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2014 Year in Review: Division of Investment Management Guidance Updates

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Introduction

In 2014, the Division of Investment Management (the Division) of the US Securities and Exchange Commission (SEC or Commission) continued its practice of providing guidance and interpretations of legal, regulatory and compliance matters through its *Guidance Update* initiative.[1] The 13 guidance updates published by the Division during 2014, in addition to the 14 published in 2013, have received a mixed welcome from the investment management industry. Although the guidance updates clarify and offer insight into the Division's view and interpretation of discrete issues, the guidance updates are not rules, regulations or statements of the SEC, and the Commission itself has neither approved nor disapproved the statements and policies set forth in the guidance updates. However, the guidance updates reflect current Division Staff views and have begun to serve as a basis for formal and informal initiatives of both the Division and the SEC's Office of Compliance Inspections and Examinations (OCIE). Accordingly, the investment management industry should continue to be mindful of the Division's guidance updates and carefully consider the potential implications of the guidance updates to existing and future policies and procedures, disclosures to investors, filings with the SEC and other legal and regulatory matters.

This article provides background on the *Guidance Update* initiative. It then provides an overview of the guidance updates published during 2014 as well as certain practice points and potential implications that industry participants may consider in connection with their review of those guidance updates.

Overview of Guidance Update Initiative

The *Guidance Update* initiative began in 2013, during which the Division published 14 guidance updates on a number of topics, including compliance with the conditions of exemptive orders, counterparty risk management practices with respect to tri-party repurchase agreements and fund names that suggest safety or protection from loss.[2] The Division continued on a similar pace, issuing 13 guidance updates in 2014. These guidance updates varied in length from two to seven pages and covered a wide range of topics affecting registered investment companies (funds), fund boards of directors (boards), investment advisers, insurance separate accounts, and business development companies (BDCs). The format of the 2014 guidance updates also varied, with some structured as questions and answers and hypothetical scenarios and others in a more traditional legal analysis format. Various offices within the Division authored the guidance updates, including the Chief Counsel's Office, the Disclosure Review Office and the Chief Accountant's Office.

In December 2014, Norm Champ, Director of the Division, stated that the Division Staff views the "Guidance Updates as a meaningful way to decrease ambiguity and improve the public's understanding of the Staff's view on critical issues."[3] The Division has encouraged industry participants to contact the Division Staff with any questions or matters that may benefit from greater clarification or to provide comments about previously issued guidance updates. The Division intends that the *Guidance Update* initiative will supplement its traditional work of considering and issuing no-action relief and interpretive guidance and provides a transparent and timely mechanism for publishing the Division's views on particular matters, rather than serve as a substitute "for the established rulemaking, exemption application and No-Action processes."[4] The guidance updates also support the Division's goal of increased open communication and regulatory transparency.[5] Accordingly, it is reasonable to expect that the Division will continue its *Guidance Update* initiative in 2015.

2014 SEC Division of Investment Management Guidance Updates

No. 2014-01—"Risk Management in Changing Fixed Income Market Conditions" (January 2014)[6]

In January 2014, the Division published a guidance update regarding steps that investment advisers and fund boards may consider in light of changing fixed income market conditions (Fixed Income Guidance). The Fixed Income Guidance related primarily to risk management and disclosure matters that, in the Division's view, are of heightened importance in light of recent fixed income market conditions and the growth of fixed income mutual funds and exchange traded funds. The Fixed Income Guidance attributes such risk management and disclosure considerations principally to potential volatility and lack of liquidity in the fixed income market.

The Fixed Income Guidance provided an overview of the fixed income market structure and recent changes in those markets that could increase the risks associated with fixed income funds. In particular, the Division Staff noted that, although the assets of fixed income funds have grown in recent years, primary dealer capacity in fixed income markets in 2014 was roughly in line with the level of primary dealer capacity in 2001. Cautioning that reductions in market-making capacity in fixed income markets "has the potential to decrease liquidity and increase volatility in the fixed income markets," the Fixed Income Guidance suggested that the prospect of Board of Governors of the Federal Reserve System (the Fed) policy changes and rising interest rates, which may cause increased volatility in the fixed income market and outflows from fixed income funds, would occur in a market environment much different from those in the past when dealer inventories provided adequate liquidity during periods of increased volatility.

Among other things, the Fixed Income Guidance suggested that a board overseeing a fixed income fund may consider communicating with the fund's investment adviser to determine what actions, if any, are being reviewed and considered to ensure the fund adequately addresses the changing fixed income environment, including risk management and appropriate disclosure. To assist investment advisers, the Fixed Income Guidance provided the following non-exhaustive list of steps that advisers may consider in light of the changing fixed income market conditions:

- **Assess and Stress Test Fund Liquidity Needs**—Section 22(e) of the Investment Company Act of 1940, as amended (the 1940 Act), requires funds to pay shareholders for shares tendered for redemption within seven days of tender. Consistent with this requirement, investment advisers generally assess on an ongoing basis a fund's liquidity as well as the fund's ability to meet potential redemption requests. The Fixed Income Guidance indicated that investment advisers may

consider assessing and stress testing fund liquidity during both normal and stressed market conditions, including over various periods of time (for example, one day, five days, 30 days or longer).

- **Conduct Additional Stress Tests and Scenario Analyses Assessing Factors Beyond Liquidity**—The Fixed Income Guidance suggested that, when constructing stress tests and scenario analyses, investment advisers may consider a variety of factors in addition to reduced market liquidity, including, among others, interest rate hikes, widening spreads, price shocks to fixed income products, and increased volatility.
- **Evaluate Fund Risk Management Strategies**—The Fixed Income Guidance noted that it may be prudent for investment advisers to evaluate existing risk management strategies to account for changing fixed income market conditions. Investment advisers also may consider whether additional actions should be taken with respect to a fund's portfolio composition, concentration, diversification, and liquidity.
- **Consider What Should Be Communicated to Fund Boards**—The Fixed Income Guidance stated that, in order to ensure that fund boards are fully informed, investment advisers may consider what additional information should be provided in order to inform boards of fund risk exposures and liquidity positions as well as the fund's ability to manage changing interest rate conditions and increased fixed income market volatility.
- **Assess the Adequacy of Shareholder Disclosures**—The Fixed Income Guidance suggested that funds should consider assessing shareholder disclosures to ensure that they adequately disclose the potential impact of the Fed "tapering" its quantitative easing program as well as potential rising interest rates, including the prospect for periods of volatility and increased redemptions. The Fixed Income Guidance stated that, to the extent a fund determines that its risk disclosures are insufficient, the fund should consider the appropriate manner of communicating risks to shareholders, such as through additional disclosures in the prospectus and/or shareholder reports.

No. 2014-02—"Unbundling of Proxy Proposals—Investment Company Charter Amendments" (February 2014)[7]

In February 2014, the Division published a guidance update in response to numerous inquiries from registrants seeking clarification related to amendments to fund charters in light of the "unbundling" requirements of Rule 14a-4 under the Securities Exchange Act of 1934, as amended (the Securities Exchange Act) (Unbundling Guidance).

