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DEVELOPMENTS OF NOTE

Federal District Court Rules Against SEC in First Insider Trading Case Involving Credit Default Swaps

On June 25, 2010, the U.S. District Court for the Southern District of New York ruled in favor of a high yield bond salesman and a former portfolio manager for one of the bond salesman's hedge fund clients, dismissing the first insider trading case brought by the SEC involving credit default swaps. (*SEC v. Rorech*, No. 09-4329, 2010 U.S. Dist. LEXIS 63804 (S.D.N.Y. June 24, 2010).) The Court's decision provides important additional definition regarding how insider trading prohibitions apply to the high yield debt markets and credit default swaps and the SEC's jurisdiction over the credit default swaps. A [Goodwin Procter Alert](#) prepared by the firm's [White Collar Crime & Government Investigations Practice](#) discusses the decision in greater detail.

A litigation team of Goodwin Procter attorneys led by [Richard M. Strassberg](#) and [Roberto M. Braceras](#) represented the high yield bond salesman charged by the SEC in the case.

House Passes Dodd-Frank Act

The U.S. House of Representatives approved the conference report on the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") by a vote of 237-192. For a discussion of the Act, please see the [June 29, 2010 Alert](#). The Act will now be voted upon

by the Senate, where its chances of approval are regarded as good, but less than certain. The Act has been primarily supported by Democrats and with the death of Senator Robert Byrd there are only 58 Democratic senators; 60 votes are needed to end debate on the Act. The governor of West Virginia may appoint a successor to Sen. Byrd before the Senate returns from its Fourth of July recess on July 12. Of the two Democratic senators who did not vote for the previous Senate financial reform bill, Sen. Maria Cantwell has stated that she will vote for the Act and Senator Russ Feingold has stated that he will not vote for the Act. Republican Senator Susan Collins, who voted for the previous Senate financial reform bill, has also stated that she will vote for the Act. The three other Republican senators who voted for the previous Senate financial reform bill, Sens. Olympia Snowe, Scott Brown and Charles Grassely, have not indicated whether they will vote for the Act.

SEC Adopts Final Rule Addressing Pay-to-Play Practices for Investment Managers Seeking to Manage Money on Behalf of State and Local Authorities

The SEC issued the [formal release](#) adopting a new rule under the anti-fraud provisions of the Investment Advisers Act of 1940, as amended (the “Advisers Act”), and making related changes to existing Advisers Act rules (collectively, the “Amendments”), that are designed to address “pay to play” practices in which an investment adviser makes political contributions or gifts to government officials or candidates for office in circumstances that could suggest an attempt to influence the selection of the investment adviser to manage money on behalf of state and local government entities (*e.g.*, for public pension plans, retirement plans and 529 plans). The Amendments include the basic elements set forth below. Additional detail on the Amendments including the schedule of compliance dates will be provided in Goodwin Procter Client Alert that will be circulated to *Alert* readers.

TWO YEAR COMPENSATION TIMEOUT

The Amendments make it unlawful for an investment adviser that (a) is registered with the SEC or (b) has not registered with the SEC in reliance on the “private adviser” exemption in Advisers Act Section 203(b)(3) (in each case, an “Adviser”), to receive compensation for providing advisory services to a state or local government entity (a “government entity”) for a two year period after the Adviser or certain of its related persons (“covered associates”) make a political contribution to a public official of a government entity or candidate for office with a government entity who is or will be in a position to influence the how the government entity awards advisory business.

PROHIBITION ON PAYMENTS TO THIRD PARTIES TO SOLICIT GOVERNMENT ADVISORY CLIENTS

The Amendments generally prohibit an Adviser from paying a third party to solicit government entities for advisory business unless the third party is a registered broker-dealer or registered investment adviser that is itself subject to pay to play restrictions. The SEC’s decision not to adopt an absolute prohibition on the use of third party solicitors represents one of several changes from its original proposal. (The SEC release adopting the Amendments notes that FINRA is preparing rule changes that would prohibit a FINRA member from soliciting advisory business from a government entity on behalf of an investment adviser unless the member complies with requirements prohibiting pay to play activities.)

