will remain unchanged at $0.0042 per round turn transaction.

The adjusted fee rates will not affect the amount of funding available to the SEC. The SEC will announce the new fee rates for fiscal year 2011 no later than April 30, 2010. These fee rates will become effective October 1, 2010, or after the SEC's fiscal year 2011 appropriation is enacted, whichever is later.

Click http://www.sec.gov/news/press/2009/2009-270.htm to access the release.

Attorney-Client Privilege Protection Act Introduced (HF, IA & MF)

12.16.09 Congressman Robert C. Scott (D-VA-3) introduced the Attorney-Client Privilege Protection Act, H.R. 4326. The bill is designed to address the government's use of "coercive waivers" to gain access to privileged communications that otherwise would remain private and protected under the doctrine of attorney-client privilege.

In 2008, the Department of Justice issued new guidelines to address many of the prior concerns about placing corporate defendants at greater risk of prosecution if they seek to rely upon their attorney-client privilege. However, these guidelines do not govern agencies outside that Department, and the bill's sponsors believe the entire Executive Branch should be bound by a uniform policy in this area. This bill is introduced to impose such a uniform policy.

Click http://www.bobbyscott.house.gov/index.php?option=com_content&task=view&id=467&Itemid=62 to access the release.

House Approves the Wall Street Reform and Consumer Protection Act of 2009 (HF, IA & MF)

12.11.2009 The House of Representatives approved the Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, which will purportedly overhaul regulation of the financial services sector with tough new controls and create a new agency to protect consumers.

Click http://www.gop.gov/portfolio/votes/111/1/968 to access the voting roll.

DeFazio Introduces the Let Wall Street Pay for the Restoration of Main Street Act (HF, IA & MF)

12.3.2009 U.S. Representative Peter DeFazio (D-OR), Chairman of the House Subcommittee on Highways and Transit, was joined by 22 of his House colleagues in introducing new legislation that assesses a miniscule tax on Wall Street securities transactions. The money it generates will be used to rebuild Main Street. The legislation, Let Wall Street Pay for the Restoration of Main Street Act, H.R. 4191, has powerful support from economists, Wall Street investors, labor organizations, and consumer groups.

The legislation assesses a small securities transaction tax on Wall Street. A securities transaction tax is applied to:

- Stock transactions (tax rate will be one-quarter of 1 percent (0.25%));
- Futures contracts to buy or sell a specified commodity of standardized quality at a certain date in the future, at a market determined price (tax rate will be 0.02%);
- Swaps between two firms on certain benefits of one party's financial instrument for those of the other party's financial instrument (tax rate will be 0.02%);
- Credit default swaps where a contract is swapped through a series of payments in exchange for a payoff if a credit instrument (typically a bond or loan) goes into default (fails to pay) (tax rate will be 0.02%); and
- Options (at the rate of the underlying asset).

The tax could raise approximately $150 billion a year. To ensure that the tax is appropriately targeted to speculators and has no impact on the average investor and pension funds, the tax will be refunded for tax-favored retirement accounts, mutual funds, education savings accounts, health savings accounts, and the first $100,000 of transactions annually that are not already exempted.

Half the revenue generated by this transaction tax (approximately $75 billion) would be deposited in a Job Creation Reserve to fund the creation of good-paying jobs and put Americans back to work rebuilding our nation's infrastructure. Each $1 billion of Federal infrastructure investment creates or sustains more than 34,000 American jobs and $6.2 billion in economic activity. The Surface Transportation Authorization Act of 2009, which would create or sustain more than 12.5 million family wage jobs, would be partially funded through this tax. The second half of the revenue generated by this transaction tax (approximately $75 billion) would be used to directly reduce the deficit.

Click http://www.defazio.house.gov/index.php?option=content&task=view&id=532 to access the release.

House Passes Enhanced SEC Enforcement Authority Act (HF, IA & MF)

12.2.2009 The U.S. House of Representatives approved the Enhanced SEC Enforcement Authority Act, H.R. 2873, a bill that would enhance the SEC's enforcement authority by allowing the SEC to compel the attendance of a witness at a hearing or trial anywhere in the United States.

Click http://www.opencongress.org/bill/111-h2873/text?version=eh to access the text of the bill.

Judiciary

Delaware Supreme Court Applies Statute of Frauds to LLC Agreements (HF)

12.15.2009 In *Olson v. Halvorsen*, No. 338, 2009 (Del. Dec. 15, 2009), the Delaware Supreme Court affirmed that the statute of frauds prevents the former member of a limited liability company (LLC) from using oral agreements to increase the payout his former hedge fund partners allegedly owed him. The court held that because it could construe the statute of frauds and the Delaware LLC Act together and the General Assembly did not clearly intend the LLC Act to render the statute of frauds inapplicable. The court further held that the Delaware LLC Act does not explicitly remove LLC agreements from the application of the statute of frauds. Therefore, the statute of frauds applies to LLC agreements.

Click http://courts.delaware.gov/OPINIONS/(2u5zbv55ueysurytbraoaqvj)/download.aspx?ID=130950 to access the decision.

Regulatory

SEC Adopts, as Final, Rule 206(3)-3T (IA)

12.23.2009 The Securities and Exchange Commission (SEC) adopted, as final, Rule 206(3)-3T under the Investment Advisers Act of 1940 (Advisers Act), the interim final temporary rule that establishes an alternative means for investment advisers who are registered with the SEC as broker-dealers to meet the requirements of § 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients. As adopted, the only change to the rule is the expiration date. Rule 206(3)-3T will sunset on December 31, 2010. Rule 206(3)-3T was set to expire on December 31, 2009, approximately 27 months after its adoption.