Rule 14a-4 under the Securities Exchange Act

Rule 14a-4, in relevant part, requires that registrants identify clearly and impartially each separate matter to be acted upon in connection with proxy proposals and provide shareholders with the option to approve, disapprove or abstain from voting on each separate matter.[8] This requirement applies regardless of whether the matter is related to, or conditioned on, the approval of other matters.

Prior Guidance Related to "Unbundling"

Consistent with an interpretation previously published by the SEC's Division of Corporation Finance, the Unbundling Guidance reiterated that a matter should be voted separately if the 1940 Act, state law or a fund's organizational documents so require.[9] Although the Unbundling Guidance noted that proposed material amendments to a fund's organizational documents must be unbundled, it did not provide an explicit test for determining materiality within the context of Rule 14a-4. To determine materiality, the Division Staff noted that a fund should first consider the facts and circumstances of each matter and then determine whether the particular matter "substantively affects shareholder rights."[10]

Unbundling Guidance

To assist funds in determining whether a given proxy proposal should be presented separately, the

Unbundling Guidance provided the following non-exhaustive list of charter amendments that should be presented separately: (1) amending voting rights from one vote per share to one vote per dollar of net asset value; (2) authorizing a fund to involuntarily redeem small account balances; (3) authorizing a fund to invest in funds; (4) changing supermajority voting requirements; (5) authorizing the board to terminate a fund or merge with another fund without a shareholder vote; and (6) authorizing the board to make future amendments to the charter without a shareholder vote.

The Unbundling Guidance noted that, although each material amendment should be "unbundled," Rule 14a-4 does not prohibit a soliciting party from conditioning effectiveness of any proposal on the approval of one or more other proposals, if permitted by applicable state law. Moreover, the Division Staff noted that it generally has not objected to the bundling of proposals that are ministerial in nature or otherwise immaterial with respect to a single matter.

No. 2014-03—"Multi-Manager Funds—Aggregate Advisory Fee Rates" (February 2014)[11]

In February 2014, the Division published a guidance update relating to multi-manager funds to clarify the circumstances that may trigger an increase in the aggregate advisory rate and, therefore, require shareholder approval under certain exemptive orders (Multi-Manager Guidance). Multi-manager funds are funds that have received an exemptive order from the SEC to operate under a "multi-manager" structure, under which a fund's investment adviser generally selects and oversees sub-advisers that serve as the primary day-to-day managers for the fund. Such exemptive orders require, among other things, that the aggregate fee rate (for example, advisory and subadvisory fees) to be paid by a fund remains subject to shareholder approval.

Background

Section 15(a) of the 1940 Act, in relevant part, makes it unlawful for any person to serve or act as investment adviser of a fund, except pursuant to a written contract, which contract, whether with such fund or with an investment adviser of such fund, has been approved by a majority of the outstanding shareholders of that fund.[12] Notwithstanding Section 15(a), the SEC has routinely granted multi-manager exemptive orders that allow investment advisers to hire and/or terminate sub-advisers without first obtaining shareholder approval. The Multi-Manager Guidance, however, reiterated the longstanding requirement that the fund's primary advisory contract and any increases to the aggregate advisory rate must be approved by the vote of a majority of the outstanding voting securities of such fund.

Multi-Manager Exemptive Orders

As described in the Multi-Manager Guidance, there are two primary forms of multi-manager arrangements, which may be referred to as the "traditional" and "direct pay" models. Under the "traditional" model, a fund's primary investment adviser enters into contracts with, and is responsible for compensating, sub-advisers out of the advisory fee it receives from the fund. A shareholder vote would be required for any increase in the aggregate advisory fee, but increases in sub-advisory fees would not require shareholder approval, if the aggregate advisory fee remains the same. By contrast, under the "direct pay" model, a fund enters into contracts with, and compensates, the primary investment adviser and sub-advisers separately. According to the Multi-Manager Guidance, a "direct pay" multi-manager order includes a condition that requires the fund to seek shareholder approval for any sub-advisory contract change that would result in an increase in the aggregate advisory rate.

Potential Applicants for Multi-Manager Exemptive Orders

In the Multi-Manager Guidance, the Division Staff requested that all new multi-manager exemptive applications include an aggregate fee condition, which provides that any new sub-advisory contract

or any amendment to an existing advisory or sub-advisory contract that directly or indirectly increases the aggregate advisory fee must be submitted to fund shareholders for their approval.

Existing Multi-Manager Exemptive Orders

In response to numerous interpretive questions, the Multi-Manager Guidance provided the following non-exhaustive list of examples when shareholder approval would or would not be required in the context of the "direct pay" model:

- shareholder approval generally would be required when a fund hires its first sub-adviser, unless the rate that the fund pays the primary investment adviser under the advisory contract is proportionately reduced by at least the amount to be paid to the sub-adviser;
- shareholder approval generally would not be required when a fund hires an additional sub-adviser whose rate is no higher than (1) the rate of the sub-adviser being replaced or (2) the rate of another existing sub-adviser to which the investment adviser could have allocated the fund's assets being allocated to the new sub-adviser (for example, assets in the same asset class); and
- shareholder approval generally would not be required when a rate increase to a sub-adviser is accompanied by a corresponding decrease in the advisory contract of the rate payable to the primary investment adviser.

No. 2014-04—"Guidance on the Testimonial Rule and Social Media" (March 2014)[13]

In March 2014, the Division published a guidance update concerning the use of social media in investment adviser advertising (Social Media Guidance). In the Social Media Guidance, the Division Staff sought to clarify when registered investment advisers may use reviews available on independent social media sites without violating Rule 206(4)-1(a)(1) under the Investment Advisers Act of 1940, as amended (the Advisers Act), specifically as it relates to genuine third-party commentary that may be useful to consumers. The Division prepared this guidance update in a question and answer format.

Background

Generally, Section 206(4) of the Advisers Act prohibits investment advisers from engaging in any act, practice or course of business that the SEC, by rule, defines as fraudulent, deceptive or manipulative.[14] The SEC designed Rule 206(4)-1(a)(1) under the Advisers Act (the Testimonial Rule) to address the nature of testimonials when used by investment advisers in their advertisements. In particular, the Testimonial Rule prohibits the use of a testimonial by an investment adviser in advertisements "because the testimonial may give rise to a fraudulent or deceptive implication or mistaken inference, that the experience of the person giving the testimonial is typical of the experience of the adviser's clients."[15] However, the Testimonial Rule does not include a definition of what constitutes a testimonial. Notwithstanding the absence of such definition, the Division Staff historically has interpreted a testimonial to include, among other things, a "statement of a client's experience with, or endorsement of, an investment adviser."[16] Whether public commentary on a social media site is deemed a testimonial depends upon the facts and circumstances relating to the particular statement.

