

A Summary of
Current Investment
Management Regulatory
Developments

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SEC Rules & Regulations

Realtime Investor Protection Act Passes House

On April 6, 2005, the House passed a bill, the Realtime Investor Protection Act (H.R. 1077), that would give investors immediate online access to broker, dealer and investment adviser information through the NASD's BrokerCheck. The bill, introduced by Rep John Shadegg (R-Arizona), would amend the Securities Exchange Act of 1934 to require registered securities associations to establish and maintain (i) a registration information system on its members and their associated persons and (ii) a toll-free telephone number and a readily accessible electronic platform to receive and quickly respond to inquiries regarding registration information. An association is currently required to maintain a toll-free telephone listing for questions regarding disciplinary actions involving its members and their associated persons. In 1990, Congress allowed the NASD to provide broker information in written form (including via email) in response to inquiries, without vetting the data, through its BrokerCheck system. The new bill would increase the NASD's immunity when providing such information by allowing the NASD to display such information through a closed Internet site that could be accessed by investors. Although the information on the closed Internet site would be the same as that currently available through an email request, the Internet site would offer investors the opportunity to obtain more context for the broker reports.

House passes bill giving investors immediate online access to broker, dealer and investment adviser information

The bill would also amend the Advisers Act to authorize the SEC to require investment advisers to (i) file with the SEC any fee, application, report or notice required to be filed through any entity designated for that purpose by the SEC and (ii) pay the reasonable costs associated with such filing and the establishment and maintenance of the telephone and electronic systems required by the bill. A copy of the Realtime Investor Protection Act (H.R. 1077) is available at: <http://www.govtrack.us/congress/billtext.xpd?bill=h109-1077>.

SEC Interpretations: No-Action Letters

SEC No-Action Letter Provides Guidance Regarding Section 2(a)(51) of Investment Company Act

On March 29, 2005, the SEC issued a no-action letter with respect to Section 2(a)(51) of the Investment Company Act, concluding that Marion Searle (“Searle”), the Settlor of fifteen trusts (the “Trusts”) created pursuant to her will, is a qualified purchaser under Section 3(c)(7). The trustees of the Trusts (the “Trustees”) were concerned that Searle would not be considered a qualified purchaser because of the “Settlor requirement,” which requires a Settlor to have been a qualified purchaser at the time he or she contributed assets to a trust. The determination of a Settlor’s qualified purchaser status was clarified in a 1998 no-action letter to the Meadowbrook Real Estate Fund (the “Meadowbrook Letter”), in which the SEC stated that if a Settlor contributed enough assets for a trust to be worth \$5 million, measured in 1996 dollars (the year in which the legislation on 3(c)(7) was passed), then the Settlor was probably worth at least \$5 million and likely possessed the financial sophistication to appreciate the risks presented by a 3(c)(7) fund at the time he or she contributed assets to the trust, thereby satisfying the purpose of the Settlor requirement. The Trustees argued that even though no single Trust met the \$5 million threshold, the Meadowbrook Letter should be applied to the Trusts because, in the aggregate, they met the monetary requirement, and the fact that Searle created a series of trusts rather than a single trust should not “diminish the applicability of the Meadowbrook ‘proxy’ reasoning.” Alternatively, the Trustees claimed that Searle met the qualified purchaser standard at the time she contributed assets to the Trusts because the value of Searle’s investments at the time of her death were equivalent to approximately \$17 million in 1996 dollars, significantly exceeding the \$5 million dollar qualified purchaser threshold.

The SEC agreed that it would not recommend enforcement action under Section 2(a)(51)(A)(iii) of the Act because (i) as measured in 1996 dollars, Searle’s wealth at the time of her death exceeded the \$5 million qualified purchaser threshold and (ii) the Meadowbrook Letter should apply even though Searle’s wealth was divided among a series of trusts, rather than concentrated

SEC reaffirms that aggregation of trusts is permissible and looks at value in 1996 dollars as opposed to original value in determining satisfaction with \$5 million requirement

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in a single trust, because the Trusts, in the aggregate, were worth \$26 million (in 1996 dollars). A copy of the no-action letter is available at: <http://www.sec.gov/divisions/investment/noaction/searle032905.htm>.

SEC No-Action Letter Provides Guidance Regarding Section 15(a) of Investment Company Act

On April 1, 2005, the SEC issued a no-action letter to Mellon Equity Associates LLP (“Mellon”) with respect to Section 15(a) of the Investment Company Act. Section 15(a) makes it unlawful for any person to act or serve as an investment adviser to a registered investment company, except pursuant to a written contract approved by a vote of the majority of the fund’s shareholders and was “adopted to give fund shareholders a voice in approving advisory contracts and to prevent trafficking in fund advisory contracts.” In its letter, the SEC said that Mellon may temporarily serve as an investment adviser to TimesSquare VP S&P 500 Index Fund (the “Fund”) pursuant to a written investment advisory agreement that was not approved by a majority vote of the Fund’s shareholders, without violating Section 15(a) of the Investment Company Act.

