# HENDERSON & LYMAN

## DERIVATIVES & SECURITIES REGULATORY UPDATE

APRIL 2010

## *Welcome to our Inaugural Newsletter*

We are pleased to provide our clients and friends with a quarterly update of the many regulatory issues that may impact your business.

Given the financial market turmoil in 2008 and 2009, CFTC and SEC registrants and various market participants have never been bombarded with the prospect of more regulation. Our goal in this newsletter is not only to alert you to these developments, but to help you identify the implications that these developments may have on your business.

The breadth of recent developments is nothing short of unprecedented: Members of Congress have introduced dozens of bills aimed at numerous aspects of the derivatives and securities industries, ranging from hedge fund registration and reporting requirements to limits on speculative trading to bans on certain types of products, such as credit default swaps. At the same time, the CFTC and the SEC have continued their calls for increased regulation, and have advocated stringent requirements for OTC derivatives and market participants and proposed significant limits on speculative trading, among many other proposals.

At Henderson & Lyman, we understand that these developments are both significant and complex, and we look forward to helping you plan accordingly.

If you would like to discuss any of the topics mentioned in this newsletter, please call your Henderson & Lyman attorney or (312) 986-6960.

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# *Derivatives Developments*

## *FINANCIAL MARKET REFORM*

### Dodd Introduces Sweeping Financial Market Reform Bill

Based upon the financial turmoil during 2008 and 2009, a number of financial proposals have been tendered by legislators, trade associations, and regulators. One of the most recent regulatory proposals was introduced without bipartisan support by Senate Banking Committee Chairman Christopher Dodd on March 15, 2010. The "Restoring American Financial Stability Act of 2010" includes extensive financial industry regulatory reforms. Components of the proposal include:

- OTC derivatives regulation that generally imposes a mandatory centralized clearing requirement with respect to "standardized" swaps. The mandatory clearing requirement would not apply to a swap if one of the counterparties is not a swap dealer or major swap participant and is using swaps to hedge risk. All swaps that are not accepted for clearing by any derivatives clearing organization would be reported either to a swap repository or to the CFTC/SEC. Additionally, margin requirements would be imposed on uncleared swaps and swap dealers, and major swap participants would be subject to capital requirements.
- Creation of the Consumer Financial Protection Bureau within the Federal Reserve, which would have the authority to autonomously write consumer protection rules for all entities offering consumer financial services or products and would have examination and enforcement authority for banks with assets in excess of $10 billion and all non-bank financial companies.
- Creation of a Financial Stability Oversight Committee to monitor, identify and address systemic risks posed by large, complex financial firms.
- Granting the Federal Reserve the power to order divestitures of assets or impose any conditions on a financial company's operations if it determines that the company poses a threat to the financial system.
- Elimination of the private adviser exemption and, consequently, investment advisers to private funds would generally become subject to the provisions of the Advisers Act.

Click here to view the bill in its entirety.

### Senators Introduce Bill Restricting Proprietary Trading

On March 10, 2010, several Senators introduced the Protect Our Recovery Through Oversight of Proprietary Trading Act. The PROP Trading Act amends the Bank Holding Company Act and would prohibit banks and other financial institutions from engaging in prop trading and entering into certain relationships with hedge funds and private equity funds. The bill would also raise capital requirements and prohibit brokers from buying swaps on financial products sold to clients. In general, the Act would not affect hedge funds' or private equity funds' own prop trading activities.

To read Senator Merkley's press release on the PROP Trading Act click here.

### CFTC Chairman Testifies Regarding OTC Derivatives Reform

On March 9, 2010, CFTC Chairman Gensler testified before the Senate Committee on

Energy and Natural Resources. Chairman Gensler's testimony criticized credit default swaps ("CDS") and called for comprehensive OTC derivatives reform in order to lower risk and promote transparency in the marketplace.

## TRIVIA

Name the only person to coach a WNBA and NBA championship team.

*The first person to email nkmiecik@henderson-lyman.com with the correct answer will win a **$50 Starbucks Giftcard.***

The regulatory framework Chairman Gensler proposed would apply to all dealers and derivatives, regardless where traded or marketed, and would include interest rate swaps, currency swaps, foreign exchange swaps, commodity swaps, equity swaps, credit default swaps, and any product developed in the future. The reform requires three key components: explicit regulation of derivatives dealers; a transparent marketplace, which would be achieved by trading OTC derivatives on exchanges or other trading platforms; and centralized clearing.

