Simpson Thacher

# Registered Funds Alert

This edition of the Simpson Thacher Registered Funds Alert discusses recent developments in the registered funds industry, including recent academic speculation regarding potential antitrust implications of horizontal shareholdings by mutual funds, the SEC's liquidity management proposals for open-end funds and ETFs, and the possibility of the SEC utilizing a third-party inspection program to examine the growing number of registered investment advisers. In addition, this Alert discusses the continued focus by the SEC on cybersecurity, including additional examinations and a recent enforcement action, as well as the publication by the NYSE of a cybersecurity guide aimed at directors and officers of listed companies. Finally, we report on notable transactions that occurred in the third quarter of 2015, including M&A transactions and closed-end fund initial public offerings.

**November 2015**

## Do Mutual Fund Managers' Horizontal Shareholdings in Competing Firms Create Antitrust Risks?

Two recent academic papers, a law review article and an econometric study, theorize that mutual fund complexes owning significant shares in corporations that compete against each other, particularly in concentrated industries, may violate U.S. antitrust laws. These recent papers invite regulatory agencies and the private plaintiffs' bar to bring antitrust claims against institutional investors who engage in horizontal shareholdings. Indeed, the Department of Justice has initiated an investigation into possible collusion in the airline industry, and, it was recently reported, sought discovery of communications between the airlines and firms that advise mutal funds. (click here for full article)

## SEC Proposes Minimum Liquidity Requirement for Open-End Funds; Raises Questions Regarding the Relationship Between Liquidity and Valuation

The SEC proposed new rules that would require open-end funds and ETFs (other than money market funds) to develop and maintain liquidity management programs. If adopted, the proposed rules would impose a variety of new duties on advisers and fund boards and open-end funds would be permitted to utilize "swing pricing" to shift costs associated with purchase and redemption activity to the purchasing/redeeming shareholders. This Alert focuses on whether the SEC has the statutory authority to adopt one of its proposals and discusses how the proposal raises questions regarding the relationship between liquidity and valuation. (click here for full article)

## Possibility of Requiring Advisers to Undergo Third-Party Inspections Gains Traction

As the number of registered investment advisers has grown over the years, the SEC has struggled to keep up when it comes to examining advisers. Over the years, a number of solutions have been proposed to solve the shortfall in examining the growing number of investment advisers. The idea of a third-party inspection program has recently gained traction and the SEC is currently developing a proposal for such a program. (click here for full article)

## SEC Increasing Scrutiny of Cybersecurity Practices; NYSE Publishes Cybersecurity Guide

The SEC recently announced a new round of cybersecurity examinations and an enforcement action related to cybersecurity. Additionally, the NYSE published a cybersecurity guide aimed at directors and officers of listed companies that may be of interest to registered funds. (click here for full article)

## 3rd Quarter 2015 Notable Transactions

List of notable transactions occurring in the third quarter of 2015, including M&A transactions and closed-end fund initial public offerings. (click here for full article)

# Do Mutual Fund Managers' Horizontal Shareholdings in Competing Firms Create Antitrust Risks?

Two recent academic papers, a law review article and an econometric study, hypothesize that horizontal shareholdings—a term that refers to the practice of mutual fund complexes owning significant shares in corporations that compete against each other, particularly in concentrated industries—may violate U.S. antitrust laws. For example, under the view presented in these papers, antitrust issues could arise when institutional investors hold even relatively small (5-10%) ownership stakes in competitors in an industry with few (generally fewer than five) major players. These recent papers invite regulatory agencies and the private plaintiffs' bar to bring antitrust claims against institutional investors who engage in horizontal shareholdings. Indeed, the Department of Justice has initiated an investigation into possible collusion in the airline industry, and, it was recently reported, sought discovery of communications between the airlines and firms that advise mutual funds.

In a law review article published online this past summer and forthcoming in the *Harvard Law Review*, Harvard Law School Professor Einer Elhauge argues that shareholdings in competing companies should be subject to scrutiny under Section 7 of the Clayton Act, which prohibits the acquisition of stock or assets where "the effect of such acquisition may be to substantially lessen competition, or to tend to create a monopoly."[1] According to Professor Elhauge, horizontal shareholdings reduce the incentives of portfolio companies to undercut each other on price and compete for market share because such behavior is contrary to the interests of the companies' shareholders (to maximize profits across all portfolio companies). He argues that the dilution in incentives occurs "even if their respective management never communicate or coordinate with each other."

Professor Elhauge relies on a recently-published working paper by economists José Azar, Martin Schmalz, and Isabel Tecu, which concludes that common ownership in the airline industry has resulted in higher ticket prices. Using econometric analysis and a modified Herfindahl-Hirschman Index designed to capture the effects of common ownership, these economists claim that horizontal shareholdings of airlines has resulted in presumptively anticompetitive concentration levels and price increases of 3-5% on the average U.S. airline route than would be the case in the absence of such horizontal shareholdings. Notably, they acknowledge that their work "does not contribute direct evidence of the mechanism that implements the incentives" that supposedly cause higher average prices.