The purpose of the rule was to permit broker-dealers to sell to their advisory clients, in the wake of *Financial Planning Association v. SEC*, certain securities held in the proprietary accounts of their firms that might not be available on an agency basis—or might be available on an agency basis only on less attractive terms—while protecting clients from conflicts of interest as a result of such transactions. Rule 206(3)-3T permits an adviser, with respect to non-discretionary advisory accounts, to comply with § 206(3) of the Advisers Act by, among other things, meeting the following conditions:

1. Providing written, prospective disclosure regarding the conflicts arising from principal trades;

2. Obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal transactions;

3. Making certain disclosures, either *orally or in writing*, and obtaining the client's consent before each principal transaction;

4. Sending to the client confirmation statements disclosing the capacity in which the adviser has acted and disclosing that the adviser informed the client that it may act in a principal capacity and that the client authorized the transaction; and

5. Delivering to the client an annual report itemizing the principal transactions made during the year.

The rule also requires that the investment adviser be registered as a broker-dealer under § 15 of the Securities Exchange Act of 1934 (Exchange Act) and that each account for which the adviser relies on the rule be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which it is a member. The rule is not available for principal trades of securities if the investment adviser or a person who controls, is controlled by, or is under common control

with the adviser is the issuer or is an underwriter of the security. The rule includes one exception—an adviser may rely on the rule for trades in which the adviser or a control person is an underwriter of non-convertible investment-grade debt securities.

Rule 206(3)-3T(b) clarifies that the rule does not relieve in any way an investment adviser from its obligation to act in the best interests of each of its advisory clients, including fulfilling the duty with respect to the best price and execution for a particular transaction for the advisory client.

Click http://www.sec.gov/rules/final/2009/ia-2965.pdf to access the adopting release.

SEC Proposes Amendments to Rule 163 to Facilitate Access to Capital Markets (HF, IA & MF)

12.22.2009 The SEC proposed amendments to Rule 163 under the Securities Act of 1933 to further facilitate the ability of certain large companies to communicate with broader groups of potential investors and gauge the level of interest in the market for their securities offerings. The proposed amendments would apply to companies that are "well-known seasoned issuers" (WKSIs) and would allow them to authorize an underwriter or dealer to communicate with potential investors on their behalf about potential securities offerings prior to filing registration statements for such offerings. Under the current Rule 163, only WKSIs are permitted to communicate directly with potential investors before filing a registration statement. A WKSI is an issuer that is current and timely in its Exchange Act reports for at least one year and has either $700 million of publicly held shares or has issued $1 billion of non-convertible securities, other than common equity, in registered offerings for cash in the preceding three years.

As proposed, an underwriter or dealer could act as an agent or representative of a WKSI if the following conditions are satisfied:

- The underwriter or dealer receives written authorization from the WKSI to act as its agent or representative before making any communication on its behalf.
- The WKSI authorizes or approves any written or oral communication before it is made by an authorized underwriter or dealer.
- Any authorized underwriter or dealer that has made any authorized communication on behalf of the issuer in reliance on Rule 163 is identified in any prospectus contained in the registration statement that is filed for the offering to which the communication relates.

All other current requirements of Rule 163 would continue to apply, including that all communications made by or on behalf of the WKSI in reliance on the rule would be subject to Regulation FD (Fair Disclosure).

Click http://www.sec.gov/news/press/2009/2009-273.htm to access the release. Click http://www.sec.gov/rules/proposed/2009/33-9098.pdf to access the proposed amendments.

SEC Holds Open Meeting, Approves Change to Advisers Act Custody Rule and Enhanced Proxy Disclosures (HF, IA & MF)

12.16.2009 The SEC held an open meeting at which it approved a change to the Advisers Act custody rule and also a requirement for enhanced proxy disclosure on risk, compensation and corporate governance.

The new custody rule provides safeguards where there is a heightened potential for fraud or theft of client assets. The new rule promotes independent custody and requires the use of independent public accountants as third-party monitors. Depending on the investment adviser's custody arrangement, the rules would require the adviser to be subject to a surprise exam and custody controls review that are generally not required under existing rules. The new rule also imposes an important new control on advisers to hedge funds and other private funds that comply with the custody rule by obtaining an audit of

the fund and delivering the fund's financial statements to fund investors. The rule will require that the auditor of such a private fund be registered with and subject to regular inspection by the Public Company Accounting Oversight Board. The new rule also requires that the adviser reasonably believe that the client's custodian delivers the account statements directly to the client, to provide greater assurance of the integrity of these account statements. It also will enable clients to compare the account statement they receive from their adviser to determine that the account transactions are proper.

The proxy disclosure rules will improve corporate disclosure regarding risk, compensation and corporate governance matters when voting decisions are made. In particular, the new rules require disclosures in proxy and information statements about:

- The relationship of a company's compensation policies and practices to risk management;
- The background and qualifications of directors and nominees;
- Legal actions involving a company's executive officers, directors and nominees;
- The consideration of diversity in the process by which candidates for director are considered for nomination;
- Board leadership structure and the board's role in risk oversight;
- Stock and option awards to company executives and directors; and
- Potential conflicts of interests of compensation consultants.

Click http://www.sec.gov/rules/final/2009/ia-2968.pdf to access the release on the custody rule change.

