Simpson Thacher

Registered Funds Alert

November 2016

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This latest edition of Simpson Thacher's Registered Funds Alert discusses: the SEC's final rules regarding liquidity risk management and data reporting and notable changes since the rules were initially proposed; the potential for recent money market reforms to affect how corporate treasurers handle cash reserves and potential traps that could trigger 1940 Act registration requirements; and a summary of what happened when a fund board discovered that the funds' adviser may have provided false or misleading information during the Section 15(c) contract approval process.

Update on SEC Asset Management Rulemakings and Adoption of Liquidity Risk Management and Data Reporting Rules for Registered Funds

On October 13, 2016, the Securities and Exchange Commission ("SEC") adopted final rules regarding liquidity risk management and modernized data reporting for registered funds. We have summarized the initially proposed versions of these rules and some notable comments made by the industry in prior Alerts (available here, here and here). In this Alert, we focus on changes that the SEC made in response to industry comments, review potential examination and enforcement implications and discuss whether other pending asset management rulemakings will be adopted before the upcoming change in presidential administrations.

Liquidity Risk Management

The liquidity risk management rule is aimed at reducing the risk that open-end funds will be unable to meet their redemption obligations. The final rule follows the same basic structure as the 2015 proposal, but the SEC made substantial changes in response to industry comments that recognize the inherent challenges in making liquidity determinations. Relative to the proposed rule, the final rule better balances the SEC's regulatory goals with practical considerations, resulting in a more flexible and administrable rule. The rule, and its attendant reporting requirements, do not apply to closed-end funds or business development companies ("BDCs").

Rule 22e-4 will require that each registered open-end fund, including exchange-traded funds ("ETFs") but excluding money market funds, adopt and implement a written liquidity risk management program. These programs must accomplish several specified goals, although ETFs that redeem shareholders in-kind are exempt from certain of these requirements:

- Assessment, management, and periodic review of the fund's liquidity risk.
- Classification of the liquidity of each of the fund's portfolio investments into one of four categories (does not apply to in-kind ETFs):

HIGHLY LIQUID	can be **converted to cash** in three **business** days or less
MODERATELY LIQUID	can be **converted to cash** in between three and seven **calendar** days
LESS LIQUID	can be **sold** in seven **calendar** days or less, but will be expected to settle in more than seven days
ILLIQUID	cannot be **sold** in less than seven **calendar** days

- Determine and periodically review a highly liquid investment minimum (does not apply to in-kind ETFs).
  - Funds' advisers will be required to determine their minimum percentage of highly liquid assets and implement policies and procedures that will enable them to respond to a shortfall from this percentage.
- Limit the fund's illiquid investments to no more than 15% of the fund's net assets (codifying long-standing SEC guidance).
  - Funds will be required to review illiquid investments at least monthly. Breaches of the 15% limit must be reported to the fund's board with an explanation and plan for remediation within a reasonable time period. If the breach is not resolved within 30 days, the board must determine whether the breach remediation plan is in the best interest of shareholders and investors.

The fund's board is required to review and approve the fund's liquidity risk management program when it is created, but it can designate that the adviser run the program. The board must receive and review an annual written report on the program's efficacy. Additionally, in response to industry comments, the final rule clarified that the board is only responsible for general oversight of the program, and not specifically responsible for approving material changes or setting the highly liquid investment minimum.

Perhaps the most controversial component of the 2015 proposal was the "bucketing" that would have forced funds to classify each of the positions in their portfolios into six different categories based on how quickly they could be converted into cash (at a price that would not materially affect the position's value).

The overwhelming majority of commenters felt that this was an implausibly burdensome and somewhat unworkable system.