## Legal Framework Under the Clayton Act

Potential liability under Section 7 of the Clayton Act most commonly arises when an entity acquires the whole, or any part, of the stock or assets of a direct competitor. Because Section 7 does not apply to stock purchases that are solely for investment purpose (a provision known as the "passive investor defense"), acquisitions by mutual fund complexes and other institutional investors have generally not been subject to antitrust scrutiny. However, investors invoking the passive investor defense bear the burden of proving a lack of control over portfolio investments. The concept of "control" is not clearly defined and requires a case-by-case analysis; however, the defense is generally unavailable if: (i) the investor acquires or attempts to acquire a sufficient stake to give it control; (ii) seeks to influence business decisions; (iii) appoints members to the portfolio company's board of directors; or (iv) has access to non-public information.

Although rare, application of Section 7 to horizontal shareholdings by an investment firm not otherwise controlling at least one of two direct competitors is not entirely unprecedented. For example, in 1974 the Department of Justice brought an enforcement action challenging an investment company's minority holdings in competing brick companies.[2] Together, the brick companies held a market share of about 50%. The Department of Justice argued that the passive investor defense was unavailable because the investment company appointed members to the brick companies' boards of directors and used its voting rights to influence management and policy decisions. Before a decision could be reached, one of the portfolio brick companies rendered the action moot by voluntarily exiting the market.

The recent literature takes this argument a step further, and many would say goes a bit too far. Professor Elhauge would lower the burden for regulators and private plaintiffs by arguing that horizontal shareholdings are subject to antitrust scrutiny even absent significant voting and governance rights. First, he argues that "passive" investors engage in behind-the-scenes "active

1. 15 U.S.C. § 18.

2. *See United States v. Cleveland Trust*, 392 F.Supp. 699 (N.D. Ohio 1974).

ownership," such that the passive investor defense should not apply. Second, and most novel of all, Professor Elhauge claims that the mere fact of horizontal shareholdings alone can restrain competition by inducing portfolio companies to compete less aggressively or by facilitating coordinated action. He interprets the passive investor defense under Section 7 to require not only that a purchase of stock be solely for investment, but also that such shareholdings not bring about a substantial lessening of competition. Thus, all a regulator or plaintiff needs to establish, according to Professor Elhauge, is evidence (in the form of an econometric study) that horizontal shareholdings actually raised prices in a relevant market.

### Will the Recent Novel Theory and Economic Study Gain Traction?

It is too early to predict whether U.S. regulators or the plaintiffs' bar will test Professor Elhauge's novel interpretation of the passive investor defense in court or rely on econometric studies similar to that presented in the Azar, Schmalz and Tecu working paper. The legal theory under Section 7 of the Clayton Act appears fundamentally misconceived given the wording of the passive investor exception: "This section shall not apply to persons purchasing such stock solely for investment ***and not using the same*** by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition."[3] In contrast to the two-prong passive investor test posited by Professor Elhauge, the statutory language only requires that a shareholder not affirmatively ***use*** shares to bring about anticompetitive effects. That is a far cry from imposing liability on mutual fund complexes or their advisers simply because an alleged effect of otherwise passive shareholdings is to increase prices in a concentrated industry. Beyond this legal flaw, the econometric study described in the economists' working paper is subject to numerous potential criticisms and says nothing about the effect of horizontal shareholdings in industries other than the airline industry.

More likely, the U.S. regulators and the private plaintiffs' bar will, at least for now, favor exploration of more traditional Sherman Section 1 conspiracy and Clayton Act Section 7 theories, including whether competitors have used communications with fund advisers to facilitate collusion and whether mutual fund shareholdings were, in fact, not acquired solely for investment purposes. Indeed, recent media reports concerning the Department of Justice investigation of the major airlines suggest that the Department of Justice is focused on a more traditional line of inquiry under the Sherman Act. Mutual fund advisers, meanwhile, should review and consider updating their antitrust compliance policies and heighten employee awareness of the potential antitrust risks that may arise from both traditional and possibly novel approaches to horizontal shareholdings in competitors in concentrated industries.

For questions regarding the potential antitrust implications, please contact members of our antitrust team.