SEC Consents to Delay of Indexed Annuity Rule Effective Date (HF, IA & MF)

12.8.2009 The SEC filed a supplemental brief in the litigation challenging Rule 151A (which would require the registration of virtually all indexed annuities). In its brief, the SEC consented to a two-year stay of Rule 151A's effective date to run from the date of publication in the Federal Register of a reissued or retained Rule 151A. Previously, in that litigation, the U.S. Court of Appeals for the District of Columbia Circuit issued an opinion on July 21, 2009, holding that: (1) while the SEC had reasonably interpreted the exemption for annuity contracts in § 3(a)(8) of the Securities Act of 1933 (1933 Act) in connection with Rule 151A, (2) the § 2(b) analysis that the SEC had conducted was "lacking" because it "failed to properly consider the effect of [Rule 151A] upon efficiency, competition, and capital formation"; (§ 2(b)) of the 1933 Act requires that when the SEC is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the SEC "shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation"). The court's July opinion remanded Rule 151A to the SEC, without vacating the Rule and without a stay of the Rule's effective date, for further consideration consistent with the court's opinion.

Subsequently, on November 6, the court issued a Per Curiam order directing the parties to submit additional briefs addressing the appropriate remedy for the SEC's failure properly to consider the rule's effect upon efficiency, competition and capital formation. The SEC filed its supplemental brief in response to the court's November 6 Per Curium order. In that brief, in addition to consenting to a two-year stay, the SEC also argued that remand without vacatur is the most equitable and appropriate remedy in the case.

Click http://sutherland-news.com/ve/ZZ65U5991CJu63P94ZS/stype=dload/OID=209129235433911/VT=0 to access a Sutherland legal alert on the topic.

Amendments Filed to Rule G-37 Regarding Contributions to Bond Ballot Campaigns (HF, IA & MF)

12.4.2009 The Municipal Securities Rulemaking Board (MSRB) filed with the SEC amendments to Rule G-37, on political contributions and prohibitions on municipal securities business, and Rule G-8, on books and records to be made by brokers, dealers and municipal securities dealers. The proposed amendments to Rule G-37 would require the public disclosure of contributions to bond ballot campaigns made by dealers, municipal finance professionals (MFPs), their political action committees, and non-MFP executive officers on MSRB Form G-37. Dealers would be required to report on revised Form G-37 the official name of each bond ballot campaign receiving contributions during such calendar quarter; the jurisdiction (including city/county/state or political subdivision) by or for which municipal securities, if approved, would be issued; the contribution amount made; and the category of contributor. The proposal would provide a *de minimis* exception from the reporting of contributions on Form G-37 made by an MFP or non-MFP executive officer to a bond ballot campaign for a ballot initiative with respect to which such person is entitled to vote if all contributions by such person to such bond ballot campaign, in total, do not exceed $250 per ballot initiative. The amendments would parallel the existing disclosure requirements for contributions to issuer officials and state and local political parties. Such amendments would not, however, provide for a ban on municipal securities business as a result of contributions to bond ballot campaigns. The proposed amendments to Rule G-8 would require dealers to create and maintain records of the non-*de minimis* contributions to bond ballot campaigns.

The MSRB requested that the proposed rule change become effective on, and would apply solely to contributions made on or after, the first business Monday at least five business days after SEC approval.

Click http://www.msrb.org/msrb1/whatsnew/2009-62.asp to access the release.

Enforcement

SEC Settles Case Against Ohio Investment Adviser Who Allegedly Defrauded Elderly Clients (IA)

12.24.2009 The Securities and Exchange Commission (SEC) announced that investment adviser (IA) Julie M. Jarvis, of Columbus, Ohio, and her financial advisory firm, Crossroads Financial Planning, Inc., have agreed to settle the SEC's pending civil action against them. The SEC alleges that Jarvis misappropriated at least $2.3 million from two elderly clients between June 2000 and March 2009. Evidence obtained during the SEC's ongoing litigation allegedly revealed additional misappropriations by Jarvis in the amount of approximately $360,000.

Under the settlement, Jarvis and Crossroads admitted to the allegations in the SEC's complaint and consented to the entry of permanent injunctions against each of them. The proposed settlements are subject to the court's approval.

In a related criminal proceeding, on October 14, 2009, the U.S. District Court for the Southern District of Ohio sentenced Jarvis to 66 months incarceration based upon her plea of guilty to criminal charges stemming from the same conduct alleged in the SEC's complaint. The court also ordered her to pay restitution in the amount of $2,663,681.44.

Click http://www.sec.gov/litigation/litreleases/2009/lr21352.htm to access the release.

SEC Charges Austin-Based IA and Two Businesses With Operating a Multimillion-Dollar Scam Utilizing Former Football Stars (IA)

12.22.2009 The SEC filed securities fraud charges against an Austin, Texas, investment adviser and two businesses he controls for operating a multimillion-dollar scam that used former professional football players to promote its offerings. The SEC alleges that Kurt B. Barton and Triton Financial LLC raised more than $8.4 million from approximately 90 investors by selling "investor units" in an affiliate, Triton Insurance, and telling investors that their funds would be used to purchase an insurance company. The

SEC alleges that these representations were false and investor proceeds were instead misused to pay day-to-day expenses at Triton and its affiliate. According to the SEC, Barton and Triton used former football players as well as stockbrokers and other salesmen to promote Triton securities to potential investors.

Triton was the subject of a March 2009 *Sports Illustrated* article that prompted the Texas State Securities Board (TSSB) to examine Triton's business. The article described Triton's use of former Heisman Trophy winners and NFL players to promote its investments to potential investors, including other football players. The article noted one particular mass e-mail, sent by a former NFL quarterback to numerous NFL alumni, that discussed Triton's activities and touted Triton's returns on its investments. According to the SEC, the defendants provided the TSSB with altered and fabricated documents during the examination that followed the article's publication.