Third-Party Commentary on Social Media

In the Social Media Guidance, the Division Staff reiterated that the Testimonial Rule continues to generally restrict testimonials posted on an investment adviser's own social media site. However, the Division Staff acknowledged that the concerns of publishing testimonials on traditional media may not be present in social media because social media "allows for instantaneous updating of posted commentary and concurrent viewing of all of the comment history." In this regard, the Division Staff noted that an investment adviser's publication of testimonials from an independent social media site would not

raise any of the dangers that the Testimonial Rule is intended to prevent if the independent social media site is designed to make it equally easy for the public to provide negative or positive commentary about the investment adviser. Accordingly, the Social Media Guidance provided that an investment adviser may publish on its own social media website commentary from an independent social media site if there is:

- **Independence**—The commentary from the independent social media site is provided by commentators who are independent of the investment adviser. For example, the Social Media Guidance noted that an investment adviser who directed its employees to write reviews about the investment adviser on an independent social media site, and then subsequently used those testimonials in advertisements would violate the Testimonial Rule;
- **No Material Connection**—A material connection is present when an investment adviser exerts influence over the commentary by selectively censoring, accentuating, or otherwise editing the content. Further, the Social Media Guidance provided that a material connection between the investment adviser and an independent social media site could exist if the investment adviser compensated a social media user, either directly or indirectly, for writing the review. According to the Division Staff, advertising on an independent social media site would not necessarily impeach such site's independence or establish a material connection if: (1) it would be readily apparent to a reader that the advertisement is separate from the public commentary on the site; and (2) advertising revenue did not influence which public commentary is included or excluded from the site; and
- **Completeness**—An investment adviser must publish all of the testimonials regarding the investment adviser in their entirety. It is not permissible for the investment adviser to arrange the commentary in a manner that emphasizes favorable reviews while de-emphasizing negative reviews.

Ratings of Investment Advisers and Traditional Media Advertisements

The Division Staff noted that investment advisers may publish testimonials that include a mathematical average of the commentary, if the ratings are not based on a system that is designed to elicit any pre-determined results that could benefit the investment adviser. In addition, the investment adviser may not accompany such a rating with its own subjective analysis.

According to the Social Media Guidance, investment advisers are restricted in their ability to include public commentary from an independent social media site in traditional media advertisements such as in newspaper or television advertisements. With respect to these traditional media advertisements, investment advisers may only reference the fact that the public commentary regarding the investment adviser is available on particular social media sites, and may include the logos of such sites.

No. 2014-05—"Deregistration of Investment Companies: Applications on Form N-8F" (April 2014)[17]

In April 2014, the Division published a guidance update to assist registrants when responding to certain items in Form N-8F, the form funds submit to the SEC to deregister as an investment company under the 1940 Act (Deregistration Guidance). The Deregistration Guidance noted that a fund seeking an SEC order to deregister may file an application with the SEC on Form N-8F if the fund falls within one of four enumerated categories, which include a fund merger, liquidation or abandonment or a fund becoming a BDC.

The Deregistration Guidance outlined the Division Staff's process for reviewing Form N-8F, noting that the process includes a notice period of approximately 25 days. In most situations, the SEC issues an order granting the applicant's

deregistration request at the conclusion of the notice period. Although most Form N-8F filings proceed to notice based on the initial filing, the Division Staff has observed a number of common deficiencies in the initial applications filed on Form N-8F. To assist future applicants, the Division Staff identified several common deficiencies and provided guidance on how to appropriately respond to certain items to avoid these deficiencies:

- **Item 2**—This item requests the fund's name. The Division Staff noted that applicants should provide the name of the registrant as it appears on EDGAR. The Deregistration Guidance noted that applicants should avoid providing the name of any particular series of the registrant in response to this item. Additionally, applicants should ensure that the fund name provided in response to this item matches the name provided in the verification at the end of the Form N-8F.
- **Item 6**—This item requests information about the fund's contact person. The Deregistration Guidance noted that it is acceptable for the applicant to provide an email address where Division Staff comments, if any, can be forwarded.
- **Item 15(a)**—This item requests information relating to whether the fund's board has authorized the action leading to the deregistration. The Deregistration Guidance noted that, because unit investment trusts (UITs), including insurance company separate accounts organized as UITs, do not have a board, they should respond "not applicable," or otherwise note that as a UIT, the applicant does not have a board.
- **Item 25**—This item relates to an applicant filing on the basis of "Abandonment of Registration" either in the case of a fund that has never publicly offered securities and plans to wind up, or a fund or separate account that will continue to operate but qualifies for an exclusion from registration as an investment company under Sections 3(c)(1) or 3(c)(7) of the 1940 Act.[18] The Division Staff noted that funds routinely fail to identify which category applies and provided guidance on how to properly respond to this item.

No. 2014-06—"Series Investment Companies: Affiliated Transactions" (June 2014)[19]

In June 2014, the Division published a guidance update regarding certain transactions prohibited under the 1940 Act in the context of series investment companies (that is, an investment company that offers a number of investment portfolios under one company registered with the SEC) (Affiliated Transaction Guidance). In many respects, the Affiliated Transaction Guidance confirmed the Division Staff's position with respect to certain interpretive matters, but also raised certain compliance considerations.

Series Investment Companies

A series investment company is organized as a single trust or corporation, but offers several separate portfolios to shareholders. Such organizational structures afford fund complexes various operating efficiencies, including cost savings. Each series of a series investment company establishes investment objectives and investment policies separate from other series of the same company. However, each series is treated as a separate investment company for purposes of certain provisions of the 1940 Act.[20] Generally, the 1940 Act permits the use of series, yet it does not specifically contemplate how all of its requirements apply to series investment companies.

Affiliated Transactions

Section 17(a) of the 1940 Act generally prohibits an "affiliated person"[21] of a fund or an affiliated person of such person acting as principal from knowingly selling to, or purchasing from, the fund any security or property.[22] In the Affiliated Transaction Guidance, the Division Staff stated that Section 17(a) not only applies when a series is a party to a transaction, but

also when determining whether the counterparty to a fund transaction is an "affiliated person."

Compliance Policies and Procedures

Rule 38a-1 under the 1940 Act requires that funds adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws. The Affiliated Transaction Guidance indicated that Rule 38a-1 requires such policies and procedures be reasonably designed to prevent violations of the federal securities laws as they apply to each series. Accordingly, the Division Staff suggested that funds review their compliance policies and procedures for appropriate identification of "affiliated persons" with respect to each series for purposes of any transactions that may be prohibited by the 1940 Act. In addition, the Affiliated Transaction Guidance provided that a fund's policies and procedures should account for the identification of entities that own five percent or more of the total outstanding voting securities of the series company to which the series belongs for purposes of monitoring transactions with affiliated persons and preventing violations of the 1940 Act.[23]

No. 2014-07—"Private Funds and the Application of the Custody Rule to Special Purpose Vehicles" (June 2014)[24]

In June 2014, the Division published a guidance update explaining, among other things, how managers of hedge funds, private equity funds, and other private pooled investment vehicles (pooled investment vehicles) using special purpose vehicles (SPVs) and escrow accounts may comply with Rule 206(4)-2 under the Advisers Act (the Custody Rule) (Custody Guidance). The Division Staff noted that it has received inquiries, and OCIE has identified issues in examinations, regarding how the Custody Rule applies when investment advisers to pooled investment vehicles, particularly private equity funds, utilize: (1) SPVs when making investments; and (2) escrow accounts when selling interests in portfolio companies. The Custody Guidance provided clarity and relief for investment advisers that manage certain pooled investment vehicles that are subject to the provisions of the Custody Rule. In particular, the Custody Guidance provided four scenarios and the Division Staff's responses to each of these scenarios.