The CFTC and SEC both would play a role in regulating the CDS markets. The reform defines each entity's role, and provides the SEC would concentrate on single-issuer and narrow-based CDS, and the CFTC would concentrate on broad-based products.

If you are interested in obtaining more information with respect to CDSs, one of our partners has recently published an article which is available at your request. To view the Chairman's complete testimony, click here.

**CFTC Seeks Increased Funding for New Initiatives**

Chairman Gary Gensler testified before Congress regarding the CFTC's need for additional resources. The Chairman argued that the Commission needs funding in the amount of $216 million to address two major concerns – staff increases and technology updates. He noted that in 2000, the CFTC staffed 567 employees and currently staffs 580 employees, but the volume of futures trading has increased nearly five-fold. Additionally, the number of actively traded futures and options contracts has increased seven-fold, and have become increasingly more complex in nature. Chairman Gensler maintained that a staff increase is necessary in order to properly oversee the growing market. He also noted that the CFTC has filed 50 enforcement actions, resulting in more than $280 million in civil monetary penalties, restitution and disgorgement from respondents and defendants.

Click here to view the complete testimony.

## *FOREX*

**Public Comment Deluge Regarding Proposed Forex Regulations**

On January 13, 2010, the CFTC released the proposed regulations concerning off-exchange retail foreign currency transactions. The proposed regulations follow the passage of the Food, Conservation, and Energy Act of 2008, commonly known as the "Farm Bill." The proposal would subject retail forex transactions to significant regulation and is based on both the CFTC's existing regulations for commodity interest transactions and intermediaries, as well as

existing NFA rules regarding retail forex transactions.

The proposed comprehensive regime would include requirements for registration, disclosure, recordkeeping, financial reporting, minimum capital, and other operational standards. Specifically, the proposed rules would require persons offering to be or acting as counterparties to retail forex transactions to register as retail foreign exchange dealers ("RFEDs") with the CFTC. FCMs that are substantially engaged in FCM activities would be permitted to engage in retail forex transactions without also registering as RFEDs. Entities other than RFEDs and FCMs that introduce retail forex transactions will be required to register with the Commission as IBs, CTAs, CPOs, or APs, and will be subject to the regulations applicable to that registrant category.

Additionally, the proposal would require any IB that introduces retail forex transactions to an FCM or RFED to be guaranteed by that FCM or RFED. The proposal would also implement a $20 million minimum net capital standard for registering as an RFED or offering retail forex transactions as an FCM, and would require those registrants to collect margin in order to limit the leverage available to their retail customers on such transactions to 10:1.

The CFTC's request for public comment letters has generated thousands of submissions. Generally, the commenters' have focused on the proposed 10:1 leverage requirement, stemming from the concern that the leverage limit will lower profitability and will likely drive retail forex out of the U.S. Click here to view comments.

**FIA Files Comment Letter Regarding Forex Proposal**

In response to the CFTC's proposed forex regulations, FIA submitted a comment letter expressing its support for many provisions of the proposal and its strong opposition to select provisions. Specifically, FIA opposes the 10:1 leverage limit, the requirement that firms disclose the number of profitable accounts, and the guarantee requirement imposed on all IBs.

## TRIVIA

Predict the number of goals that the Blackhawks collectively will score in the 2010 playoffs.

*The first person to email nkmiecik@henderson-lyman.com with the correct answer will win a **$50 Starbucks Giftcard**.*

FIA urged the CFTC to reconsider the leverage limit based on FIA's belief that NFA's current standards, when coupled with the rest of the CFTC's new reforms, will better protect customer interests, and asked the CFTC to wait until its reforms have taken full effect before reconsidering whether any adjustments to NFA's leverage limits are warranted. Additionally, FIA noted that the CFTC has not provided any evidence to support its choice of a 10:1 limit and that the CFTC has not taken the least anticompetitive means of achieving the Commodity Exchange Act's objectives in violation of Section 15(b).