BAN ON SOLICITING AND COORDINATING CONTRIBUTIONS AND PAYMENTS

The Amendments prohibit an Adviser and its covered associates from soliciting or coordinating (a) any contribution to an official or candidate for office of a government entity to which the adviser is providing (or is seeking to provide) investment advisory services or (b) payments to a political party of the state or locality where the Adviser is providing (or is seeking to provide) investment advisory services to a government entity.

APPLICATION OF THE PROPOSED RULE TO CERTAIN POOLED INVESTMENT VEHICLES

The Amendments treat an Adviser that manages certain types of pooled investment vehicles, referred to as “covered investment pools,” in which a government entity invests or is solicited to invest in the same manner as if the Adviser were providing (or seeking to provide) investment advisory services directly to the government entity. A “covered investment pool” is any (i) registered investment company that is an investment option in a plan or program of a government entity that is participant-directed (*e.g.*, a retirement plan such as a 403(b) or 457 plan, or a college savings plan) or (ii) investment vehicle that relies on any of the exclusions from the definition of “investment company” under Sections 3(c)(1), 3(c)(7) or 3(c)(11) of the 1940 Act. (Because the Amendments apply only to investment advisers that are registered or that rely on the private adviser exemption, a bank that is not an “investment adviser” under Section 202(a)(11) of the Act is not subject to the Amendment's various prohibitions and limitations even when the bank manages a collective investment fund that relies on Section 3(c)(11) of the 1940 Act.)

OTHER INDIRECT CONTRIBUTIONS OR SOLICITATIONS

The Amendments prohibit an Adviser and its covered associates from otherwise doing indirectly, such as by channeling contributions to officials of government entities through third parties such as spouses, attorneys or companies affiliated with the Adviser, what the Amendments prohibit them from doing directly.

SEC Staff Provides Responses to Questions Concerning New Disclosure Requirements Adopted as part of Recent Money Market Fund Rule Amendments

The Staff of the SEC’s Division of Investment Management published [responses](#) to various questions relating to Rule 30b1-7 under the Investment Company Act of 1940, as amended (the “1940 Act”), and new Form N-MFP. Rule 30b1-7 generally requires a money market fund to file a report of its portfolio holdings on Form N-MFP each month, with the portfolio holdings information becoming publicly available sixty days after the end of the month to which the report relates. Rule 30b1-7 and Form N-MFP were adopted by the SEC in conjunction with the recent amendments to Rule 2a-7 under the 1940 Act and other rules relating to money market funds, which were discussed in the [March 5, 2010](#) and [June 1, 2010 Alerts](#). Below is a summary of the Staff’s responses (with references to the relevant Items of Form N-MFP, as applicable). The compliance date for the requirements relating to Form N-MFP is December 7, 2010.

SCOPE OF RULE 30b1-7

Any fund subject to Rule 2a-7 (that is, a registered investment company that holds itself out as a money market fund) must file a Form N-MFP each month, even if the fund does not maintain a stable share price using the amortized cost method or penny rounding method.

DISCLOSURE OF MARKET-BASED QUOTATIONS OF PORTFOLIO SECURITIES (ITEMS 18, 25, 45 AND 46)

Form N-MFP Items 45 and 46 require a money market fund to provide a market-based quotation for each of its securities as of the last business day of each month. In contrast, Items 18 and 25 require a money market fund to provide a market-based quotation for each of its securities as of the date on which the fund's shadow price was calculated.

MULTI-CLASS MONEY MARKET FUNDS (ITEM 25)

A multi-class money market fund may use the same market-based (or "shadow") net asset value for each class, provided that the fund's dividend and accounting policies assure that there will be no deviation between the market-based net asset values of the fund's share classes.