Custody Rule

Generally, Rule 206(4)-2 under the Advisers Act requires SEC-registered investment advisers that are deemed to have custody of client funds or securities, to maintain such funds or securities with a qualified custodian. An investment adviser to a pooled investment vehicle may comply with certain provisions of the Custody Rule by furnishing financial statements, audited by an independent public accountant, to each beneficial owner of a pooled investment vehicle it manages within 120 days of the vehicle's fiscal year end.[25]

The Commission stated in the adopting release related to the Custody Rule that to comply with certain provisions of the rule an investment adviser could either treat the SPV as a separate client, in which case the adviser will have custody of the SPV's assets, or treat the SPV's assets as assets of the pooled investment vehicles of which it has custody indirectly.[26] As a general matter, the Division Staff explained in the Custody Guidance that, if the investment adviser treats the SPV as a separate client, the Custody Rule requires the adviser to comply separately with the Custody Rule's audited financial statement distribution requirements and the adviser should distribute the audited financial statements of the SPV to the beneficial owners of the pooled investment vehicles that own the SPV. However, if the investment adviser treats the SPV's assets as assets of the pooled investment vehicle of which it has custody indirectly, such assets must be considered within the scope of the pooled investment vehicle's financial statement audit.

Custody Guidance

In the Custody Guidance, the Division Staff outlined the following four scenarios that relate to the

application of the audit provision of the Custody Rule (summarized above) to SPVs utilized by pooled investment vehicles: (1) an SPV used by a vehicle for a single investment; (2) an SPV used by multiple related vehicles to make a single investment; (3) an SPV used by one or more related vehicles to make several investments; and (4) an SPV used by one or more related vehicles and at least one third-party investor to make at least one investment (an investment fund).

The Custody Guidance provided that a separate audit of the SPV, and a distribution of the audited financial statements of the SPV to the beneficial owners of the pooled investment vehicles that own the SPV, is not necessary for scenarios (1) through (3) above if (i) the SPV's assets are included in the scope of the audited financial statements of the pooled investment vehicles advised by the adviser and (ii) the SPV is not owned by anyone other than the adviser, the adviser's related persons or the pooled investment vehicle client that is controlled by the adviser or its related persons. If these requirements are not satisfied then a separate audit and distribution of the SPV's financial statements must be performed to comply with the provisions of the Custody Rule. With respect to scenario (4) above, the Division Staff noted that an investment adviser to a pooled investment vehicle should treat the assets of the investment fund as a separate client for the purposes of the Custody Rule and comply with the Custody Rule's audited financial statement distribution requirements for the investment fund separately from those of the pooled investment vehicle.

The Custody Guidance provided that the Division Staff would not object if an investment adviser to a pooled investment vehicle maintains assets owned by the vehicle in an escrow account with other client or non-client assets if: (i) the portion of the escrow attributable to the pooled investment vehicle is included in the vehicle's audited financial statements; (ii) the escrow account is formed in connection with the sale or merger of a portfolio company that the vehicle owns; (iii) the escrow account contains an amount of money that was agreed upon by the buyer and seller following bona fide negotiations; (iv) the escrow account exists only for the period of time agreed upon during the negotiations; (v) the escrow account is maintained at a qualified custodian; and (vi) the sellers' representative is contractually obligated to promptly distribute the funds remaining in the escrow account to the sellers at the end of the escrow period that is based upon a predetermined formula.

No. 2014-08—"Guidance Regarding Mutual Fund Enhanced Disclosure" (June 2014)[27]

In June 2014, the Division published a guidance update based on comments the Division has provided to mutual funds related to prior amendments to mutual fund disclosure requirements and "to focus funds on certain form and rule requirements to provide investors with improved disclosure" (Disclosure Guidance). The Disclosure Guidance set forth the Division Staff's observations and positions with respect to a number of disclosure matters, including the summary section of the mutual fund statutory prospectus (Summary Prospectus), plain English requirements and cross references. As a general matter, the Disclosure Guidance provided that the SEC intended its enhanced mutual fund disclosure amendments adopted in 2009 (2009 Amendments) would provide investors with a brief and clear summary of the fund's key information that they need before making an investment decision.[28]

Since the 2009 Amendments, the Division Staff noted that it has observed a significant number of prospectuses that contained "complex, technical and duplicative" disclosure or "unnecessarily long" Summary Prospectuses, which the Division Staff views as undermining the usefulness of the Summary Prospectus. To avoid constraining appropriate disclosure, the Division Staff noted that the SEC opted not to impose page limits on the Summary Prospectus. However in the Disclosure Guidance, the Division Staff noted that the Summary Prospectus should only be approximately three or four pages in length. The Disclosure Guidance noted that the Division Staff has continually provided general comments to

the initial Summary Prospectus filings for various fund groups to ensure that the disclosure is concise and only contains the specific disclosure required by Form N-1A. Based on comments that it has provided funds and their counsel, the Division Staff provided the following guidance intended to assist funds in providing clear disclosure to investors:

- **Adhere to Summarization**—The Summary Prospectus should contain only a summary of the fund's principal investment strategies and risks. The Division Staff reiterated that principal investment strategies and risks in Item 4 of Form N-1A should be a summary of the information provided in response to Item 9 of Form N-1A. Accordingly, funds should avoid providing duplicative information in response to Items 4 and 9. Additionally, the Division Staff noted that it will continue to remind funds that provide long and complex disclosure in the Summary Prospectus that the purpose of this section is to provide a clear and concise summary of the fund's key information.
- **Plain English**—Form N-1A requires the Summary Prospectus be written in a manner that is clear, concise and possible for the average investor to easily understand. Notwithstanding this requirement, the Division Staff noted that it has observed that funds continue to use technical terms and compound sentences that are difficult for investors to understand.
- **Only Include Required or Permitted Information**—The Disclosure Guidance emphasized that the Summary Prospectus may only include the information or disclosure that is permitted or required by the applicable items of Form N-1A (that is, Items 2 through 8). A fund may include information elsewhere in the prospectus or SAI that is not otherwise required by Form N-1A.
- **Inclusion of Non-Principal Strategies and Risks in the Prospectus**—A fund is permitted to disclose in its prospectus, other than the summary section, information that is not otherwise required by Form N-1A. In the Division Staff's view, any information related to non-principal strategies and risks should be clearly identified as such.
- **Avoid Cross References**—Form N-1A provides that funds should avoid in the prospectus cross-references to the SAI or shareholder reports. Form N-1A also provides that funds may include internal cross-references in the prospectus, which are most helpful when designed to assist investor understanding of the information presented in the prospectus and do not add complexity to the prospectus. In the Division Staff's view, funds should delete cross-references within the prospectus to streamline the prospectus.

The Disclosure Guidance encouraged investment companies to review their previous responses to items in Form N-1A in light of the observations contained in the Disclosure Guidance.