FIA opposes the disclosure requirement because it is unprecedented, and it "lacks balance and will most likely misinform customers." FIA further questioned the value of providing any past account performance data, noting that the CFTC's rules for dis-

closure of performance by trading professionals always contain the mandated warning that "past performance is not necessarily indicative of future results."

FIA opposes the guarantee agreement imposed on IBs because it is too restrictive, and from the proposal, it is not clear whether the CFTC intends to prohibit IBs that are guaranteed by an RFED or FCM from introducing forex business to banks or overseas dealers. FIA believes that the CFTC may not have considered the ramifications of this provision and requests that the CFTC clarifies its position.

**Additional Proficiency Exam Required Under Proposed Forex Regulations**

The CFTC has recently published its proposed forex rules, including the registration requirements. The final rules and effective dates have not yet been announced; however, a summary of the proposed registration requirements is provided below.
All forex firms registering as a GIB, CTA, or CPO would be required to complete the online registration forms. Specifically, IBs would be required to file a completed 7-R form through NFA's Online Registration System ("ORS") and submit a complete Guarantee Agreement form from an FDM. CTAs and CPOs would be required to file a completed 7-R form through ORS and submit a Disclosure Document to NFA for approval before they can begin soliciting customers.

Any individual applying as an AP or Principal of a forex IB, CTA, or CPO would be required to file a completed 8-R form through ORS and submit fingerprint cards. Additionally, all individuals who solicit forex business or who supervise that activity would be required to pass two exams. The first exam is the Series 3, which covers futures trading and regulation. The second exam is the Series 34, which covers forex-related trading and regulation.

NFA has published Study Guides for both exams in the Registration Section of its website and can be accessed by clicking here.

## *MARKET STRUCTURE*

**Media Derivatives Exchange Seeks CFTC Approval to Offer Futures Contracts Based Upon Movie Box Office Revenues**

More than 18 months ago, Media Derivatives Exchange (MDEX) (a/k/a the Trend Exchange), and another exchange submitted applications with the CFTC to become designated contract markets (DCM) and offer regulated futures products based upon movie box office revenues and other entertainment-related products. The contracts are designed to provide movie studios and financing companies, among others, with the ability to manage the significant risks associated with financing, producing and marketing major motion pictures.

However, despite the lapse of the comment period for MDEX's DCM application, the Motion Picture Association of American submitted a comment letter one day prior to the expiration of the CFTC's review period, asking the CFTC to deny the exchanges' approval based upon the generalized (and outdated) notion that derivatives contracts would introduce an element of gambling to the movie industry. The MPAA's comment letter makes no distinction between the opaque OTC market and the transparent futures markets, nor does the MPAA recognize that MDEX's contracts are fully collateralized, which would substantially reduce excessive speculation in

the contracts. The CFTC expects to issue a decision in the next 7 to 14 days.

**CFTC Seeks Comments on Proposed Position Limit Rules**

The CFTC is proposing to implement speculative position limits for four energy commodities: Henry Hub natural gas; West Texas Intermediate; heating oil; and gasoline blendstock. The proposal is designed to reduce, eliminate or prevent excessive speculation and unreasonable price fluctuation.

Significant provisions of the proposal include: (1) application of speculative position limits across markets listing contracts on ton the same commodity in addition to each market separately; (2) the methodology for setting limit levels, which is largely based on current regulations; (3) no longer permitting disaggregation of positions by commodity pool operators, commodity trading advisors and others that have authorized an independent account controller to control all trading decisions for an account; and (4) a new exemption for swap dealers.
Comments must be received on or before April 26, 2010.

Click here to view the proposal.

**FIA Files Comment Letter Regarding Position Limits**

On March, 18, 2010, FIA filed a comment letter in opposition to the CFTC's proposed speculative position limits on energy contracts. FIA's president, John Damgard, stated that the FIA strongly supports the CFTC's ongoing efforts to protect price discovery and conduct market surveillance; however, based on FIA's analysis, the proposed rules would harm the public interest and should not be adopted.

FIA lists the following grounds for its opposition: The Commodity Exchange Act allows the CFTC to limit speculation only when the CFTC finds those limits to be "necessary" to prevent price distortions, and the CFTC has never indicated that it found the proposal to be "necessary"; the CFTC has not provided any evidence that supports speculation caused energy price distortions; and the proposed account aggregation standard unjustifiably departs from CFTC practice and precedent.