The SEC has charged each defendant with securities fraud and seeks permanent injunctions, disgorgement of illegal gains, and financial penalties. The SEC also seeks an asset freeze and a receiver over the defendants' assets and operations. Without admitting or denying the SEC's allegations, the defendants have consented to permanent injunctions against future securities fraud violations. They have also consented to the appointment of a receiver and to orders freezing their assets, prohibiting destruction of documents, and requiring that they provide an accounting.

Click http://www.sec.gov/news/press/2009/2009-274.htm to access the release.

Victoria Investors' Sole General Partner and IA Barred From Association (HF & IA)

12.18.2009 An Administrative Law Judge issued an Initial Decision against James C. Dawson, barring him from associating with any investment adviser. From 2003 through 2005, Dawson was the sole general partner of, and investment adviser to, Victoria Investors, L.P., an unregistered hedge fund and limited partnership with assets of approximately $13 million, and approximately 20 individual and institutional investors. During that time period, Dawson secretly allocated profitable trades to his personal account and unprofitable trades to investors in Victoria Investors. On July 24, 2009, the U.S. District Court for the Southern District of New York enjoined Dawson from future violations of federal securities laws and ordered him to disgorge $303,472, plus pre-judgment interest of $102,975; and ordered him to pay a $100,000 civil penalty.

Click http://www.sec.gov/litigation/aljdec/2009/id392bpm.pdf to access the initial decision.

Massachusetts-Based IA Criminally Charged for Defrauding Investors (IA)

12.16.2009 The U.S. Attorney's Office for the District of Massachusetts filed an Information against Stephen F. Clifford, a former investment adviser based in Plymouth, Massachusetts. The SEC filed an emergency action against Clifford on June 17, 2008. On that date, the SEC sought and obtained a temporary restraining order against Clifford and an order freezing Clifford's assets. The SEC alleges that Clifford, between at least July 2004 and June 2008, while acting as an investment adviser, defrauded investors of at least $2.9 million and fraudulently converted investor funds for his personal use. The Information against Clifford makes substantially similar factual allegations as the SEC. The Information also charges Clifford with filing false tax returns.

Click http://www.sec.gov/litigation/litreleases/2009/lr21343.htm to access the release.

SEC Issues Order Against Mermelstein for Failure to Supervise Portfolio Manager (IA)

12.14.2009 The SEC issued an order against Stephen Jay Mermelstein, finding that Mermelstein, the former Chief Operating Officer of a formerly registered investment adviser, Ark Asset Management, Co., Inc., failed reasonably to supervise a portfolio manager who engaged in fraudulent trade allocation practices during the years 2000 through 2003. As a result of this fraudulent conduct, Ark realized at least $19 million of ill-gotten gains. The Order suspends Mermelstein from association in a supervisory capacity

with any investment adviser for a period of six months and orders Mermelstein to pay a civil penalty of $50,000.

Click http://www.sec.gov/litigation/admin/2009/ia-2961.pdf to access the order. Click http://www.sec.gov/litigation/admin/2009/ia-2962.pdf to access the order against Ark Asset Management Co., Inc., for the same $19 million in ill-gotten gains, among other things.

SEC Distributes $418 Million to Harmed Investors in Invesco Mutual Funds (MF)

12.14.2009 The SEC announced the Fair Fund distribution of approximately $418 million to more than one million investors who were affected by undisclosed market timing in certain Invesco mutual funds advised by Invesco Funds Group, Inc. (IFG). The distribution stems from a prior SEC enforcement action against IFG. The distribution also includes money from two other Fair Funds related to separate unlawful marketing timing enforcement actions that affected Invesco investors.

Specifically, the IFG Fair Fund includes $325 million in disgorgement and penalties collected from IFG after the SEC brought settled administrative and cease-and-desist proceedings against IFG in 2004, as well as accrued interest. This distribution also includes approximately $45.8 million in disgorgement, penalties, and accumulated interest from the Banc of America Capital Management, LLC, BACAP Distributors, LLC, and Banc of America Securities, LLC, Fair Fund; and approximately $8.7 million in disgorgement, penalties, and accumulated interest from the Bear, Stearns & Co., Inc., and Bear, Stearns Securities Corp. Fair Fund.

Click http://www.sec.gov/news/press/2009/2009-264.htm to access the release.

SEC Issues Order Against Moises Pacheco (IA)

12.11.2009 The SEC issued an order against Moises Pacheco based on the entry of a permanent injunction against Pacheco in the civil action entitled *SEC v. Pacheco*, No. 09-CV-1355-W-RBB (S.D. Cal.). The SEC alleges that on November 19, 2009, the district court entered a judgment against Pacheco, permanently enjoining him from future violations of federal securities laws. The SEC further alleges that Pacheco was an officer and the sole director of Advanced Money Management, Inc. (AMM), a Nevada corporation, and controlled Business Development & Consulting Co. (BD&C), a California corporation; that AMM was the investment adviser to and general partner of AP Premium Value Fund I, a Nevada limited partnership, and BD&C was the investment adviser to and managing member of AP Premium Value Fund II, AP Premium Value Fund III, AP Premium Value Fund IV, and Capital Partnership Group, all of which are California limited liability companies; and that through his control of AMM and BD&C, Pacheco controlled and acted as investment adviser for all of the AP Premium Value Funds and CPG (the Funds), including making all investment decisions on their behalf.