No. 2014-09—"Business Development Companies With Wholly-Owned SBIC Subsidiaries—Asset Coverage Requirements" (June 2014)[29]

In June 2014, the Division published a guidance update regarding the requirements under exemptive orders for BDCs providing limited relief from certain asset coverage requirements under Sections 18(a) and 61(a) of the 1940 Act (Asset Coverage Guidance). The exemptive orders granted in this regard permit a BDC to treat certain indebtedness issued by its wholly owned subsidiary operating as a small business investment company (SBIC) as indebtedness not represented by senior securities for purposes of determining the BDC's asset coverage. The Asset Coverage Guidance responds to the Division Staff's recent understanding that certain BDCs have sought to rely on this relief from the asset coverage requirements even when the indebtedness issued by the SBIC is not held or guaranteed by the Small Business Administration (SBA). In the Asset

Coverage Guidance, the Division Staff expressly indicated that it "does not believe that reliance on the relief for this purpose is consistent with the representations historically included in the exemptive applications."[30]

Background

The 1940 Act generally prohibits a BDC from issuing a class of senior securities unless the company complies with certain asset coverage requirements. Absent the limited relief from such asset coverage requirements provided by exemptive orders, a BDC could be deemed an indirect issuer of any class of senior securities issued by its direct or indirect wholly-owned SBIC subsidiary because the asset coverage requirements would apply on a consolidated basis.

To avoid such outcomes, exemptive orders allow BDCs to treat certain indebtedness issued by their wholly-owned SBIC subsidiaries as indebtedness not represented by senior securities for purposes of determining the BDC's consolidated asset coverage. However, the Asset Coverage Guidance noted that, because SBICs are already subject to SBA leverage and capital requirements, there is no need to impose duplicative regulatory burdens on these entities. The Asset Coverage Guidance also noted that, when an SBIC subsidiary has issued indebtedness that is not fully subject to the regulatory requirements of the SBA, the Division Staff believes the asset coverage requirements are appropriate to ensure adequate oversight of the indebtedness issued by the SBIC subsidiary.

Potential Applications for Orders and Compliance with Existing Orders

Although the Division Staff stated its belief that the rationale for exemptive relief in this context implied a condition that the SBA guarantee the SBIC's indebtedness, in the Asset Coverage Guidance the Division Staff explicitly requested a modified condition be included in all future exemptive applications. Specifically, future applicants must include the following condition in their applications for relief from the "asset coverage" requirements, "[a]ny senior securities representing indebtedness of an SBIC subsidiary will not be considered senior securities and, for purposes of the definition of "asset coverage" in Section 18(h), will be treated as indebtedness not represented by senior securities but only if the SBIC subsidiary has issued indebtedness that is held or guaranteed by the SBA." The Asset Coverage Guidance effectively provides that, to comply with the Division Staff's position, any BDCs that currently rely on an SEC exemption from the asset coverage requirements must now comply with the provisions set forth in the modified condition.

No. 2014-10—"Mixed and Shared Funding Orders" (October 2014)[31]

In October 2014, the Division published a guidance update intended to respond to certain inquiries as well as to clarify regulatory obligations and reduce unnecessary compliance burdens regarding mixed and shared funding arrangements (Mixed and Shared Funding Guidance). The Mixed and Shared Funding Guidance expressly provided that a mutual fund is not required to obtain a "mixed and shared funding order" prior to offering its shares as an investment option under variable life and/or annuity contracts and a fund that has previously obtained such an order is not required to comply with the terms and conditions of the order if the fund is not relying on the exemptions granted by the order.[32] The Mixed and Shared Funding Guidance also provided guidance on certain other related technical matters, which are summarized below.

"Mixed Funding" generally refers to the sale of a mutual fund to variable life insurance companies or when the fund is utilized as an investment option in both variable life insurance contracts and retirement plans. "Shared Funding" is when mutual fund shares are offered as an investment option in variable insurance contracts that are issued by various unaffiliated insurance companies.

The Mixed and Shared Funding Guidance noted the infrequent reliance on exemptions provided by

mixed and shared funding exemptive orders. The 1940 Act prohibits neither "mixed funding" nor "shared funding" arrangements. However, a mutual fund may not rely on certain exemptions under the 1940 Act, unless it obtains and complies with the restrictions set forth in a mixed and shared funding order. These orders set forth conditions that, among other things, require the underlying fund to monitor participating insurers for potential conflicts of interest. These exemptions provide limited relief from certain restrictions under Sections 9(a), 13(a) and 15(a) and (b) of the 1940 Act.[33] If a mutual fund engages in mixed and shared funding without obtaining an exemptive order, a participating insurer will not have the benefit to rely on the exemptions typically granted by such orders. However, as noted in the Mixed and Shared Funding Guidance, "the absence of these exemptions . . . may be of limited, or no, practical significance given the infrequency of reliance on the exemptions."

Based on the infrequent reliance on the exemptions provided by mixed and shared funding orders and the limited practical significance of such exemptions, the Division encouraged insurance companies that issue variable insurance contracts, mutual funds that offer their shares as investment options under the contracts, and advisers to those funds to "carefully consider the staff's views in determining whether to apply for mixed and shared funding orders." For example, the Mixed and Shared Funding Guidance suggested that these persons consider whether any parties are relying on mixed and shared funding orders and, if not, whether continued compliance with any conditions of these orders is necessary. The Mixed and Shared Funding Guidance also suggested that insurers that issue variable insurance contracts and mutual funds that offer their shares as investment options under those contracts consider whether it may be appropriate to revise the terms of any participation agreements between the insurer and the mutual fund to eliminate any provisions relating to compliance with mixed and shared funding orders.

No. 2014-11—"Investment Company Consolidation" (October 2014)[34]

In October 2014, the Chief Accountant's Office of the Division published a guidance update on the presentation of consolidated financial statements for certain investment companies, including feeder funds and fund of funds that are registered under the 1940 Act as well as BDCs that have wholly-owned subsidiaries (Consolidation Guidance). Under Regulation S-X, which governs the presentation of financial statements filed pursuant to certain federal securities laws, investment company financial statements may be consolidated if such presentation is more meaningful than separate financial statements. Generally, Regulation S-X presumes that consolidated financial statements are "more meaningful than separate statements . . . and usually necessary for a fair presentation when one entity directly or indirectly has a controlling interest in another entity."[35] However, Regulation S-X permits registered investment companies and BDCs to consolidate their financial statements only with the financial statements of its subsidiaries that are also investment companies.[36]

Registered Funds that are Feeder Funds or Funds of Funds

The Consolidation Guidance noted that a feeder fund in a master-feeder structure or a fund that is a fund of funds in the same group of investment companies may have a "controlling interest in another entity" for purposes of Regulation S-X. With respect to feeder funds and funds of funds, the Division Staff generally takes the position that the presentation of financial statements on an unconsolidated basis is most meaningful. For feeder funds, the Chief Accountant's Office believes that, "because a feeder fund typically is one of several investors in the master fund, [unconsolidated] disclosure provides a meaningful and appropriately transparent presentation of the financial position and results of operations of the feeder fund." This is contingent on the fact that, among other things, (1) the feeder

fund attaches the financial statements of the master to its own financial statements, (2) if a master fund is organized as a partnership, the feeder fund must provide separate disclosure of certain income figures attributable to the master fund on its income statement, and (3) if the master fund is organized as a partnership, the feeder fund must include certain income and expense ratios in its financial highlights. Similarly, the Chief Accountant's Office has taken the position that funds of funds should display their financial statements on an unconsolidated basis as it provides a more meaningful and transparent illustration of the funds' financial position, particularly because a fund of funds typically invests in multiple underlying funds and its interest in some underlying funds may fluctuate between controlling and non-controlling.[37]

BDCs with Wholly-Owned Subsidiaries

In the Consolidation Guidance, the Division Staff noted that some BDCs do not consolidate their wholly-owned subsidiaries, "even though the design and purpose of the subsidiary may be to act as an extension of the BDC's investment operations and to facilitate the execution of the BDC's investment strategy." According to the Consolidation Guidance, however, BDCs generally should consolidate wholly-owned subsidiaries because such "consolidation provides investors with the most meaningful financial presentation in those statements."