# SEC Proposes Minimum Liquidity Requirement for Open-End Funds; Raises Questions Regarding the Relationship Between Liquidity and Valuation

On September 22, 2015, the Securities and Exchange Commission ("SEC") proposed new rules that would require open-end funds and exchange-traded funds ("ETFs") (other than money market funds) to develop and maintain liquidity management programs (the "Release"). The SEC stated that the proposed rules are intended to create a regulatory framework that will reduce the risk that a fund will be unable to meet its redemption obligations. If adopted, the proposed rules would impose a variety of new duties on advisers and fund boards. Additionally, under proposed amendments to Rule 22c-1 under the Investment Company Act of 1940 ("1940 Act"), open-end funds (other than money market funds and ETFs) would be permitted to utilize "swing pricing" under certain circumstances to adjust their net asset value per share ("NAV"), a practice common in

3. 15 U.S.C. § 18.

non-U.S. jurisdictions that permits a fund to impose transaction costs on purchasing or redeeming shareholders, instead of diluting the value of shares held by all fund shareholders.

The Release has been summarized by many industry commentators, and this Alert does not attempt to summarize the proposed new rules and amendments. As we have previously discussed, the liquidity management proposal is part of a series of regulatory initiatives by the SEC that are part of a broader initiative by the SEC and the Financial Stability Oversight Council to impose risk-based and prudential standards on the asset management industry. This Alert focuses on the SEC's claimed statutory authority to adopt one of its proposals and discusses how the Release raises questions regarding the relationship between liquidity and valuation in the context of the 1940 Act.

## Questions Regarding the SEC's Authority to Enact a Minimum Liquidity Requirement

Long-standing SEC guidance on liquidity standards for open-end funds has been based on Section 22(e) of the 1940 Act, which provides that the right of redemption or the payment of redemption proceeds may not be suspended for more than seven days, except in unusual circumstances. The SEC has very limited rulemaking authority under this section of the statute; it may only make rules to determine when trading on the New York Stock Exchange should be deemed to be restricted or an emergency exists (in which cases redemptions or payments may be suspended), or may issue orders to suspend redemptions or payments in other circumstances.

Proposed Rule 22e-4 would require open-end funds and ETFs (other than money market funds) to establish a minimum level of "three-day liquid assets" in their portfolios. "Three-day liquid assets" are defined in proposed Rule 22e-4(a)(8) as cash and any position that the fund believes is convertible into cash within three business days at a price that does not materially affect the value of the position. So how does the SEC go from a statute designed to provide for redemptions in seven days with limited rule-making authority to a prescriptive three-day liquidity determination requirement?

While SEC guidelines have espoused the position that open-end funds can hold no more than 15% of their assets in illiquid securities,[4] the Release acknowledges that there are "no requirements under the federal securities laws or Commission rules" that require open-end funds to maintain a minimum level of portfolio liquidity, other than Rule 2a-7 under the 1940 Act. However, Rule 2a-7 is an exemptive rule limited to money market funds, enacted to allow money market funds to operate on an amortized cost basis. Under any exemptive rule, a regulator has significant latitude to impose the conditions and requirements that it sees fit.

4. The SEC would codify the 15% limit as part of the proposed rules.

The Release goes on to state that the statutory authority for Rule 22e-4 comes from Sections 22(c) and (e) and 38(a) of the 1940 Act. As discussed, Section 22(e) provides no apparent basis for this rule-making. Section 22(c) is a stronger argument—the SEC, under that section of the statute, has the ability to adopt rules for the "purpose of eliminating or reducing so far as reasonably practicable any of the dilution of the value of other outstanding securities... [as a result of a] redemption...." However, the cited language modifies the granting of a right to adopt rules relating to computation of net asset value or minimum holding periods of a security, and a proper reading of the statute does not support the proposed Rule.

Finally, the SEC suggests that Section 38(a) grants it the power for this Rule, which states in relevant part, "[t]he [SEC] shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the [SEC] elsewhere" in the 1940 Act. If 38(a) is properly read to allow the SEC to justify any prudential regulation, even when the statutory sections governing the subject matter at issue prescribe precisely the range and nature of permitted rule-making, there presumably is no practical limit on the SEC's rule-making authority.

Even if one were to concede the SEC's rule-making authority in this area, a second step is necessary to justify a three-day, as opposed to seven-day, liquidity requirement. The proposed rule does not explicitly impose any minimum level of liquidity, making it theoretically possible for a fund to determine that it does not need to maintain any minimum three-day liquid assets. However, the proposed rule does impose certain factors that funds are required to consider in this assessment and the Release states that "it would be extremely difficult to conclude, based on the factors it would be required to consider, that a zero three-day liquid asset minimum would be appropriate."

The Release states that the SEC considered a seven-day liquidity requirement, but that "would not as well match regulatory requirements and disclosures that require most funds to meet redemption requests in shorter periods and market practices and investor expectations that effectively require all funds to meet redemption requests in shorter time periods." In particular, the regulatory requirement that the Release cites to support this proposition is Rule 15c6-1 under the Securities Exchange Act of 1934, which requires open-end fund redemptions that are processed through broker-dealers be met within three business days.