No 15(a) violation by temporary investment adviser

The Fund is one series of CIGNA Variable Products Group (the “Trust”), which is registered as an open-end management investment company. The Fund and the other series of the Trust are insurance-dedicated funds that serve as underlying investment options for insurance company separate accounts issuing variable insurance products. The Fund’s decision to exit the business, coupled with the retirement of the Fund’s portfolio manager in September 2004, resulted in the Board of Trustees (the “Board”) deciding to enter into an interim investment advisory agreement with Merrill Lynch Investment Managers L.P. (“MLIM”) to provide portfolio management of the Fund until February 27, 2005. In December 2004, the Fund’s investment adviser, under the supervision of the Board, successfully proposed a merger with the Dreyfus Index Fund, and subject to shareholder approval, the parties expected to accomplish the merger by April 30, 2005. Mellon proposed to serve as investment adviser pursuant to a written agreement, the Mellon Equity Interim Agreement (“MEI Agreement”), which will be operative from February 28, 2005 until the merger is consummated. Of concern is that the MEI Agreement has not been

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approved by a majority of the Fund's shareholders, as required by Section 15(a).

The SEC concurred that it would not recommend enforcement action under Section 15(a) if Mellon serves as an investment adviser to the Fund pursuant to the MEI Agreement that has not been approved by the vote of a majority of the outstanding voting securities of the Fund, so long as (i) Mellon will serve as investment adviser to the Fund under the MEI Agreement without any compensation or reimbursement of its costs; (ii) Mellon will otherwise comply with the terms and conditions that applied under the MLIM agreement and the original agreement with CIGNA Advisers, which were both adopted in accordance with the requirements of Section 15; (iii) the MEI Agreement will be operative only for a limited period; (iv) the Board, including those Trustees who are not "interested persons" (as defined in the Investment Company Act), has approved the MEI Agreement; and (v) Fund shareholders will have an opportunity to vote on the merger and, as a result, the management of their assets by Mellon. A copy of the no-action letter is available at: <http://www.sec.gov/divisions/investment/noaction/mellon040105.htm>.

SEC Enforcement Actions

Broker Specializing In Military Sales Agrees to Fine and Suspension Over Advice

In a statement on April 13, 2005, the NASD reported that Louis E. Stough, a former broker for First Command Financial Planning, Inc. ("First Command"), agreed to a 10-month suspension and \$25,000 fine in connection with a series of unsuitable sales recommendations made to military personnel involving liquidation of investments in the firm's systematic investment plans ("Plans"). Stough did not inform certain of his customers that they had they option of transferring assets directly from their Plans to funds in the same family of mutual funds without incurring sales charges. Instead, he recommended and sold those customers shares of other families of mutual funds, charging them sales load of up to 5.75%. As reported in the *January 2005 Investment Management Regulatory Update*, First Command agreed in December to pay

First Command broker
sanctioned by NASD for
deceptive conduct

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\$12 million in fines and restitution to settle NASD and SEC charges that it made misleading statements in the sale of Plans. A copy of the NASD's press release is available at: http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013807&ssSourceNodeId=551.

Speech by SEC Staff

SEC Commissioner Campos Says Conflicts Were at Heart of Mutual Fund Abuses

Campos states that CCOs are important gatekeepers and responsible to both the public and the SEC

On April 11, 2005, at the 2005 Fund Compliance Meeting in Washington, D.C., SEC Commissioner Roel Campos said that conflicts of interest were at the center of the compliance issues with respect to abuses in the mutual fund industry and that such conflicts provide important lessons about the operation of compliance programs today. In his speech, Campos discussed compliance programs and the role of CCOs. Campos expressed that active and effective compliance programs and CCOs must be (i) continually aware of potential conflicts of interest; (ii) respected within an organization; (iii) supported by the highest ranking officers and executives; (iv) well-resourced; and (v) constantly evolving in response to business, customer and regulatory changes. Campos also commented on the long-term damage to the industry caused by funds that had dismissed or ignored complaints from employees, such as portfolio managers and compliance personnel, about various mutual fund trading abuses. Finally, Campos discussed having CCOs as allies in the SEC's mission to protect investors, a result of the recent compliance rule requiring mutual funds and investment advisers to have comprehensive compliance programs, adopted by the SEC in December 2003, and reported in the *December 2003 Investment Management Regulatory Update* and the *January 2004 Investment Management Regulatory Update*, saying that their presence provides great opportunities to improve compliance.