No. 2014-12—"Business Development Companies—Transactions with Certain Second-Tier Affiliates" (December 2014)[38]

In December 2014, the Division published a guidance update to provide assistance to BDCs and their counsel in determining what restrictions, if any, apply to certain co-investment transactions between a BDC and its second-tier affiliates (Second-Tier Affiliates Guidance). In particular, the Second-Tier Affiliates Guidance analyzed whether certain transactional restrictions under the 1940 Act apply to limited partners of a partnership that is an "affiliated person" of the BDC, as such term is defined under the 1940 Act.[39]

Background

Generally, the 1940 Act places certain restrictions on, among other things, transactions between BDCs and their affiliated persons and affiliated persons of that person. Congress designed such restrictions to protect BDCs from undue influence and overreaching by their affiliates. Specifically, the 1940 Act distinguishes between transactions that involve "close affiliates"[40] and those involving "remote affiliates."[41] Although certain transactions between a "close affiliate" and a BDC are prohibited, BDCs may enter into transactions with a "remote affiliate" if the transactions are approved by a majority of the BDC's directors in accordance with requirements set forth under the 1940 Act.

Question Presented to Division Staff

The Division Staff was asked whether a certain second-tier affiliate of a BDC may be treated as a remote affiliate in the following situation:

- The BDC and a private fund that is organized as a limited partnership are under "common control" (as such term is defined under the 1940 Act) because the BDC's investment adviser controls the BDC and is either the general partner of the private fund or there is some element of control present between the fund and general partner.[42] The Division Staff noted that, because the private fund is under common control with the BDC, it must be classified as a "close affiliate" under the 1940 Act.
- A limited partner of the private fund would be considered to be an affiliated person of the BDC because the limited partner (1) is a partner of the private fund and (2) owns between five percent and 25 percent of the private fund's outstanding voting shares. Because the limited partner is a "close affiliate" of the private fund, and the private fund is a "close affiliate" of the BDC, the

limited partner would be considered to be a close affiliate and, therefore, prohibited from entering into certain transactions with the BDC under the 1940 Act. However, the Division Staff indicated that the limited partner would be deemed to be a "remote affiliate" if the private fund is a corporation whereby the limited partner would only be a shareholder of the BDC.

Previously, the Division Staff has indicated that limited partners and shareholders should generally be treated similarly. Accordingly, the Second-Tier Affiliates Guidance provided that, where a limited partner is a close affiliate of the BDC only because of the organizational structure of the private fund and is merely seeking to co-invest with the BDC, then "[t]he Limited Partner may be treated as if it were a shareholder of the Private Fund for purposes of determining whether it is a close or remote affiliate of the BDC." Therefore, the limited partner would be treated as a "remote affiliate" under the 1940 Act whether or not the BDC is a partnership or corporation.

No. 2014-13—"Key Employee Trusts Under the Family Office Rule" (December 2014)[43]

In December 2014, the Division published a guidance update in response to questions about whether certain key employee trusts would qualify as family clients pursuant to Rule 202(a)(11)(G)-1 under the Advisers Act (Family Office Guidance).[44] Specifically, the Division Staff has been asked: (1) whether certain decision making powers of the trust can be bifurcated between a key employee and a non-key employee; and (2) whether the key employee who contributed assets to the trust must also be the same key employee permitted to make decisions on behalf of that trust.

Background

Rule 202(a)(11)(G)-1 (Family Office Rule) provides an exception from the Advisers Act definition of investment adviser for families that manage their own wealth through a family office that provides advice solely to family clients (as defined in the Family Office Rule). The Family Office Rule permits family offices to include as family clients certain non-family members, such as key employees whose position and experience should enable them to protect themselves. In addition, family offices may include certain investment entities through which those key employees may invest in opportunities connected to the family office. These investment entities include, "[a]ny trust of which: Each trustee or other person authorized to make decisions with respect to the trust is a key employee; and each settler or other person who has contributed assets to the trust is a key employee or the key employee's current and/or former spouse or spousal equivalent… ."

Questions Presented

(1) Whether certain decision making powers of the trust can be bifurcated between a key employee and a non-key employee?

The Division Staff articulated its position that a non-key employee may make administrative/non-investment decisions for a trust so long as all investment decisions are made by a key employee. In the adopting release to the Family Office Rule, the Division Staff noted that family offices may advise a trust for which the key employee is solely responsible for all investment decisions.[45] Accordingly, the Division Staff stated that a trust may qualify as a family client if a non-key employee makes administrative/non-investment decisions for the trust. Although the Advisers Act does not specifically provide a definition of investment decision, the Family Office Guidance noted the following examples of administrative/non-investment duties that generally do not involve making investment decisions: (1) preparing and filing tax returns for the trust; (2) keeping records for the trust; or (3) distributing periodic statements or disclosures to trust beneficiaries.

(2) Whether the key employee who contributed assets to the trust must also be the same key employee permitted to make decisions on behalf of the trust?

The Division Staff indicated that, under the Family Office Rule, one key employee may make investment decisions on behalf of another key employee's trust. The Family Office Guidance noted that this approach is consistent with the Family Office Rule, because investment decisions would be made solely by a key employee regardless of the fact that he or she is a different key employee than the key employee who contributed assets to the trust.

Potential Implications

Although the guidance updates provide a mechanism for the Division to convey its views and positions to the industry, certain concerns have been expressed with respect to the *Guidance Update* initiative, including the inability of the industry or other interested parties to have an opportunity to review and comment on guidance that may have significant regulatory or business implications and that the guidance updates are published outside of the SEC's rulemaking process.[46] In addition, there is a concern that the SEC, or its various divisions and offices, may ascribe more importance to the Staff views expressed in the guidance updates than should be given to those views. For example, shortly after the publication of the Fixed Income Guidance, OCIE issued sweep examination request letters to various fund groups seeking information on fixed income fund holdings with particular emphasis placed on matters with respect to liquidity risks associated with their holdings, which were items raised in the Fixed Income Guidance. The OCIE letters also generally requested copies of certain fund records, including board minutes and the results of any stress tests that had been conducted on the fixed income securities that were held in fund portfolios. Additionally, funds have received comments from Division Staff during routine registration statement reviews that specifically cite to the Disclosure Guidance, presumably as an authoritative source.