Nonetheless, it is unclear whether any commenters or industry groups intend to challenge the SEC's authority to enact proposed Rule 22e-4 and its three-day liquid asset requirement. Generally speaking, the asset management industry appears to take the broad-based view that the SEC is the appropriate regulator for the asset management industry, due to its deep understanding of the industry through 75 years of close examination and regulation. Frustrating the SEC's ability to maintain that role may not, many believe, be ultimately to the industry's benefit. Secondly, as a practical matter many industry participants already engage in close analysis of liquidity of portfolios in various circumstances. Many industry participants do in fact commit to a three-day (or fewer) period for payment of proceeds. As such, while we expect significant comment regarding the prescriptive nature of the liquidity "buckets" for portfolio securities, it may well be that no one raises a significant challenge to the statutory basis for the proposed Rule 22e-4 itself.

## Redefining the Relationship Between Liquidity and Valuation

Another aspect that merits attention is how the concepts of liquidity and valuation will relate to one another in light of the proposed guidance and rule-making. Valuation is defined in the 1940 Act, and relies entirely on market quotations when those quotations are "readily available." When market quotations are not readily available, boards (or, pursuant to guidance, their designees) must determine fair value in good faith. While there is no one standard for fair value, it is usually considered to be, based on prior SEC and accounting guidance, "the amount which the [fund] might reasonably expect to receive for [a security] upon [its] current sale"[5] and/or "the price that would be received [for the security] … in an orderly transaction between market participants at the measurement date."[6] Neither market quotations nor these fair valuation standards permit or require that one consider whether an entire position in a security held by a fund can be currently sold. If a fund holds a large stake in a company, the value, particularly where there is a market quotation, is unaffected by that fact.

As noted above, the Release proposes that a liquidity category be assigned to a position based on the number of days it would take to convert the position into cash at a price that does not materially affect its value. The Release sets forth six liquidity categories:

- Convertible to cash within 1 business day.
- Convertible to cash within 2-3 business days.
- Convertible to cash within 4-7 calendar days.[7]
- Convertible to cash within 8-15 calendar days.
- Convertible to cash within 16-30 calendar days.
- Convertible to cash in more than 30 calendar days.

In assigning a liquidity category, the Release states that a fund must assess the liquidity of its entire position, or each portion of that position. This standard implies that some parts of a position can, or even should, be deemed to have differing levels of liquidity. If a fund holds a large position (or the fund's adviser holds large positions across many funds, presumably), then it might be that some portion could be reduced to cash in three days without affecting the value, for example, but the rest would need another ten days. Thus, if one views an orderly sale as what would happen if a sale of an entire position were attempted today, then it might be that some portion should be carried at a lower value today. What is a fund supposed to do with that information? For securities with market quotations, there is no leeway in the statute to change the valuation of a security based on this information. But if a security is being fair valued, does this liquidity determination require the fund to consider using the

5. *See Statement Regarding "Restricted Securities,"* Inv. Co. Act Rel. No. IC-5847 (1969).

6. *See* Financial Standards Accounting Board, *Accounting Standards Codification: Fair Value Measurements and Disclosures* (Topic 820) (Jan. 2010).

7. Note that there may be overlap in the 2-3 business days and 4-7 calendar days categories.

same calculation for valuation of different portions of the same security? If not, why not?

The interplay of liquidity and valuation, in unprecedented ways, shows up in other parts of the Release as well. For example, the Release includes new interpretive guidance regarding the use of cross-trades. Section 17 of the 1940 Act generally prohibits transactions between affiliated funds. Rule 17a-7 under the 1940 Act allows cross trading between affiliated funds and accounts if certain conditions are met. In order to prevent a cross-trade from being consummated at a price that is unfair to a registered fund, one of the conditions of Rule 17a-7 is that market quotations be readily available to price exchange-traded securities, and that over-the-counter securities be priced at the average of the then-highest bid and lowest offer. In the Release, the SEC states that this condition may cause certain less liquid securities to be ineligible for cross-trading (presumably, focusing on over-the-counter securities). While the SEC has broad powers to interpret its own rules, the text of Rule 17a-7 and the guidance thereunder has previously been predicated on appropriate valuation mechanisms, not sufficient liquidity. To suggest that liquidity and valuation are completely separate concepts would be absurd, of course, but valuation plays a central role in the 1940 Act and any changes in the SEC's understanding of the valuation responsibilities of funds should be explicit. In the context of the Rule 17a-7 guidance discussed here, the SEC has expressly invited comment.

Comments on the proposed rules are due January 13, 2016.

## Possibility of Requiring Advisers to Undergo Third-Party Inspections Gains Traction

As the number of registered investment advisers has grown over the years, the SEC has struggled to keep up when it comes to examining advisers. SEC Chair Mary Jo White has consistently acknowledged that the SEC currently does not have sufficient examination resources, with a current ratio of approximately 450 examination staff to 11,500 registered investment advisers and 9,000 investment companies. Currently, the SEC only examines about 10% (or about 30% of total assets under management) of advisers in a given year, and on average an adviser can expect to be examined once every 11 years.