**CME and ELX Feud Continues Over Exchange of Futures for Futures Rule**

For years, the futures industry has debated the merits of fungibility, which would allow a futures contact initiated on one exchange to be offset on another exchange. The debate has generally pitted FCMs, who promote fungibility as a function of customer choice, against exchanges, which seek to protect the intellectual property of their futures contracts.

Recently, Wall-Street-backed ELX Futures, which is owned by various FCMs and others, has breathed new life into the fungibility debate by enacting a rule—the so-called Exchange of Futures for Futures ("EFF") rule, which would allow traders to transfer an interest in Treasury futures contracts from another market to ELX. The other market that ELX has in mind is CME, which has steadfastly resisted enacting a similar rule, fearing that any such rule could siphon contracts from CME to the low-cost ELX. Earlier this year, ELX took a significant further step in petitioning the CFTC to require CME to allow the transfer of such contracts.

While CME claims that ELX is seeking to promote "transitory trades" or "wash trades," which are barred under the Commodity Exchange Act, ELX accuses CME of acting in an anti-competitive manner and misleading regulators about its EFF rule in an effort to stifle completion. CME has responded by contending, among other things, that the refusal to assist a competitor is not an unreasonable restraint of trade. Operating as the referee in this issue with potentially monumental consequences, the CFTC has asked CME to further justify its refusal to permit the transfer of such trades. Such a posture by the CFTC is unprecedented, though by no means an indication of its position. The resolution of this issue has no timetable, but H&L will keep you apprised as developments arise.

## *FCMs*

| *Five Largest FCMs Based on Capital* | |
|---|---|
| **FCM** | **Adjusted Net Capital** |
| *UBS Securities, LLC* | *$13,772,043,753* |
| *Goldman Sachs & Co.* | *$11,436,869,932* |
| *Credit Suisse Securities (USA), LLC* | *$8,609,040,256* |
| *Citigroup Global Markets, Inc.* | *$8,068,472,758* |
| *Deutsche Bank Securities Inc.* | *$7,727,995,254* |

### Net Capital Requirement Increase

The CFTC has imposed a significant increase to the minimum net capital requirement for FCMs. The increase, which took effect March 31, 2010, raised the net capital requirement from $250,000 to $1,000,000.

Similarly, the net capital requirement with respect to Forex Dealer Members ("FDMs") has increased strikingly since the NFA first adopted the FDM capital requirements in 2003. The minimum adjusted net capital for FDMs was raised by the NFA from $250,000 to $1 million in 2006, and then again to $5 million in December 2007. In 2008, a series of increases were imposed on FDMs, which required a minimum net capital of $10,000,000 through January 16, 2009, $15,000,000 from January 17, 2009 through May 15, 2009, and $20,000,000, effective May 16, 2009 forward.

## *IBs*

### Proposed Forex Regulations Require Guarantee Agreement for IBs

As previously mentioned, the CFTC has proposed a comprehensive regulation scheme for persons involved in retail forex transactions. Some of the most notable changes occur with respect to IBs involved with forex transactions.

The proposed forex regulations would require all IBs involved in forex transactions to enter into a guarantee agreement with a retail foreign exchange dealer ("RFED") or an FCM. The CFTC believes that a guarantee agreement between all forex IBs and the FCM/RFED counterparties to which they introduce forex customers will force the counterparties to more carefully evaluate the persons who solicit business on their behalf.

The CFTC intends to prepare a new Part C guarantee agreement to the Form 1-FR-IB. It will provide that FCMs and RFEDs guaranteeing performance by an IB introducing forex transactions will be jointly and severally liable for all obligations of the IB with respect to the solicitation of, and transac-

tions involving, all retail forex accounts of the IB.

Click here to view the report.

## *CPOs*

**CFTC Issues Annual Report Guidance to Commodity Pool Operators**

The CFTC's Division of Clearing and Intermediary Oversight has issued its annual guidance letter to CPOs. The letter is intended to assist CPOs and their accountants in complying with the Commission's regulations regarding the preparation and filing of commodity pool annual reports. The letter highlights current regulatory changes affecting CPOs and provides reminders of requirements noted as common deficiencies in prior years' annual reports.