PORTFOLIO HOLDINGS INVESTMENT CATEGORIES (ITEM 31)

A fund may only use the sixteen investment categories specified in Form N-MFP Item 31 to describe each of the fund's portfolio holding, and may not use other categories.

VALUE OF CAPITAL SUPPORT AGREEMENTS (ITEMS 26 THROUGH 46)

A capital support agreement that does not relate to a specific portfolio security should itself be identified as a portfolio security held by the fund and given a value, if any, as of the date of valuation. A capital support agreement, the value of which will be determined only at the time as a loss is determined (*e.g.*, an agreement to bring the fund's market-based net asset value per share to at least \$0.995), will have a value (a) only if, at the time of such determination, the conditions for a capital support payment exist and (b) in an amount equal to the amount payable at the time of such determination (otherwise it will have no value).

SEVEN-DAY GROSS YIELD (ITEM 17)

A tax-exempt money market fund that holds taxable paper, and a state tax-exempt money market fund that holds out-of-state paper, should not adjust the fund's gross yield to reflect federal or state-level taxes, respectively, that would be imposed on the taxable or out-of-state paper, as the case may be.

UNIQUE IDENTIFIERS (ITEM 29)

If a portfolio security has not been issued a CUSIP, the fund may use a "dummy," or other internally assigned, unique identifier.

REPURCHASE AGREEMENTS (ITEM 32)

A fund that holds a repurchase agreement must respond to Item 32a through 32f (which describe, among other things, the value of the collateral), even if the fund is not treating the acquisition of the repurchase agreement as the acquisition of its underlying collateral for purposes of Rule 2a-7's diversification requirements.

DESIGNATED NRSRO CREDIT RATINGS (ITEMS 34, 37 AND 38)

A fund that treats a security, demand feature or guarantee as a rated security even though for the rating of the security, demand feature or guarantee, the fund is relying on the rating of another class of securities of the issuer (and thus, the fund considers the security, demand feature or guarantee as comparable in priority and security to the other class of securities), is required to disclose the rating of the comparable class of securities.

DEMAND FEATURES AND GUARANTEES (ITEMS 37 AND 38)

A fund that is not relying on a demand feature or guarantee for the purpose of determining the quality, maturity, or liquidity of a security, is not required to respond to Items 37 or 38 with respect to that demand feature or guarantee.

PERCENTAGE OF NET ASSETS INVESTED IN A SPECIFIC SECURITY (ITEM 42)

A fund that uses the amortized cost method of valuation should base the percentage of the fund's net assets invested in a particular security on the amortized cost to the fund of that security.

FEEDER FUNDS

- **Portfolio Holdings (Items 26 through 46)** – A feeder fund should disclose as its portfolio holdings the shares of the master fund it holds, not the portfolio holdings of the master fund.
- **Weighted Average Maturity/Weighted Average Maturity Life Calculations (Items 11 and 12) and Determinations of Maturity Date (Item 35) and Final Legal Maturity (Item 36)** – A feeder fund should calculate its weighted average maturity and weighted average maturity life in accordance with Rule 2a-7(d)(8), and thus should generally treat the maturity date of each share of the master fund as the date when the master fund is required to make payment on redemption of such share by the feeder fund. In addition, the final maturity date of each share of the master fund should be the same as the maturity date of such share.
- **Shadow Price of Master Fund Shares (Items 18 and 25) and Current Market Value (Items 45 and 46)** – A feeder fund should determine and report the market value of the master fund shares it held as of the date required, which means that if the master fund redeems its shares at \$1.00 per share and the feeder fund reasonably believes on that date that the master fund's shadow price is not less than \$0.995 per share, the feeder fund should assign a current market value to each master fund share equal to \$1.00.

- Security Enhancements (Items 37, 38 and 39) – A feeder fund should not report any enhancement (*e.g.*, demand feature or guarantee) with respect to its master fund holdings.
- Principal Amount (Item 40) – A feeder fund should report the principal amount of its master fund holdings as of the reporting date.
- Current Amortized Cost (Item 41) – A feeder fund that uses the amortized cost method of valuation should provide the amortized cost of the master fund shares it held as of the reporting date. A feeder fund that does not use the amortized cost method should respond “N/A” to Item 41.