Over the years, a number of solutions have been proposed to solve this perceived examining shortfall, including: (i) increasing SEC resources; (ii) reallocating current SEC resources; (iii) delegating examination authority to a self-regulatory organization ("SRO"), such as the Financial Industry Regulatory Authority or a newly created body (either of which would presumably be funded by dues from investment advisers); or (iv) requiring advisers to be audited by a third-party each year.

An act of Congress would be required to increase SEC resources as well as to turn over regulatory oversight to a SRO. And, while Chair White has consistently requested significant budget increases over the years, appropriations have fallen short, and it is difficult to imagine the bipartisan effort that would be required for either such option to materialize in the current political environment. However, no such Congressional act would be required for the SEC to implement a third-party inspection program. Given this, it is not surprising that the third-party inspection/audit program recently has gained significant traction. Chair White has directed SEC staff to develop a proposal that would require investment advisers to undergo third-party compliance inspections, which would supplement, not replace, SEC examinations and then make such inspection results available to the SEC.

Proponents of the third-party inspection program, such as former SEC Commissioner Dan Gallagher, have pointed to certain unique benefits of this approach, such as the ability to "leverage the resources and expertise of the private sector." Advisers would have the flexibility to "shop around" for an examiner and select the firm that provides the best fit for it. From an investor-protection perspective, a third-party inspection program would, proponents argue, give the SEC the ability to oversee effectively a much larger percentage of the growing number of investment advisers, which theoretically could increase the deterrent effect of inspections as well as detect a higher percent of wrong-doing within the industry.

However, some interested parties argue against imposing a third-party inspection requirement on advisers. Some have concerns and questions regarding the quality, scope, cost, oversight and confidentiality of such an inspection program. For example, what standards would apply? Unlike for financial statement audits, there are no clear standards and principles that deal with grey areas. If the inspections only focus on black-and-white issues, it raises the question of whether there is really a problem that needs to be addressed (i.e., is clear-cut non-compliance a significant enough concern that this huge imposition of costs, ultimately borne at least in part by investors, is justified?). Separately, would inspection results be subject to FOIA requests and civil discovery?

Others have raised questions regarding the qualifications of potential third-party examiners, noting that Chair White has acknowledged that current SEC examiners are the most qualified experts in this field. Finally, given that the proposed third-party inspection program would only supplement SEC inspections, some also contend that the proposed system would only add another burden on advisers, as even after an adviser made available the results of its third-party inspection, it would not exclude the SEC from also performing its own inspection of the adviser. As in the current debate over the fiduciary rule, initiatives that may serve to make investment advice more costly for retail investors need to be considered carefully to avoid unintended consequences.

# SEC Increasing Scrutiny of Cybersecurity Practices; NYSE Publishes Cybersecurity Guide

The SEC continues to focus on cybersecurity, as demonstrated by recent announcements of more examinations and an enforcement action related to cybersecurity. Additionally, the NYSE published a cybersecurity guide aimed at directors and officers of listed companies that may be of interest to registered funds.

## OCIE Announces a Second Round of Cybersecurity Examinations

On September 15, 2015, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a new Risk Alert announcing a second round of cybersecurity examinations in light of recent breaches and threats against financial services firms. OCIE's first round of cybersecurity examinations started in 2014, concluding with a Risk Alert on February 3, 2015, summarized in our prior Alert. As part of its 2015 Examination Priorities, OCIE announced that, in contrast to the 2014 Initiative, the 2015 Initiative would concentrate more on evaluating a firm's implementation of systems regarding its individual cybersecurity preparedness. The most recent Risk Alert noted six core focus areas for the second round of exams. By asking to review policies on these topics, OCIE is effectively requiring firms to have such policies. The six core focus areas included in the Risk Alert are:

- Governance and Risk Assessment: OCIE will assess cybersecurity policies, procedures, and processes, including whether they are evaluated regularly.
- Access Rights and Controls: OCIE will examine how firms control access to various systems through management of user credentials, authentication and authorization, such as the use of RSA tokens to access firm systems.
- Data Loss Prevention: Examiners will evaluate whether a firm monitors its own network traffic, including content transferred outside of the firm by its employees or by third parties as email attachments or uploads. Additionally, they will assess how firms block unauthorized data transfers and verify the authenticity of a customer request to transfer funds.
- Vendor Management: Reviews may include firm practices and controls related to vendor management, such as vendor selection, due diligence, monitoring and contractual terms.
- Training: Examiners will note whether and how training of employees and vendors is tailored to specific job functions in order to encourage responsible behavior, in addition to procedures for responding to cyber incidents under an incident response plan.
- Incident Response: OCIE will assess whether firms have established policies, assigned roles, located vulnerabilities, and developed plans to address possible future cyber-events.