TRIVIA

Who was the last player to be cut from the 1980 U.S. Men's gold medal winning hockey team and is also currently registered with the NFA and FINRA?

.

*The first person to email nkmiecik@henderson-lyman.com with the correct answer will win a* ***$50 Starbucks Giftcard.***


The annual report includes: recent amendments to Commission regulations; commodity pool financial filing procedures and due dates; considerations applicable to filings made for Master/Feeder and Fund of Fund structures; requests for limited relief from generally accepted accounting principles compliance for certain offshore commodity pools; amendment to Rule 4.13 reporting requirements for pools in liquidation; reporting requirements for series funds structured with a limitation on liability among the different series; and various accounting developments.

Click here to view the report.

## *LITIGATION*

**Lehman Brother's Examiner's Report Released**

The court-appointed examiner who investigated the collapse of U.S. investment bank Lehman Brothers Holding Co. released his 2,200 page report on March 11, 2010.

The examiner analyzed three substantive areas: (1) Why did Lehman fail? Are there colorable cause of action that arise from its financial condition and failure? (2) Are there administrative claims or colorable claims for preferences or voidable transfers? (3) Are there colorable claims arising out of the Barclays sale transaction?
According to the report, Lehman failed because it was unable to retain lender confidence and because it did not have sufficient liquidity to meet its current obligations. The examiner explains that Lehman utilized "materially misleading" accounting gimmicks to mask the troubled state of its finances and leverage dependency. Lehman concealed its dependence on leverage with techniques that amounted to financial engineering in order to temporarily shuffle $50 billion of assets off its books in the months before its September 2008 collapse.

While the examiner found that the "business decisions that brought Lehman to its crisis of confidence may have been in error but were largely within the business

judgment rule," he also states that "the decision not to disclose the effects of those judgments does give rise to colorable claims against the senior officers who oversaw and certified misleading financial statements."

Click here to view the report.

## *ENFORCEMENT*

**CFTC Sanctions Firm for Exceeding Position Limits**

On February 24, 2010, the CFTC filed and settled a complaint against UBS. According to the settlement, on more than one occasion during the period December 2006 and March 2008, UBS AG exceeded NYMEX position limits on certain NYMEX natural gas, heating oil, and platinum futures contracts in violation of CEA Section 4a(e). The order imposes a $130,000 civil monetary penalty and an order to cease and desist from further such violations.

It is uncommon for the CFTC to take disciplinary action against a firm for violating limits set by an exchange, but the CFTC has the legal authority to do so. Currently, the CFTC only sets hard trading limits in certain agricultural commodities, and allows the exchanges to set and oversee compliance with trading limits on other products, such as energy and metals. Traders in metals and energy commodities are only subject to hard trading limits during the last three days of trading before a contract expires. At all other times, traders in those commodities are only subject to accountability levels, which are nonbinding limits set by the exchanges that trigger additional surveillance if exceeded. However, the CFTC is examining whether to change this practice in its proposed energy position limit rule.

**MF Global Charged with Supervision Violations**

The CFTC simultaneously filed and settled charges against MF Global, Inc., ("MF") relating to risk supervision failures. Specifically, CFTC's order alleged that from 2003 to 2008, MF failed on four separate occasions to ensure that its risk management, supervision, and compliance programs sufficiently fulfilled its obligations to supervise its business. In one instance, the failure to supervise the trading activities of an AP resulted in wheat futures trading losses by MF of over $141 million.

The CFTC order imposes a $10 million civil monetary penalty and requires MF to enact new policies and procedures designed to enhance its risk monitoring procedures, training, and compliance procedures.

## *NFA*

**NFA Issues Rule Amendment and Interpretive Notice Regarding Member use of Online Social Networking**

NFA's amendment to Compliance Rule 2-29 (h) regarding a Member's use of audio or video advertisements was put into effect on February 1, 2010. The amendment requires the Member to submit any podcast or video on the internet that makes specific trading recommendations or refers to profits that have been obtained to the NFA for approval ten days prior to use.