In light of the potential implications of the *Guidance Update* initiative, funds, investment advisers, boards, participating insurance companies, and other industry members may wish to carefully review and consider the views expressed in the guidance updates. A brief overview of certain general practice points is provided below, which should be considered in light of the facts and circumstances particular to each fund, adviser, board, insurer and other industry member.

Potential Updates to Policies and Procedures

Funds and fund advisers may wish to consider identifying the policies and procedures implicated by the guidance updates, including policies and procedures designed to address liquidity and risk monitoring as well as the identification of affiliates, and review and revise such policies and procedures to the extent they determine to be necessary or appropriate. Advisers also may wish to consider whether any additional actions are advisable to address the matters discussed in the guidance updates and whether reports on such review and related actions to a fund's board are appropriate.

- A review of policies and procedures relating to monitoring risks associated with fixed income funds may include updating liquidity determination procedures and stress testing the fund's portfolio under scenarios of varying market volatility.
- In addition, mutual funds may consider developing or enhancing appropriate procedures to identify and monitor potential fund affiliates based on ownership of fund voting securities in light of the Affiliated Transaction Guidance. The Division Staff suggested that mutual funds review their compliance policies and procedures for appropriate identification of "affiliated persons" at the individual series and series company level for purposes of identifying any transactions that may be prohibited by the 1940 Act. Such procedures may vary from fund to fund, but could, for example, include the categorization of accounts during the account application process (for example, whether an omnibus account holder has voting discretion with respect to

shares held in the account), arrangements to flag beneficial or record owners of greater than a certain percentage of fund shares (for example, three percent) for additional monitoring, and agreements with omnibus account holders to inform funds when a beneficial owner owns a certain percentage of fund shares.

- In the Asset Coverage Guidance, the Division Staff articulated its position that, to comply with a representation included in existing exemptive orders granting limited relief from the asset coverage requirements of Sections 18(a) and 61(a) of the 1940 Act, any indebtedness issued by an SBIC subsidiary should be subject to the SBA's separate oversight. Although many exemptive orders may not expressly require that any indebtedness issued by an SBIC subsidiary be held or guaranteed by the SBA, BDCs relying on existing exemptive orders in this context may wish to consider complying with the Division Staff's belief set forth in the Asset Coverage Guidance. Such a BDC may also wish to consider reviewing and revising, as appropriate, existing compliance policies and procedures that are reasonably designed to ensure ongoing compliance with each representation and condition of the order, including the Division Staff's interpretation described in the Asset Coverage Guidance.[47]

Potential Updates to Disclosures

Funds and advisers may wish to review existing disclosure documents and disclosure preparation and review practices and procedures based on applicable guidance updates.

- Funds and advisers may wish to consider whether any changes to the disclosures they provide to investors would be necessary or appropriate in light of the Disclosure Guidance. For example, the Disclosure Guidance highlighted certain rule and form requirements that, although not exhaustive, are intended to focus mutual funds on providing investors with clear and concise disclosure. Accordingly, mutual funds may wish to consider reviewing existing fund disclosures to identify potential enhancements to existing disclosure, including summarizing principal investment strategies and principal risks in the Summary Prospectus.
- In light of the Fixed Income Guidance, funds and fund advisers may also wish to consider reviewing fixed income related disclosures, including risk disclosures, descriptions of investment strategies and the flexibility afforded to a fund in connection with taking a temporary defensive position in certain market conditions.
- Moreover, advisers may wish to consider the Social Media Guidance when deciding whether and how to use commentary available on independent social media sites in light of the requirements set forth in the Testimonial Rule under the Advisers Act. Because the Social Media Guidance appears to provide additional opportunities to use social media as a means of advertising, the Division Staff set forth only limited guidance with respect to applying the Testimonial Rule in the context of social media advertising. As a result, advisers may consider reviewing the Testimonial Rule and the Social Media Guidance before using such commentary in their marketing efforts, including the potential increased use of social media.

Potential Updates to Filings with the SEC

In addition to prospectus disclosure, certain guidance updates addressed matters relating to other filings made with the SEC that funds and fund advisers may consider in connection with the preparation of such filings.

- The Deregistration Guidance provided an overview of common deficiencies in applications for deregistration. Accordingly, funds, fund advisers and other applicants should be mindful of the Deregistration Guidance in connection with the filing of a Form N-8F. Applicants may also

consider the items set forth in Form N-8F that require action, either prior or subsequent to filing the Form N-8F, in order to ensure compliance with the representations contained therein (for example, in the case of a registered fund becoming a private fund, that certain investment limitations and other requirements under the 1940 Act will no longer apply).

- The Unbundling Guidance provided the Division's perspective on the presentation and mechanics of shareholder voting on certain matters. Funds and fund advisers should be aware of the non-exhaustive list of charter amendments that should be presented separately and consider seeking the advice of counsel in connection with determining whether an amendment to a fund's organizational documents is material for purposes of Rule 14a-4 and the Unbundling Guidance.
- Certain registered investment companies may wish to consider the Consolidation Guidance when determining the appropriate presentation of their financial statements. As noted earlier, Regulation S-X permits registered investment companies to consolidate their financial statements if such presentation is more meaningful than separate financial statements. When making this determination, registered investment companies and BDCs should be mindful that they are only permitted to consolidate their financial statements with subsidiaries that are also investment companies. Master-feeder funds and funds-of-funds should be particularly attentive to the Division's views set forth in the Consolidation Guidance.

Conclusion

Although the 13 guidance updates published by the Division during 2014 received a mixed reception from the investment management industry, they offer insight into the Division's views and interpretations of discrete issues of interest to the industry. In addition, they have served as a basis for formal and informal initiatives of OCIE. Accordingly, the investment management industry should continue to be mindful, and consider the potential implications, of the Division's guidance updates.

Mr. Murphy is a partner, and **Messrs. Cohen, Catano** and **McGrady** are associates, in the Financial Services Group of Dechert LLP.

NOTES

1 Norm Champ, Director, SEC Div. of Inv. Mgmt., Remarks to the 2014 Mutual Funds and Investment Management Conference (Mar. 17, 2014) , available at: *http://www.sec.gov/News/Speech/Detail/Speech/1370541168327#.VH-2yK0g-r8*.

2 IM Guidance Update, Compliance With Exemptive Orders (May 2013), available at: *http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-02.pdf*; IM Guidance Update, Counterparty Risk Management Practices With Respect to Tri-Party Repurchase Agreements (July 2013), available at: *http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-03.pdf*; IM Guidance Update, Fund Names Suggesting Protection From Loss (Nov. 2013), available at: *http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-12.pdf*.

3 Norm Champ, Director, SEC Div. of Inv. Mgmt., Remarks to the ICI 2014 Securities Law Developments Conference, available at: *http://www.sec.gov/News/Speech/Detail/Speech/1370543675348#.VI4i660tAq0*.

4 SEC Div. of Inv. Mgmt., 2013: Div. of Inv. Mgmt. Year in Review, (Mar. 2014), available at: *http://www.sec.gov/investment/reportspubs/annual-reports/2013-Information+Update.pdf*; *see also* Champ *supra* n.1.