## SEC Brings Enforcement Action Against Registered Investment Adviser

Further demonstrating the SEC's focus on cybersecurity, on September 22, 2015, the SEC announced that R.T. Jones Capital Equities Management ("R.T. Jones"), a St. Louis-based investment adviser, had settled charges that it had not adopted written cybersecurity policies and procedures before a 2013 data breach that compromised the personally identifiable information ("PII") of approximately 100,000 individuals, consisting of both clients and others. In connection with the attack, an unknown hacker who was later traced to China was able to gain access to sensitive PII stored by R.T. Jones on a third party-hosted web server. In light of the incident, R.T. Jones provided notice of the breach to any individual whose PII may have been compromised and further offered free identity theft monitoring.

Following an investigation, the SEC alleged that the firm had entirely failed to adhere to the "safeguards rule"—Rule 30(a) under Regulation S-P—which requires registered investment advisers to adopt written policies and procedures reasonably designed to protect the security and confidentiality of customer records and information against anticipated threats or unauthorized access. For example, the firm had never conducted periodic risk assessments, implemented a firewall, encrypted PII stored on its server, or maintained a response plan for cybersecurity incidents. In settling the allegations, R.T. Jones agreed to cease and desist from committing or causing any future violations of Rule 30(a) of Regulation S-P, and also agreed to be censured and pay a $75,000 penalty.

## NYSE Publishes Cybersecurity Guide

In October 2015, the NYSE published a 355-page book to serve as what it deems the "definitive cybersecurity guide for the directors and officers of public companies." The subject areas of the book – which was written by over 35 contributors across the information security, business, and government arenas – range from board obligations and action plans to how to protect trade secrets, in addition to consumer protection and incident response. The book aims to outline a listed company's responsibilities to oversee, manage, and mitigate cyber risks.

Notably, the NYSE provides a decision tree regarding whether companies should disclose a cybersecurity breach. The book offers a flexible response depending on a multitude of factors, including whether the hack is material, whether there is a separate obligation to disclose (e.g., under trading rules); whether the discovery of the breach is likely or inevitable; and whether there is a potential requirement to disclose the incident pursuant to Regulation FD.

The NYSE book may serve as a useful resource for registered funds, including open-end funds (which may have access to PII of thousands of individuals) and listed closed-end funds (which have similar Regulation FD obligations to those of other public companies).

# 3rd Quarter 2015 Notable Transactions

## M&A Transactions

- **Janus Capital Group Inc.** announced and closed the acquisition of a 51% interest in **Kapstream Capital Pty Limited**, a global unrestrained fixed income asset manager with approximately $6.6 billion in assets under management. With this transaction, the total Janus Global Macro Fixed Income assets under management increased to approximately $8.7 billion. The transaction included initial upfront cash consideration of approximately $85 million. Janus has the option to purchase the remaining 49% interest in the future.

- **F-Squared Investments** announced that it entered into an asset purchase agreement with **Broadmeadow Capital, LLC**, a wholly owned subsidiary of **Cedar Capital, LLC**, which will acquire the intellectual property, investment strategies and substantially all of the investment contracts of F-Squared.

- **Eagle Ridge Investment Management, LLC**, an independent advisory firm headquartered in Westport, CT, and **Laidlaw Group, LLC**, an investment adviser headquartered in Bedford Hills, NY, announced that they merged effective July 1, 2015. The combined firm, which will be known as **Eagle Ridge Investment Management, LLC**, will have approximately $550 million in assets under management.

- **BT Wealth Management LLC**, an independent adviser providing fee-only wealth management services to high-net-worth individuals and families and an affiliate of Atlanta-based certified public accounting and consulting firm Bennett Thrasher LLP, announced that it acquired **Excelsia Investment Advisors**. With the addition of Excelsia, BT will have more than $350 million in assets under management.

- **Ares Management, L.P.** and **Kayne Anderson Capital Advisors, L.P.** announced that they had entered into a definitive merger agreement to create Ares Kayne Management, L.P., which would have become one of the largest and most diversified alternative asset managers with combined assets under management of approximately $113 billion. Under the terms of the agreement, Ares would have provided $2.55 billion in consideration, the majority of which would have been in the form of Ares Operating Group Units. On October 27, 2015, the parties announced the termination of the merger agreement.

- **Titan Advisors, LLC**, which focuses on the liquid long/short equity and global macro CTA sectors, announced that it completed the acquisition of **Saguenay Strathmore Capital**, a leading fund of hedge funds business with a 13-year track record and an emphasis on credit-related strategies.