The NFA also issued an interpretive notice, titled "Use of On-Line Social Networking Groups to Communicate with the Public." The notice discusses a Member or Associate's responsibilities in connection with

electronic communications. Specifically, the notice addresses developing procedures for employee use of social networking and summarizing the steps the Member should take to supervise and enforce the policies the Member enacts. The interpretive notice makes clear that online communications are subject to the same standards as other types of communications with the public.

**Changes Coming to NFA's BASIC**

NFA's Background Affiliation Status Information Center ("BASIC") contains CFTC registration and NFA membership information, along with futures-related regulatory and non-regulatory actions contributed by NFA, the CFTC and the U.S. futures exchanges. In the near future, BASIC will begin displaying information regarding whether or not a firm is actively engaged in futures and/or forex-related business activity. A firm will be listed as "inactive" if it fails to complete the new questions related to their business in their Annual Questionnaire. The change is designed to assist potential customers in deciding whether a firm can actively solicit business. NFA reminds firms to complete the Annual Questionnaire, which is available by clicking here.

## *Securities Developments*

### *SEC NEWS*

**SEC Approves Short Selling Restrictions**

On February 24, 2010, the SEC adopted Rule 201, also known as the alternative uptick rule. The stated purpose of the rule is to preserve investor confidence and promote investor efficiency. Rule 201 is designed to restrict short selling from further driving down the price of a stock that has dropped more than 10% in one day. The restriction will enable long sellers to sell their shares before any short sellers
once the "circuit breaker" is triggered. The circuit breaker will be triggered for a security any day in which its price declines by 10% or more from the prior day's closing price. Once the circuit breaker has been triggered, the alternative uptick rule would apply to short sale orders in that security for the remainder of the day as well as the following day.

Rule 201 will become effective 60 days after the date of publication in the Federal Register, and market participants will
have six months to comply with the requirements.

Rule 201 generally applies to all securities, except options, that are listed on a national securities exchange. The rule applies whether the security is traded on an exchange or in the OTC market. Furthermore, the rule requires trading centers to establish, maintain, and enforce written policies and procedures that are reasonably designed to impose the short sale price test restriction.

Click here to view the press release.

**SEC Reviewing the Use of Derivatives by Funds**

On March 25, 2010, SEC staff announced for the first time, that it is conducting an ongoing evaluation of the use of derivatives by mutual funds, ETFs and other investment companies. The staff intends to explore issues related to the use of derivatives, including, among other things, whether:

- current market practices involving de-

rivatives are consistent with the leverage, concentration and diversification provisions of the Investment Company Act;

- funds that rely substantially upon derivatives, particularly those that seek to provide leveraged returns, maintain and implement adequate risk management and other procedures in light of the nature and volume of the fund's derivatives transactions;
- fund boards of directors are providing appropriate oversight of the use of derivatives by funds;
- existing rules sufficiently address matters such as the proper procedure for a fund's pricing and liquidity determinations regarding its derivatives holdings;
- existing prospectus disclosures adequately address the particular risks created by derivatives;
- funds' derivative activities should be subject to special reporting requirements.

The staff also will seek to determine what, if any, changes in SEC rules or guidance may be warranted. Click here to view the SEC press release.

**New SEC Cooperation Policy**

The SEC's Division of Enforcement is implementing a series of measures designed to improve and encourage cooperation in its investigations and litigation, and expedite the enforcement program. The SEC has approved three main measures to improve the "quality, quantity, and timeliness of information and assistance" it receives.

First, the Staff has been authorized by the Division of Enforcement to utilize various cooperation "tools" to foster and reward cooperation. The new tools are set out in the Division's enforcement manual, which can be viewed by following the link listed at the end of this article.

Second, the process for submitting witness immunity requests to the Justice Department has been streamlined. Lastly, the SEC has issued guidelines for evaluating cooperation by individuals.

In the SEC's announcement, Enforcement Director Robert Khuzami emphasized that the cooperation initiatives are designed to encourage "extraordinary cooperation," not mere compliance with "routine or ordinary requests."

Click here to view the SEC's enforcement manual.

## *HEDGE FUNDS*

**IOSCO Proposes Hedge Fund Reporting Requirements**

The Technical Committee of the International Organization of Securities Commissions' ("IOSCO"), chaired by SEC Commissioner, Kathleen Casey, has published details of an agreed template for the global collection of hedge fund information. The template was created by the IOSCO's Task Force on Unregulated Entities ("Task Force") and it is intended to "enable the collection and exchange of consistent and comparable data amongst regulators and other competent authorities for the purpose of facilitating international supervisory cooperation in identifying possible systemic risks in this sector."