5 Champ, *supra* n.3.

6 IM Guidance Update, Guidance Regarding Fixed Income Market Conditions (Jan. 2014), available at: *http://www.sec.gov/divisions/investment/guidance/im-guidance-2014-1.pdf*

[7] IM Guidance Update, Guidance Regarding Unbundling of Proxy Proposals (Feb. 2014), available at: *http://www.sec.gov/divisions/investment/guidance/im-guidance-2014-02.pdf.*

[8] *See* Rule 14a-4 under the Securities Exchange Act (unbundling of proxy proposals to be acted upon by shareholders). Unbundling is not a new concept and has long been the position of the SEC and its Staff. *See* Securities Exchange Act Release No. 31326 (Oct. 16, 1992); 57 Fed. Reg. 48276, 48287 (Oct. 22, 1992).

[9] *See*, *e.g.*, *Division of Corporate Finance Manual of Publicly Available Telephone Interpretations, Fifth Supplement* (Sept. 2004).

[10] Guidance Regarding Unbundling of Proxy Proposals, *supra* n.7.

[11] IM Guidance Update, Guidance Regarding Multi-Manager Orders (Feb. 2014), available at: *http://www.sec.gov/divisions/investment/guidance/im-guidance-2014-03.pdf.*

[12] *See* § 15(a) of the 1940 Act.

[13] IM Guidance Update, Guidance Regarding Testimonial Rule and Social Media (Mar. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-04.pdf.*

[14] 15 U.S.C. § 80b-6(4).

[15] *See* Richard Silverman, Staff No-Action Letter (pub. avail. March 27, 1985).

[16] *See* Cambiar Investors, Inc., Staff No-Action Letter (pub. avail. Aug. 28 1997).

[17] IM Guidance Update, Guidance Regarding Deregistration of Investment Companies (Apr. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-05.pdf.*

[18] *See* § 3(c)(1) of the 1940 Act. A 3(c)(1) fund is excluded from registration under the 1940 Act so long as the fund is not owned by more than 100 accredited investors (as defined by Rule 501 under the Securities Act of 1933, as amended) and the fund is not making a public offering of its securities. *See also* § 3(c)(7). Similarly, funds relying on the 3(c)(7) exclusion from registration offer their interests through private offerings. However, interests in funds relying on this exclusion may only be purchased by "qualified purchasers."

[19] IM Guidance Update, Guidance Regarding Series Investment Companies (Jun. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-06.pdf.*

[20] *See*, *e.g.*, Rule 17a-7 under the 1940 Act (exempting from the prohibition in § 17(a), among other things, certain transactions between an affiliated person and a series).

[21] *See* § 2(a)(3) of the 1940 Act.

[22] *See* § 17(a) of the 1940 Act.

[23] The statement that funds should monitor for affiliation of persons owning five percent or more of the shares of the "series company" – *i.e.*, at the registrant level – was called "a surprising and expansive reading of the application of the prohibitions against affiliated transactions to series companies" in an article on the guidance. *See* Jeffrey S. Puretz and William J. Bielefeld, "SEC Staff Reminds Funds about Affiliated Transaction Prohibitions," in *The Investment Lawyer*, Vol. 21, No. 11 (Nov. 2014).

[24] IM Guidance Update, Guidance Regarding Private Funds and the Custody Rule (June 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-07.pdf.*

[25] An adviser to a pooled investment vehicle that does not rely on this audit provision must, among other things, obtain an independent verification of the pooled investment vehicle's funds and securities and have a reasonable basis for believing that the qualified custodian sends quarterly account statements to each limited partner (or member or other beneficial owner). *See* Rule 206(4)-2(a)(2)-(5) under the Advisers Act.

[26] *Custody of Funds or Securities of Clients by Investment Advisers*, SEC Release No. IA-2968 (Dec. 30, 2009).

[27] IM Guidance Update, Guidance Regarding Mutual Fund Enhanced Disclosure (June 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-08.pdf.*

[28] *See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, Investment Company Act Release No. 28584 (Jan. 13, 2009), available at: *http://www.sec.gov/rules/final/2009/33-8998.pdf.*

[29] IM Guidance Update, Guidance Regarding BDC Asset Coverage (Jun. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-09.pdf*.

[30] *Id*.

[31] IM Guidance Update, Guidance Regarding Mixed and Shared Funding Orders (Oct. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-10.pdf*.

[32] The Division Staff noted that the parties who may rely on exemptions provided by a mixed and shared funding order include insurance companies offering contracts under which the mutual fund shares are offered as an investment option, as well as advisers and underwriters of the fund that are affiliated with those insurance companies.

[33] For example, the exemptions from § 9(a) provided by the rules generally permit an insurance company or an affiliate that has an officer, director or employee who is ineligible under § 9(a), to serve as investment adviser, depositor or principal underwriter with respect to an underlying fund, as long as the ineligible individual does not participate in the management or administration of the fund. The exemptions from §§ 13(a), 15(a), and 15(b) permit an insurance company in narrowly circumscribed situations to disregard instructions of contract owners in voting underlying fund shares on matters relating to the appointment of an adviser or principal underwriter and on matters that could result in changes to the sub-classification of the fund or to its investment objectives.

[34] IM Guidance Update, Guidance Regarding Investment Company Consolidation (Oct. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-11.pdf*.

[35] *See* Rule 3A-02 of Regulation S-X; *see also* Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) paragraph 810-10-10-1.

[36] *See* Rule 6-03(c) of Regulation S-X.

[37] The Consolidation Guidance also noted that a fund of funds should consider whether investments in a single underlying fund may be so significant to the fund of funds that its presentation of financial statements should be made in a manner similar to a master-feeder fund.

[38] IM Guidance Update, Guidance Regarding Second-Tier Affiliates (Dec. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-12.pdf*.

[39] *See* § 2(a)(3) of the 1940 Act.

[40] *See* § 57(b) of the 1940 Act.

[41] *See* § 57(e) of the 1940 Act.

[42] *See* § 2(a)(9) of the 1940 Act.

[43] IM Guidance Update, Guidance Regarding Family Office Rule (Dec. 2014), available at: *http://www.sec.gov/investment/im-guidance-2014-13.pdf*.

[44] Rule 202(a)(11)(G)-1 under the Advisers Act.

[45] *See Family Offices*, Investment Advisers Act Release No. 3220 at 37990 (June 22, 2011); 76 Fed. Reg. 37983 (June 29, 2011).

[46] *See* US Securities and Exchange Commission, "Rulemaking, How it Works" (last visited on December 14, 2014) available at *http://www.sec.gov/answers/rulemaking.htm*. Typically, the SEC's rulemaking process begins with a rule proposal, which must be approved by a majority of the Commissioners. Once approved, the rule proposal is published for public notice and comment for a specified time period, usually between 30 and 60 days. The public's comment letters on a rule proposal are considered as a final rule is drafted and are discussed in the adopting release. When the SEC approves a final rule by a vote of the Commissioners, the new rule then becomes part of the official rules that govern the securities industry.

[47] *See also* IM Guidance Update, Compliance With Exemptive Orders *supra* n.2 (suggesting that entities address the risk of failing to comply with the representations and conditions of exemptive orders by adopting and implementing policies and procedures, for example under Rule 38a-1 of the 1940 Act, that are reasonably designed to ensure ongoing compliance with each representation and condition of the orders).

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