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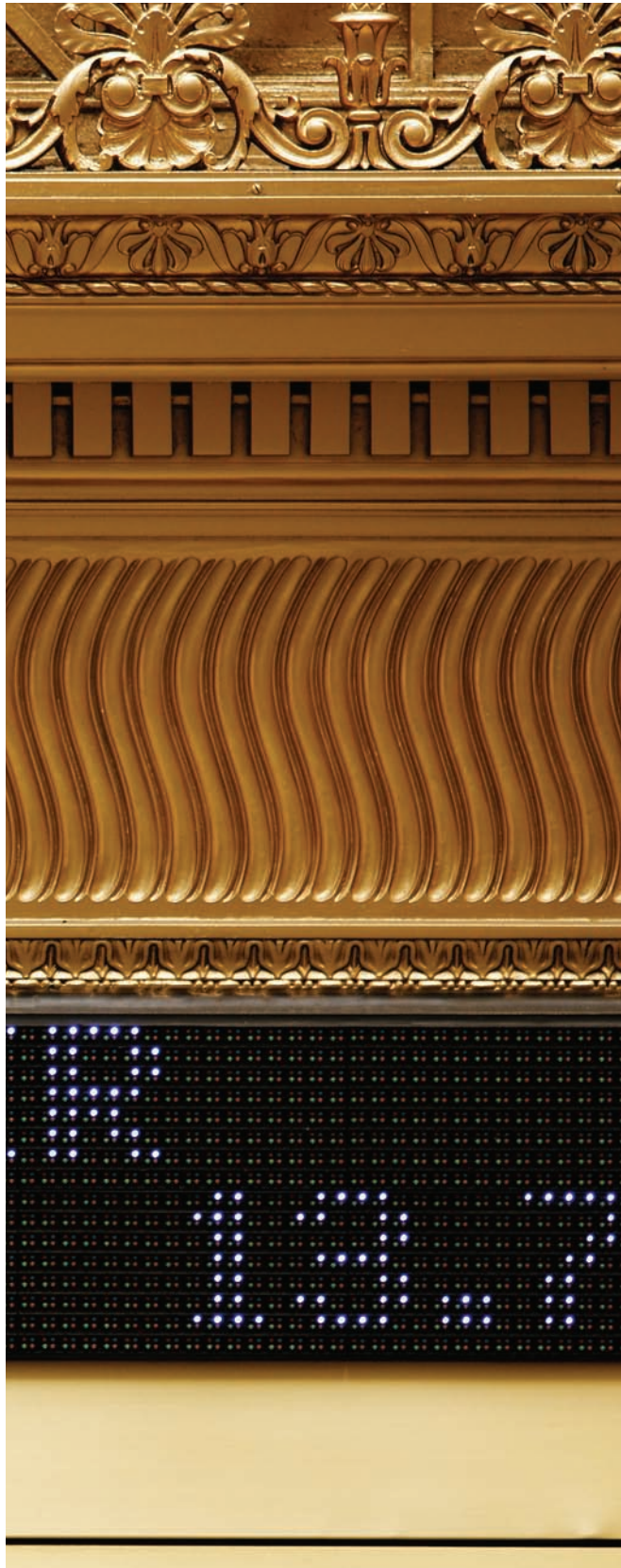
# Investment Management Review

A Quarterly Update for the Investment Management Industry

2nd Quarter 2010

# Regulatory & Legislative Update

U.S. Mutual Funds



The second quarter was dominated by an event that actually culminated shortly after the end of the quarter, the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act"), which was signed into law by President Obama on July 21, 2010. The Act is the result of almost two years of negotiation, debate, research and hard work involving elected officials and their staffs, regulatory agencies, the financial services industry and consumer advocates. It most certainly changes the landscape for all financial institutions for many years to come. Most pertinent for investment firms, the Act includes several provisions affecting investment advisers. First, investment advisers to certain unregistered investment products, including hedge funds and private equity funds having assets under management of \$150 million or more, will be required to register with the Securities and Exchange Commission ("SEC") no later than July 21, 2011. In addition, all SEC-registered investment advisers will be subject to new filing, record-keeping and examination requirements related to these unregistered pools. Also, funds relying upon Regulation D under the Securities Act of 1933 are immediately subject to an amended definition of an accredited investor. The amended definition no longer allows an investor to include the value of their primary residence in their net worth.

Another event that could have a large effect on the registered fund community also occurred shortly after the end of the second quarter. On July 21, the SEC voted to propose amendments to Rule 12b-1 under the Investment Company Act of 1940 (the "1940 Act"). The proposed amendments are intended to improve regulation of fund distribution fees and allow for improved investor disclosures. The proposal would limit ongoing sales charges that an individual investor could pay to the total they would have paid in a class of the fund that charges a front-end sales charge. Funds could continue to use up to 25 basis points for "marketing and service fees" outside of the ongoing sales charge limitation. However, offering documents would no longer refer to these amounts as Rule 12b-1 fees. Rather, they would be referred to as marketing and service fees. Funds would have to disclose any ongoing sales charges and any marketing and service fees in their prospectus, shareholder reports and in confirmations. The proposal would also create a fund exemption that would permit broker-dealers to establish their own class-specific sales compensation structure to encourage competition among financial intermediaries. A fund relying on the exemption would not be permitted to deduct other asset-based sales charges for that class of shares. Finally, the rule proposal would eliminate the requirement for a fund's board to approve, or annually reapprove, fund distribution plans.

There was also movement on several other fronts. Notably, the SEC staff released two sets of responses to questions about the new amendments to the rules governing money market funds which went into effect on May 5. The first, issued by the staff on May 25, covered compliance dates and implementation, liquidity, stress testing, quality and website posting. The second, issued on June 25, concentrated on questions regarding the scope of Rule 30b1-7 under the 1940 Act and Form N-MFP (shadow pricing, multiple classes, investment categories, capital support agreements, master feeder funds and money market funds that do not use amortized cost or penny-rounding methods of valuation). The Q&A releases did not provide any major surprises; however, they did

provide money market fund managers with greater comfort in their approach and interpretation of the amendments' provisions.

The "flash crash" of May 6 also led to some quick revisions to the market exchange circuit breaker rules. Regulators were quick to implement a new single-stock circuit breaker rule that would suspend trading for five minutes anytime a stock (currently limited to stocks in the S&P 500) drops by more than 10% during a five-minute period during the trading day. In addition, plans are to expand the rule to cover stocks in the Russell 1000 and exchange traded funds. Regulators are also considering revisions to the market-based circuit breaker rules, which were not activated during the May 6 market drop because it occurred after the last trigger point (2 p.m. EST) for the day.

In other news during the second quarter, the SEC staff posted a new technology infrastructure and taxonomy on the SEC's EDGAR filing website. The new taxonomy, validation and document preview tools are intended to provide the filing support necessary for a fund's submission of XBRL risk/return and investment objective information. The compliance date for these XBRL filings is currently slated for January 1, 2011. Finally, the requirement for funds to implement identity theft prevention programs (the "Red Flag Rule") was delayed again, this time until December 31, 2010. This marks the fifth compliance date delay for the Red Flag Rule. It is unlikely that funds will receive any sympathy from regulators if they are not ready by the new compliance date.

In conclusion, the Act was the biggest story of the quarter. As we all know, the implementation work is just beginning and, to a certain extent, is reliant upon SEC and other regulatory agency rulemaking initiatives. Firms will need to remain vigilant in their monitoring of industry news as they navigate these new and uncharted regulatory waters. ■

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