Industry Updates

SEC Names Meyer Eisenberg Acting Director of Division of Investment Management

On April 1, 2005, the SEC named Meyer Eisenberg Acting Director of its Division of Investment Management. Director Eisenberg assumed his new role on April 4, 2005, replacing outgoing Director Paul Roye, who headed the division for six years. Since 1998, Eisenberg has served as Deputy General Counsel for the SEC and has acted as the principal liaison between the Office of General Counsel and the Division of Investment Management on all matters involving investment advisers, investment companies, their service providers and their distributors. From 1970 to 1998, Eisenberg was in private practice. Prior to that, he served at the SEC from 1959 to 1970. A copy of the SEC's press release naming Eisenberg Acting Director of the Division of Investment Management is available at: <http://www.sec.gov/news/press/2005-46.htm>.

Eisenberg to serve during interim period

Enforcement Director Cutler to Leave SEC

On April 14, 2005, Stephen M. Cutler, Director of the SEC's Division of Enforcement, announced that he plans to leave the SEC within the month to return to the private sector. Cutler was named Enforcement Director in October 2001. During Director Cutler's tenure, he (i) led the SEC's efforts against banks, insurance companies and other financial intermediaries for their roles in a number of public company financial reporting failures; (ii) helped bring some of the SEC's most significant financial reporting cases involving foreign companies; (iii) oversaw the SEC's investigations into inter-positioning and trading ahead violations; (iv) spearheaded the SEC's crackdown on illegal IPO allocation practices; (v) led the SEC's enforcement efforts against mutual fund abuses; (vi) played a key role in the global settlement with Wall Street brokerage firms over research analyst conflicts of interest; (vii) ratcheted up the SEC's efforts to hold audit firms, and their personnel, accountable for misconduct; and (viii) initiated a comprehensive review and self-assessment of conflicts of interest by the largest financial services companies in the country. Of the largest 12 penalties in SEC history, 10 were obtained in cases brought under

Cutler returning to private sector

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Director Cutler's leadership. Before joining the SEC, as Deputy Director of the Division of Enforcement in January 1999, Director Cutler was a partner at a Washington, D.C. law firm. A copy of the SEC's announcement regarding Cutler's intention to step down is available at: <http://www.sec.gov/news/digest/dig041405.txt>.

ICAA Changes Name To Investment Adviser Association

On April 19, 2005, the Investment Counsel Association of America (ICAA) announced that its members had voted to change the name of the organization to the Investment Adviser Association, effective immediately. The organization, which has been in existence since 1937, provides a range of advocacy, educational and business services to its membership, which is comprised of approximately 400 investment advisory firms that collectively manage \$5 trillion for a variety of individual and institutional clients. The association's members elected to change its name to better reflect its mission, which is to serve the current business and regulatory needs of investment adviser firms and represent the industry to regulators. A copy of this announcement is available at: <http://www.investmentadviser.org>.

New name more accurately reflects organization's mission

GAO Issues Report Recommending Steps to Improve SEC's Detection of Mutual Fund Trading Abuses

On April 22, the Government Accountability Office (the "GAO") released a report detailing the SEC's failure to detect mutual fund trading abuses due to the SEC's belief that market timing was not a high-risk area for examination. Market timing typically involves rapid buying and selling of mutual fund shares to profit on the price differential between overseas and U.S. markets. Although market timing is not per se illegal, it may constitute illegal conduct if a fund adviser permits favored customers, such as hedge funds, to engage in the practice contrary to stated mutual fund trading restrictions.

GAO identifies information inconsistent with SEC view that market timing was low-risk area and makes recommendations for SEC

The GAO report found that (i) the SEC did not examine for market timing abuses prior to September 2003, when the abuses were exposed; (ii) there was information available before September 2003 that was inconsistent with the SEC's views that market timing was a low-risk area; and (iii) fund company

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compliance staff often detected evidence of undisclosed market timing arrangements with favored customers, but lacked sufficient independence within their organizations to correct such deficiencies. The GAO recommended that the SEC take three actions (i) request and review all compliance-related internal company reports during the examination planning process to gain a broad perspective on the company's risks and the adequacy of controls in place to monitor those risks; (ii) ensure that staff assess the independence and effectiveness of mutual fund CCOs as a component of all mutual fund company exams; and (iii) formulate a plan to receive and review mutual fund company and adviser annual compliance reports on an ongoing basis. A copy of the GAO's report is available at: <http://www.gao.gov/new.items/d05313.pdf>.

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*This memorandum is a summary for general information only.
It is not a full analysis of the matters presented and should not be relied upon as legal advice.*