The SEC further alleges in the Order that the SEC's complaint in the civil action alleged that from January 2005 through June 2008, Pacheco, through AMM and BD&C, raised more than $14.7 million from more than 200 investors in the Funds. Pacheco told Fund investors that he had developed a lucrative investment strategy involving the purchase and sale of covered call options. Pacheco claimed that the Funds had generated returns ranging from 2.5% to 4% per month during their existence, and continued to claim that they generated returns in that range until January 2008, when he reduced the returns to 1.25% per month. In reality, from January 2005 through June 2008—a span of 42 months—the Funds had net profits of $367,001 on the millions of dollars under their management, a return of about 1% per year. During the same time period, the Fund paid out more than $9.7 million in purported monthly profits to Fund investors. To bridge the enormous difference between the actual profits and the ersatz ones, Pacheco drew upon the only financial resource available to him—investor principal. Thus, Pacheco's representations that the monthly payments were funded with trading profits were false. In addition, Pacheco failed to disclose that he had dissipated a substantial portion of investor monies through a series of illicit transfers.

A hearing will be scheduled before an administrative law judge to determine whether the allegations contained in the Order are true, to provide Pacheco an opportunity to dispute the allegations, and to determine what, if any, remedial action is appropriate and in the public interest.

Click http://www.sec.gov/litigation/admin/2009/ia-2960.pdf to access the order.

SEC Obtains Consent Judgments Against Frank J. Russo and FJR Corporation (IA)

12.11.2009 The Federal Court for the District of Massachusetts entered consent judgments in a previously filed enforcement action against Frank J. Russo, a Massachusetts-based former investment adviser, and his investment advisory corporation, FJR Corporation. The court also entered an order by default on October 30, 2009, against Russo Associates Limited Partnership, a now defunct limited partnership controlled by Russo. The judgments enjoin Russo, FJR, and Russo Associates from future violations of the securities laws. Also, on October 2, 2009, the SEC voluntarily dismissed without prejudice the SEC's case against Eliot Partners, also defunct, because it had no status as a legal entity and was merely a d/b/a for Russo.

The SEC had filed an emergency enforcement action on June 6, 2006, against Russo, FJR, Russo Associates, and Eliot Partners, and obtained a court order freezing Russo's assets and the assets of entities he controlled. The SEC alleged that Russo and FJR convinced at least 160 investors to invest a total exceeding $15 million in the purported investment vehicles they controlled. The SEC alleged that Russo misled investors about the nature of the investments and their expected returns. According to the SEC, Russo also diverted at least $11.5 million in investor funds to Veritasiti Corporation, a private California company, which Russo co-founded with a college friend. On June 28, 2006, the SEC amended its complaint to name Veritasiti as a relief defendant and obtained a court order freezing its assets. On October 30, 2008, the court entered a default judgment against Veritasiti, ordering the company to pay disgorgement and pre-judgment interest of $14.1 million.

On February 25, 2008, in a parallel criminal proceeding, Russo pled guilty to federal charges of investment fraud and mail fraud. He was sentenced to 18 years in prison to be followed by three years of supervised release and ordered to pay $20 million in restitution and a $500,000 fine. Because of those criminal sanctions, the judgments the SEC obtained on December 11 against Russo and FJR do not include additional monetary relief. Russo, who is currently incarcerated, was also barred by the SEC in March 2008 from any future association with any investment adviser based on his criminal conviction.

Click http://www.sec.gov/litigation/litreleases/2009/lr21333.htm to access the release.

SEC Issues Order Against Simpson Capital Management and Two Officers for Fraudulent Late Trading Scheme in Shares of Mutual Funds (HF & MF)

12.7.2009 The SEC issued an order against Simpson Capital Management, Inc., Robert A. Simpson, and John C. Dowling, finding that, between May 2000 and September 2003, Simpson, the President and founder of Simpson Capital, a hedge fund manager, conducted a fraudulent scheme involving unlawful "late trading" in shares of mutual funds. Dowling, Simpson Capital's head trader, began participating in the scheme in November 2000. The late trading was allegedly part of a profitable investment strategy dependent upon the execution of mutual fund trades based on post-4:00 p.m. market information not reflected in the price they paid for the shares. According to the SEC, Simpson profited through his investment in the managed funds, and Simpson Capital, which Simpson owns, received management and performance fees.

The Order censures Simpson Capital; orders that Simpson Capital, Simpson, and Dowling cease-and-desist from committing or causing any violations and any future violations of federal securities laws; orders that Simpson Capital and Simpson be jointly and severally liable for disgorgement of $6,100,000 and a civil money penalty of $550,000; orders that Dowling pay a civil money penalty of $150,000; and suspends Simpson and Dowling from association with any investment adviser and from serving or acting as an employee, officer, director, member of an advisory board, investment adviser, or depositor of, or

principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of 12 months. Simpson Capital, Simpson, and Dowling consented to the issuance of the Order without admitting or denying any of the findings in the Order.

Click http://www.sec.gov/litigation/admin/2009/34-61123.pdf to access the order.

Speeches & Testimony

OCIE Acting Director Speaks at NSCP Conference (HF, IA & MF)

12.28.2009 John H. Walsh, the Acting Director of the Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE), spoke at the 2009 National Society of Compliance Professionals (NSCP) National Meeting on compliance issues. After reviewing 2009 and touching on how OCIE has reacted to the events of 2009, he discussed five specific areas where the examination program is changing:

- OCIE will gain more expertise. This is one of the most important lessons we have learned. Sweep examinations will play an important role. In a sweep review, OCIE builds a special team, reaches out around the agency for the expertise it needs, prepares a customized plan, circulates the plan through the other offices and divisions within the SEC, consults with the SEC itself, performs a series of examinations with the same team (thus providing the team with a defined learning process), and then reports back inside the agency. OCIE also created a new type of examiner position called a Senior Specialized Examiner, which is an individual with significant expertise in trading options, running an equity-trading desk, or rating the credit-worthiness of asset-backed securities, and so on. OCIE is also enhancing its training, with targeted internal programs, collaboration with other regulators, and more extensive use of external certification programs.