MONEY MARKET FUND NOT REGISTERED UNDER THE 1933 ACT

A 1940 Act registered money market fund that is not registered under the Securities Act of 1933 (the “1933 Act”) and whose shares are offered only in private placements in reliance on Rule 506 of Regulation D under, or Section 4(2) of, the 1933 Act, will not be deemed to violate Rule 506 or Section 4(2), notwithstanding that its Form N-MFP filings are publicly available sixty days after the end of the month to which those filings relate, provided that the fund (a) limits the information provided in its Form N-MFP filings to only that information required by the form and (b) does not otherwise use its Form N-MFP filings to condition the market for an offering of its securities.

TECHNICAL SPECIFICATIONS FOR FORM N-MFP

The technical specifications for Form N-MFP will be available in mid to late summer 2010.

SEC Staff Denies No-Action Relief Regarding Broker-Dealer Registration Requirements for Firm Providing Investor Introductions to Issuer Seeking Financing

The staff of the SEC’s Division of Trading and Markets (the “Staff”) [denied](#) a request for no-action assurances regarding the broker-dealer registration requirements of the Securities Exchange Act of 1934 made by a firm that proposed to provide a company with introductions to potential sources of financing in return for compensation based on the gross amount of funding raised by the company as a result of the introductions. The firm indicated that its role would solely involve introducing the company to a limited number of the firm’s contacts who may have an interest in providing financing; the firm represented that it would not (1) engage in any negotiations on behalf of the company or any contacts it provided; (2) provide any contact with any information about the company that might be used as the basis for any negotiations regarding financing to be provided to the company; (3) have any responsibility for, or make any recommendations concerning the terms, conditions, or provisions of any agreement between the company and any contact that provided financing to the company; and (4) provide any assistance to any contact or the company with respect to any financing transactions.

In its response, the Staff observed that receipt of transaction-based compensation in connection with effecting transactions in securities, or inducing or attempting to induce the purchase or sale of securities is a hallmark of broker-dealer activity requiring registration with the SEC as a broker-dealer. The Staff went on to state that the fact that the firm would

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be introducing the company only to persons with a potential interest in investing in the company's securities implied that the firm "anticipates both 'pre-screening' potential investors to determine their eligibility to purchase the securities, and 'pre-selling' [the company's] securities to gauge the investors' interest." The Staff further observed that because the firm would be compensated based on whether its introductions led to investments in the company's securities, and therefore would be transaction-based compensation, the firm would have a "salesman's stake" in the proposed transactions, creating a heightened incentive for the firm to engage in sales efforts. On this basis, the Staff concluded that the firm's proposed activities would require broker-dealer registration, and declined to grant no-action relief.

OTHER ITEM OF NOTE

SEC Publishes for Public Comment Proposals by National Securities Exchanges and FINRA to Expand Circuit Breaker Pilot to Include Stocks in Russell 1000 Index and Certain Other Exchange Traded Products Including ETFs

The SEC published for public comment proposals by the national securities exchanges and FINRA to expand a recently adopted circuit breaker program to include all stocks in the Russell 1000 Index and certain exchange-traded products (the "ETPs"), consisting of selected (a) exchange-traded funds, which are generally designed to track securities indices, (b) exchange-traded vehicles, which are designed to track the underlying performance of an asset or index, related to futures contracts, commodities or currency, and (c) exchange-traded notes, which are senior unsecured debt obligations designed to track the total return of an underlying index, benchmark or strategy. As discussed in the [June 15, 2010 Alert](#), the SEC has previously approved a circuit breaker pilot program in effect through December 10, 2010 that applies to stocks listed in the S&P 500 Index. The ETPs proposed to be included in the pilot program are listed [here](#). The NYSE proposal is available [here](#). The FINRA proposal is available [here](#).