- **Gávea Investimentos Ltda**, a Brazilian investment firm based in Rio de Janeiro with approximately $5.3 billion in assets under management, announced that its founders reached an agreement to buy back the fund manager from JPMorgan Chase & Co., which had initially acquired 55% of Gávea in 2010 and had since exercised its option to purchase the remaining 45% of Gávea. The deal calls for JPMorgan to be paid over the next 10 years with part of Gávea's earnings.

- **Federated Investors, Inc.**, one of the nation's largest investment managers, completed a transition of approximately $4 billion in shareholder accounts from **Reich & Tang's** domestic and offshore money market funds into Federated funds with similar investment strategies.

- **Legg Mason Inc.**, a global asset management firm with approximately $699 billion in assets under management, reported that it agreed to acquire a majority interest in **RARE Infrastructure, Ltd.**, an Australia-based alternative asset manager with approximately $7.6 billion in assets under management. Legg Mason will acquire a 75% equity stake in RARE, while RARE's management team will retain a 15% equity stake, and The Treasury Group, a previous minority holder, will retain a 10% equity stake. Following the closing of the deal, RARE will operate as an independent investment affiliate of Legg Mason.

- **American International Group, Inc.** announced that it will acquire **First Principles Capital Management, LLC**, a privately held investment management firm. First Principles is a fixed income investment manager and has approximately $10 billion in assets under management. Following the consummation of the transaction, First Principles will operate as a wholly-owned subsidiary of American International Group, Inc.

- **Sun Life Financial Inc.**, an international financial services organization that provides financial services to both individuals and corporate customers, announced that it completed its purchase of **Prime Advisors, Inc.**, a Washington-based investment advisory firm with approximately $13 billion of assets under management as of June 30, 2015. Prime Advisors will maintain its brand and continue to operate as a standalone unit but will also be a member company of Sun Life Investment Management platform, which provides investment solutions to institutional investors on behalf of Sun Life.

- **Pramerica Asset Managers Pvt Ltd.** entered into a definitive agreement with Deutsche Bank to acquire its asset management businesses in India. **Deutsche Asset Management India** was established in 2003 and is the second-largest foreign-owned asset manager in the country.

- **Apollo Global Management, LLC**, a global alternative investment manager with assets under management of approximately $162 billion, announced that it intended to acquire a majority interest in **AR Global Investments, LLC**, a new company that would own a majority of the ongoing asset management business of **AR Capital**. The acquisition would have more than doubled Apollo's real estate assets under management to approximately $27 billion. On November 9, 2015, the parties announced that they terminated the acquisition agreement.

- **Bronfman E.L. Rothschild LP**, a wealth management advisory firm and a registered investment adviser, acquired **Highline Wealth Management LLC**, which together will manage more than $3.6 billion.

- **United Capital Financial Advisers LLC**, a financial management firm with approximately $15 million in assets under management, acquired Seneca, North Carolina-based **McDonald, Cox & Klugh, Inc.** The acquisition includes approximately $415 million in assets under management.

- **Aberdeen Asset Management Inc**., an independent asset management company formed in 1983 and based in Aberdeen, Scotland, announced that it entered into an agreement to acquire **Arden Asset Management LLC**, a provider of hedge fund solutions with offices in New York and London. Aberdeen manages approximately $480 billion on behalf of institutional and private investors.

- **Keeley Asset Management Corp.**, a privately owned Chicago-based asset management firm with over $4.0 billion under management, announced that it entered into a definitive agreement for the transfer of the voting shares of its parent company, Joley Corp., to **TA Associates**, a global growth private equity firm which has invested in more than 450 companies and raised $18 billion in capital.

- **BlackRock, Inc.** announced that it entered into a definitive agreement to acquire digital wealth management firm **FutureAdvisor**, a San Francisco-based registered investment advisory firm that uses software to actively monitor and manage its clients' 401(k), IRA and taxable accounts. After the closing of the transaction, FutureAdvisor will operate within BlackRock's Solutions platform.

- **Savant Capital Management**, one of the nation's largest independent registered investment advisory firms headquartered in Rockford, IL, announced plans to acquire **The Corcoran Group**, a Bethesda, MD-based, RIA firm that has primarily served high to ultra-high net worth, senior level corporate executives for publicly traded and private equity companies for more than 25 years.

- **Federated Investors, Inc.** reached an agreement to acquire certain assets of **Huntington Asset Advisors**. Approximately $236 million in prime money market assets will be reorganized from the Huntington Money Market Fund into Federated Prime Cash Obligations Fund, and approximately $870 million will be reorganized from the Huntington U.S. Treasury Money Market Fund into Federated Treasury Obligations Fund.

- **OppenheimerFunds**, a leader in global asset management, announced its agreement to acquire **VTL Associates, LLC**, an independent institutional investment firm best known for its RevenueShares exchange traded funds and which manages $1.7 billion for investors across eight exchange traded funds and its separate accounts. The acquisition expands OppenheimerFunds' active client offering into the growing smart-beta space, subject to customary closing conditions and consents.