- OCIE will be better organized to make sure the right expertise is deployed to each problem. OCIE now has an Assistant Director from a regional office assigned to work full-time to seek answers to the following questions: (1) how does OCIE examine firms that are registered as both a broker-dealer and an investment adviser; (2) how does OCIE examine firms that have affiliates with another registration status; and (3) how does OCIE examine firms that have only a single registration status, but are engaging in activities that require the deployment of expertise that is not possessed by the examination team? OCIE also is establishing periodic review procedures for all examinations, in which a primary agenda item will be whether the examination team needs help with additional expertise. OCIE has conducted several cross-training programs, in which examiners and examination managers are learning about one another's areas of expertise. OCIE is building ad hoc teams to address specific compliance issues that touch multiple areas of expertise. For example, we have formed a cross-disciplinary working group to review firms that use algorithms in their trading.

- OCIE will reach out to third parties to verify what OCIE has been told. In 2009, OCIE established an aggressive program of third-party verification. OCIE is reaching out to advisers' counterparties, custodians and clients.

- OCIE examiners will not be intimidated. OCIE has established an internal Exam Hotline for examiners who believe they are being intimidated.

- OCIE will regularly review its policies and procedures to make sure it is keeping them current and up-to-date.

Click http://www.sec.gov/news/speech/2009/spch100509jhw.htm to access the speech.

Director of SEC Division of Enforcement Speaks Before the U.S. Senate Committee on the Judiciary Concerning Mortgage Fraud, Securities Fraud, and the Financial Meltdown: Prosecuting Those Responsible (HF, IA & MF)

12.9.2009 Robert Khuzami, Director of the Division of Enforcement, spoke before the U.S. Committee on the Judiciary, along with colleagues from the U.S. Department of Justice (DOJ) and the Federal Bureau of Investigation. He spoke on how the SEC is moving on five primary fronts to advance these objectives:

1. Investigating and pursuing enforcement cases based on unlawful conduct related to the financial crisis;

2. Enhancing the historically close working relationship with other law enforcement authorities, including the DOJ, in order to maximize the efficient use of limited resources, as well as to deliver a united and forceful response to those who would violate the federal securities laws;

3. Implementing several initiatives, including the creation of national specialized units that will make the Division of Enforcement more knowledgeable and efficient in attacking the causes of the recent financial crisis, as well as better arming the SEC to address current and future market practices that are a potential cause for concern;

4. Proposing various legislative reforms to provide the Division with improved tools to address securities fraud and related misconduct, including nationwide service of process, a whistleblower program, and improved access to grand jury material; and

5. Seeking to address the compelling need for additional resources within the Division and throughout the SEC.

Click http://www.sec.gov/news/testimony/2009/ts120909rk.htm to access the testimony.

Director of the Division of Investment Management Speaks at the ICI 2009 Securities Law Developments Conference (HF, IA & MF)

12.9.2009 Andrew J. Donohue, Director of the SEC's Division of Investment Management, spoke at the Investment Company Institute (ICI) conference on risk management, the SEC's accomplishments, and the Division's "to do" list.

Risk Management:

- The question is not how to eliminate risk, which can never be achieved, but rather how to determine whether the risks a fund is taking are the right risks and whether those risks can be disclosed in a way that investors understand. For investors, first, can the investor take on the risk being considered? Second, what are the investor assets that are being invested needed for?

- Target date funds try to address three types of risks that people preparing for retirement face: (1) investment risk—the risk that they might lose some or all of their retirement savings; (2) longevity risk—the risk that they might outlive their retirement resources; and (3) inflation risk—the risk that inflation devalues the resources they have for their retirement. Now, depending on how a particular investor values those risks, each investor may wind up with significantly different asset allocation strategies.

- For funds, some things to think about regarding risk are: (1) whether you have correctly identified the risks to a fund and its shareholders; (2) whether you have eliminated or mitigated risks that are not appropriate for the fund; and (3) whether you have communicated the risks the fund has accepted to the fund's investors in a manner they can understand and in a way that allows them to make an informed decision about investing in the fund. In regard to this last point, a never-ending list of "risks," without any framework for an investor to understand and evaluate the risks,

is not that helpful. To be truly meaningful to investors, a description of each risk should include some analysis as to the likelihood of the risk occurring and the consequences of the risk if it does occur.

- While in general risks and returns are related, risk appears, at times, to be not properly identified and inadequately compensated for in potential return.

The Director spoke about the SEC's accomplishments, including those related to money market funds, rulemaking under the Investment Advisers Act of 1940, director guidance, other rulemaking initiatives, the Division's Chief Counsel's Office, and disclosure review and exemptive applications.

Finally, the Director discussed upcoming initiatives, including Rule 12b-1 reform, investment adviser recordkeeping modernization, to codify and expand relief currently provided in exchange-traded fund (ETF) exemptive orders and to permit funds to invest in ETFs, and to consider re-proposed amendments to Form ADV Part 2 that would require advisers to deliver a narrative brochure to clients and prospective clients.

Click http://www.sec.gov/news/speech/2009/spch120909ajd.htm to access the speech.