In order to accomplish this goal, the template sets forth 11 proposed categories of information to be collected, which have been deemed by the Task Force to be im-

portant indicators of potential risk in the industry. The 11 categories include general manager and adviser information; performance and investor information with respect to covered funds; assets under management; gross and net product exposure and asset class concentration; gross and net geographic exposure; trading and turnover issues; asset/liability issues; borrowing; risk issues; credit counterparty exposure; and a catch-all category that includes information regarding the complexity of the investment vehicles and the concentration of their holdings. The Task Force has recommended that the first data-gathering exercise should be carried out on a best efforts basis in September 2010.

Click here to view the report.

## *FINRA*

**SEC Approves Amendments to FINRA Rules Governing Expedited Proceedings**

The SEC has approved amendments to the FINRA Rule 9550 Series, which provides a procedural mechanism for FINRA to address certain types of misconduct more quickly than would be possible using the ordinary FINRA disciplinary process. The approved amendments shorten the time in which a disciplinary hearing must be held from 60 days after a hearing request to 30 days after the request with respect to certain rules. Additionally, the amendments add an expedited proceeding for failure to pay restitution. Lastly, the amendments harmonize a remedy in an expedited procedure with a remedy in the FINRA By-Laws. The amendments took effect on March 25, 2010.

Click here to view the Regulatory Notice.

**FINRA Proposes Expansion of Information Publicly Available Through BrokerCheck**

FINRA is seeking authority to expand the amount of information that is available to the public regarding current and former securities brokers through its free online service, BrokerCheck. The proposed expansion, which FINRA will submit to the SEC

***Fast Fact***

**Number of Registrants by Category:**

**CPOs…………………………..1,353**
**CTAs…………………………..2,534**
**FCMs…………………………..179**
**IBs………………………………1,647**

in the near future, would increase the number of customer complaints reported publicly by disclosing all historic complaints against a broker dating back to 1999, when electronic filing of broker information began. The proposal would also extend the disclosure period for the full record of former brokers from two years to ten years. Additionally, the proposal would expand the amount of permanently available public information on former brokers, such as criminal convictions or pleas of guilty or nolo contendere; civil injunctions or findings of involvement in a violation of any investment-related statue or regulation; and arbitration awards or civil judgments based on the former broker's involvement in an alleged sales practice violation.

## *INVESTMENT ADVISERS*

**Supreme Court Rules on Investment Adviser Suit**

The Supreme Court issued a unanimous ruling on March 30, 2010, affirming the

standard laid out in *Gartenberg v. Merrill Lynch Asset Management Inc*., regarding excessive fees charged by mutual fund advisers.

The decision rejected a ruling by the 7th Circuit Court of Appeals that attempted to move away from the legal precedent that viewed the *Gartenberg* decision as the key standard by which courts should determine whether a particular mutual fund fee is reasonable or whether it violates Section 36(b) of the Investment Company Act. The 7th Circuit case, *Jones v. Harris Associates*, required shareholders to prove that the adviser had misled the board of directors that approved the fee. Justice Alito stated that the 7th Circuit panel erred by focusing almost entirely on the element of disclosure.

To face liability under the *Gartenberg* standard, "an investment adviser must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining." In weighing whether a fee is excessive, courts must consider all facts and circumstances surrounding the receipt of compensation, with emphasis on the following six factors: the nature and quality of the services provided to fund shareholders; the profitability of the fund to the adviser/manager; economies of scale of operating the fund as it grows larger; fee structure of comparable funds; the independence and conscientiousness of the trustees; and any indirect profits to the adviser attributable in some way to the existence of the fund.

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The Financial Services Practice Group provides counsel regarding numerous formation, compliance, regulatory, trading-related, and litigation matters. In counseling its clients, the Financial Services Practice Group draws upon its significant industry experience.

Henderson & Lyman is located in the heart of Chicago's financial district and provides goal-oriented legal services to a wide array of companies and individuals. The firm also represents clients in a wide variety of business, regulatory and commercial litigation matters.

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