- **Markel Corporation**, a financial holding company, entered into an agreement with **CATCo Investment Management Ltd.** to acquire all of the assets of CATCo, a specialist investment management business that manages approximately $2.7 billion of retrocession and traditional reinsurance portfolios. Upon completion of the transaction, the business will operate as Markel CATCo Investment Management Ltd.

- **NewStar Financial Inc.** announced its agreement to acquire **Feingold O'Keeffe Capital, LLC d/b/a FOC Partners**, a private alternative asset management firm based in Boston, Massachusetts. The acquisition will add approximately $2.3 billion to NewStar's assets under management, increasing total pro forma AUM to approximately $6.4 billion.

- General Electric Co. agreed to sell its private-equity investment group, **GE Capital Equity**, to French asset manager **Ardian**. The management group in charge of GE Capital is expected to remain in place after the closing. The sale follows GE's withdrawal from the alternative investment field. GE agreed in April of 2015 to sell most of its real estate portfolio to Blackstone Group LP and Wells Fargo & Co. for $23 billion.

- **Independent Financial Partners**, an investment adviser and wealth management firm in Tampa, FL, announced that it merged with institutional advisor **Private Wealth Alliance LLC**, an RIA based out of Ft. Lauderdale, FL, with a team of 40 investment professionals who manage more than 5,000 clients and more than $500 million in assets under management. Independent Financial Partners will now have access to Private Wealth Alliance's bank relationships, which consists of community and regional banks and credit unions with assets ranging from $200 million to $21 billion.

- **Rothschild Merchant Banking**, the merchant banking arm of Rothschild, announced that it acquired **West Gate Horizons Advisors, LLC**, a Los Angeles-based credit manager that specializes in leveraged loans and related assets with approximately $1.5 billion in assets under management across 5 collateralized loan obligation structures. Post-transaction, West Gate Horizons Advisors is a wholly owned subsidiary of Rothschild North America.

- **CAPTRUST Financial Advisors** entered into a definitive agreement to merge **Parker Carlson & Johnson Investment Management**, a Dayton, Ohio-based wealth-management and investment advisory firm, into its wealth management practice. CAPTRUST is an independent investment research and fee-based advisory firm headquartered in Raleigh, North Carolina that provides retirement plan and investment advisory services to retirement plan fiduciaries, executives and high-net-worth individuals; it currently represents about $176 billion in client assets.

**Closed-End Fund Initial Public Offerings**

- **First Trust Dynamic Europe Equity Income Fund (NYSE: FDEU)**
  - Amount raised: $330 million
  - Investment Objective/Policies: The Fund's investment objective is to provide a high level of current income with a secondary focus on capital appreciation. Under normal market conditions, the Fund will seek to achieve its investment objective by investing at least 80% of its Managed Assets in a portfolio of equity securities of European companies of any market capitalization, including, but not limited to, common and preferred stock that pay dividends, depository receipts and real estate investment trusts. The Fund will seek to focus its equity investments on income-producing securities. The fund will utilize a dynamic currency hedging process, which will include, at the discretion of the portfolio managers, the use of forward foreign currency exchange contracts to hedge a portion of the Fund's currency exposure.
  - Managers: First Trust Advisors L.P. and Henderson Global Investors (North America) Inc.
  - Book-runners: Wells Fargo Securities, Morgan Stanley, and UBS Investment Bank
- **Nuveen High Income 2020 Target Term Fund (NYSE: JHY)**
  - Amount raised: $124 million
  - Investment Objectives/Policies: The Fund's investment objectives are to provide a high level of current income and to return $9.85 per share to holders of common shares on or about November 1, 2020. The Fund seeks to identify securities across diverse sectors and industries that the portfolio managers believe are undervalued or mispriced. In seeking to return the target amount of $9.85 per share to investors on or about the Termination Date, the Fund intends to utilize various portfolio and cash flow management techniques, including setting aside a portion of its income, retaining gains and limiting the final maturity of any holding to no longer than May 1, 2021. As a result, the average maturity of the Fund's holdings is generally expected to shorten as the Fund approaches its Termination Date, which reduces interest rate risk over time.
  - Managers: Nuveen Fund Advisors and Nuveen Asset Management
  - Book-runners: Morgan Stanley, RBC Capital Markets, and Nuveen Securities

Simpson Thacher’s dynamic, long-standing Registered Funds Practice encompasses all aspects of the investment management business. Our practice is multidisciplinary—it brings together such other areas as securities, mergers and acquisitions, banking, tax and ERISA.

**Rajib Chanda**
+1-202-636-5543
rajib.chanda@stblaw.com

**Sarah E. Cogan**
+1-212-455-3575
scogan@stblaw.com



Simpson
Thacher


Simpson
Thacher
Worldwide

## UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

## EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

## ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

## SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000