SEC Chief Accountant Speaks at 2009 AICPA National Conference (HF, IA & MF)

12.7.2009 SEC Chief Accountant James L. Kroeker spoke at the American Institute of Certified Public Accountants (AICPA) National Conference. He began by discussing what can be expected of the Office of the Chief Accountant (OCA):

- Encouragement that the industry reach out to the OCA, whether that be on individual accounting, auditing, independence matters through the consultation process (outlined at www.sec.gov/info/accountants/ocasubguidance.htm), or through less formal measures such as industry or other meetings.

- Putting investor protection at the forefront in all that the SEC does; thinking about accounting issues with a focus on the benefits of transparency and usability of financial information for investors.

- Treating CPAs professionally but without leniency, so that those who fail to live up to their responsibilities and cause harm to investors or U.S. capital markets can expect that the SEC will take appropriate action.

He also discussed the following topics:

- Accounting Standard Convergence

- Principles for Addressing Changes to Accounting Standards

- Recent Developments in Accounting Standards

- Oversight of the Public Company Accounting Oversight Board

- Municipal Securities and the Governmental Accounting Standards Board

Click http://www.sec.gov/news/speech/2009/spch120709jlk.htm to access the speech.

SEC Commissioner Elisse B. Walter spoke at the conference; click http://www.sec.gov/news/speech/2009/spch120909ebw.htm to access her speech.

Enforcement Division Director Robert Khuzami spoke at the conference; click http://www.sec.gov/news/speech/2009/spch120809rsk.htm to access his speech.

SEC Assistant Director of the Office of Interactive Disclosure, Joel Levine, spoke at the conference; click http://www.sec.gov/news/speech/2009/slides120809jkl.pdf to access a detailed outline of his speech.

Miscellaneous

FINRA Issues Investor Alert Warning Investors of Green Energy Investments That Promise Large Gains (HF, IA & MF)

12.29.2009 The Financial Industry Regulatory Authority (FINRA) issued an Investor Alert warning investors to be wary of green energy investments that promise large gains from investing in companies purportedly involved in developing or producing alternative, renewable, or waste energy products. The new Investor Alert, *Save Your Greenbacks—Don't Fall for Green Energy Scams*, explains how these green energy scams typically work. In some schemes, con artists are using everything from tweets and text messages to webinars and faxes to lure investors with very aggressive, optimistic, and potentially false and misleading statements that create unwarranted demand for shares of a small, thinly traded company. This is a classic "pump and dump" fraud where con artists behind the scheme then sell off their shares, leaving investors with worthless stock. Fraudsters are also using green investing as a hook for Ponzi schemes, where a scammer uses incoming funds from new investors to pay purported returns to earlier stage investors.

The Alert warns investors to ignore unsolicited investment recommendations and to question the source of investment information. Investors should also be wary of investments that claim to be the next big thing and promise exponential returns. Another red flag for a green scheme is a hard sell that pushes investors to go "all in" on a new investment initiative. In a recently alleged Ponzi scheme, investors were encouraged to liquidate their traditional investments, such as retirement plans stocks, bonds and mutual funds, and to borrow against their home or business, so that they could invest in one company's "green" initiatives. However, according to a complaint filed in federal court, the company did not generate any income from which the promised returns—ranging from 17% to "hundreds of percents" annually—could be made.

In addition to giving investors detailed advice on how to spot potential scams and distinguish frauds from legitimate opportunities, the Alert also offers tips on how to make sound decisions and where to go to learn more about a company or stock before investing in it.

Click http://www.finra.org/Newsroom/NewsReleases/2009/P120645 to access the release. Click http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/FraudsAndScams/P120644 to access the investor alert.

SEC Posts Draft 2010 Mutual Fund Risk/Return Summary Taxonomy (MF)

12.10.2009 The Securities and Exchange Commission (SEC) has posted a Draft 2010 Mutual Fund Risk/Return Summary Taxonomy, which has been developed as an update to the 2008 Mutual Fund Risk/Return Summary Taxonomy.

Click http://www.xbrl.us/taxonomies/Pages/rr_2008.aspx to access the draft.

NERA Report Finds Decline in SEC Settlements (HF, IA & MF)

12.7.2009 According to the National Economic Research Associates (NERA) fiscal year-end SEC Settlements Trends report, the number of SEC settlements declined for the second consecutive fiscal year in 2009, with 626 defendants, compared to 673 in fiscal year 2008. The report's authors—Consultant Jan Larsen, Senior Vice President Dr. Elaine Buckberg, and Special Consultant Dr. Baruch Lev—note

that the 2009 fiscal year-end figures represent the lowest annual number of settling defendants since the Sarbanes-Oxley Act was implemented in 2002.

Click http://www.nera.com/Publication.asp?p_ID=4003 to access the release. Click http://www.nera.com/image/PUB_Settlements_Update_Q3_1209.pdf to access the report.

SEC Posts XBRL Technology Web Site (HF, IA & MF)

12.4.2009 The SEC posted a Webpage entitled XBRL.sec.gov, which provides links from the SEC Web site to sources of information about eXtensible Business Reporting Language (XBRL) technology, as well as creating and submitting XBRL-tagged interactive data files in compliance with SEC rules.

Click http://www.sec.gov/xbrl/site/xbrl.shtml to access the Web site.

ICI Finds More Than 50 Million U.S. Households Own Mutual Funds (MF)

12.3.2009 According to a newly updated annual survey published by the Investment Company Institute (ICI), more than 50 million U.S. households owned mutual funds in 2009, 3.0 million households reported owning exchange-traded funds (ETFs), and 1.8 million households reported owning closed-end funds. ICI's annual survey, released in two studies, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2009* and *Characteristics of Mutual Fund Investors, 2009*, also reported that shareholders' views of mutual funds continued to track stock market performance. Shareholders' sentiment toward mutual funds declined in 2009, following the sharp drop in stock prices, with favorability falling to 64%, down from 73% in 2008. The ICI survey was conducted in May 2009, when the S&P 500 index averaged 900, below its average of 1,400 in May 2008.

Other survey findings include:

- Most U.S. mutual fund shareholders had moderate incomes and were in their peak earning and saving years. About three in five households owning mutual funds had incomes between $25,000 and $99,999, and about two-thirds were headed by individuals between the ages of 35 and 64.

- Baby Boomers are the largest mutual fund-owning generation. In 2009, 46% of mutual fund-owning households were headed by Baby Boomers, and they held 59% of households' mutual fund assets.

- Fund performance continues to have the most influence over investors' opinions of the fund industry overall—with two-thirds of owners familiar with mutual fund companies indicating that fund performance was a "very" important factor. Other important factors that influenced shareholder views included the opinion of professional financial advisers, personal experience with a mutual fund company, and current financial events.

- Younger mutual fund investors had a more favorable view of mutual funds than did older investors. For example, in 2009, 72% of fund owners younger than 35 who were familiar with mutual fund companies had "very" or "somewhat" favorable impressions of mutual fund companies, compared with 61% of fund owners age 65 or older.

- Although shareholder confidence was shaken somewhat in 2009, the majority of mutual fund investors were still confident in mutual funds' ability to help them achieve their financial goals. In 2009, 73% of fund shareholders said they were "very" or "somewhat" confident, compared with 85% of fund shareholders in 2008.

- Employer-sponsored retirement plans and financial advisers are the main avenues for fund investments. Specifically, 68% of mutual fund-owning households owned funds through employer-sponsored retirement plans, and 69% owned funds outside of these plans. Among

households owning mutual funds outside of employer-sponsored retirement plans, 80% owned funds purchased from professional financial advisers.

- Nine in 10 mutual fund owners reported having Internet access. Among that group, eight in 10 used the Internet for financial purposes.

Click http://www.ici.org/pressroom/news/09_news_own_char to access the release. Click http://www.ici.org/pdf/fm-v18n7.pdf to access the study titled *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2009*. Click http://www.ici.org/pdf/fm-v18n8.pdf to access the study titled *Characteristics of Mutual Fund Investors*, 2009.

SEI Survey Finds Strong Majority of Brokers and Advisors Support and Understand Key Elements of the Fiduciary Standard (IA)

12.2.2009 According to a survey recently conducted by the SEI Advisor Network and the Committee for the Fiduciary Standard, a strong majority of brokers and advisors support and understand key elements of the fiduciary standard. The survey was completed by 890 Registered Independent Advisors (RIAs), Investment Adviser Representatives (IARs) and dually registered broker/advisors, in October and November 2009, with assets under management ranging from less than US $50 million to more than US $250 million. Respondents self-identified their compensation structures as the following: commission (132); commission-fee (510); and, fee-based and fee-only (242). These three categories translate into two groups: brokers (commission brokers and commission-fee brokers) and advisors (fee-based and fee-only).

The poll was conducted with the goal of determining the level of support and understanding of the fiduciary standard among financial advisors and brokers. More than half (53%) of brokers believe that "all financial professionals who give investment and financial advice should be required to meet the fiduciary standard." Additionally, of the brokers who responded to the survey, only 27% disagree that all professionals who give advice should be required to meet the fiduciary standard; and nearly one-fifth (19%) said they are undecided. Of the financial advisors (fee-based and fee only) who participated in the survey, the support for the standard is very strong as 86% agree, 10% disagree and only 3% are undecided.

Among the two groups of poll participants—advisors and brokers—understanding remains equally high on key elements of the fiduciary standard. More than three-quarters (80%) of brokers said they understand the standard either "fairly well" or "very well." Nearly all (98%) of the advisors surveyed said they understand the standard "fairly well" or "very well."

While advisors and brokers polled in the survey agree on many key issues, disparities exist between their views on some topics. These issues include whether modifications to the standard should be made to better fit brokers selling activities, whether switching to the suitability standard should be allowed when products are sold, and how investors view compensation methods. Additionally, there is a split within the brokerage community—commission-only brokers versus commission-fee brokers—on these first two issues.

Click http://www.seic.com/enUS/about/2760.htm to access the release. Click http://www.seic.com/Advisors/SEI_AdvisorNetwork_FiduciaryStandardReport.pdf to access the results of the survey.

SEC Publishes *Select SEC and Market Data Fiscal 2009* (HF, IA & MF)

12.2009 The SEC posted a 27-page document titled *Select SEC and Market Data Fiscal 2009*, which covers the following topics:

- Enforcement Milestones

- Enforcement Action Summary by Primary Classification and Cases by Program Area
- Investigations of Possible Violations
- Right to Financial Privacy
- SEC Total Investor Contacts
- Ten Most Common Complaints
- Financial Information for Broker-Dealers
    - Unconsolidated Financial Information
    - Unconsolidated Annual Revenues and Expenses
    - Unconsolidated Balance Sheet
    - Unconsolidated Revenues and Expenses for Carrying/Clearing Broker-Dealers
    - Unconsolidated Balance Sheet for Carrying/Clearing Broker-Dealers
- Transaction Activity in Equities, Options, and Security Futures

Click http://www.sec.gov/about/secstats2009.pdf to access the document.