For instance, because the buckets were based solely on how many days it would take to convert a position into cash under the previously proposed system, many commenters argued that it would have been unclear and somewhat misleading when applied to certain types of assets where there is often a delay between the execution of an agreement to sell the assets and settlement. Bank loans, for instance, can be sold relatively quickly, but settlement can take significantly longer. Under the previously proposed system, these assets could have been viewed as effectively illiquid without regard to how quickly an agreement to sell the assets could have been reached, because the sole consideration was when the cash would arrive. The new rule addressed this shortcoming. The adopting release makes it clear that the Less Liquid category in the final rule is meant to include asset classes, such as bank loans, where a delay between executing a sales agreement and settlement is common, and provides that they need not be treated as illiquid assets. Nonetheless, by categorizing such assets as "Less Liquid" in the final rule, many funds that are in fact highly liquid will appear on these metrics as less liquid than funds in similar asset categories. As a note of caution, however, the adopting release includes guidance that at a certain point the length of the settlement delay may justify an asset being treated as an illiquid asset. In this respect, the SEC cites as an example low-quality loans that "may not settle for a number of months."

In addition to addressing some of the substantive issues with the proposed rule identified by commenters, the final rule also has salient changes that reduce the practical hurdles with implementation. Many commenters felt that the previously proposed classification requirement was unduly burdensome because it required that each position be classified individually, which would have potentially required evaluating liquidity on a security-by-security basis. The final rule allows for determinations to be made for entire asset classes, unless a particular investment has characteristics that differ from the fund's other holdings in that asset class, making determinations for individual securities the exception rather than the rule. This change, like many of the other changes, seems to stem from a recognition that exact determinations of a security's liquidity are problematic because liquidity is ephemeral, and requiring statements of certainty on liquidity leaves the misimpression that liquidity determinations are a science, not an art.

In the same vein, the final rule revises the consequences of a fund failing its high liquidity minimum percentage test. Under the proposed rule, the fund would be prohibited from purchasing any securities other than highly liquid securities until the ratio was restored. Under the final rule, however, funds may continue to buy non-highly liquid securities pursuant to adopted shortfall policies and procedures and report that occurrence to the fund board at its next scheduled meeting.

"The final rule allows for determinations to be made for entire asset classes, unless a particular investment has characteristics that differ from the fund's other holdings in that asset class, making determinations for individual securities the exception rather than the rule. This change, like many of the other changes, seems to stem from a recognition that exact determinations of a security's liquidity are problematic because liquidity is ephemeral, and requiring statements of certainty on liquidity leaves the misimpression that liquidity determinations are a science, not an art."

Despite the positive changes to the liquidity management rule, it is still a complex set of rules and requirements that will require substantial compliance resources. Even though the compliance date is December 1, 2018 for fund groups with $1 billion or more in assets and June 1, 2019 for smaller fund groups, funds and other market participants would be well advised to begin thinking about implementation sooner rather than later.

Data Reporting

The final rule release for modernizing investment company reporting largely adopts the disclosure regime put forth in the proposing release, which we summarized in a prior Alert. Generally, the SEC adopted a new monthly reporting requirement on new Form N-PORT, with the first and third fiscal quarter reports including an exhibit of portfolio holdings that will replace current Form N-Q filings, and a new census filing on Form N-CEN that will replace current Form N-SAR filings.[1] Each of the new filings will be required to be made electronically in structured XML format, which will allow the SEC and investors to compile and analyze reported data more easily.

1. In line with current reporting requirements, BDCs are not subject to these reporting requirements.

In response to industry comments, the SEC made certain changes to the proposed data reporting requirements or clarified the requirements in the final release. Some of the key changes include:

- A fund may respond to certain items that involve subjective judgment calls by using its own methodology and conventions, or those of its service provider, so long as the fund reports similar information internally and to investors in the same manner. Funds also now have the opportunity to explain their methodologies, including any assumptions.

- If a fund invests 25% or more of its assets in debt instruments, or derivatives that provide that level of notional exposure to debt instruments or interest rates, it must provide a portfolio-level calculation of duration and spread duration across the applicable maturities in its portfolio. This threshold was initially proposed to be set at 20% of fund assets. Additionally, the threshold is based on the three-month average of a fund's assets as opposed to being calculated on the reporting date as initially proposed. The SEC also streamlined the potential maturities that a fund would need to calculate, retaining three-month, one-year, five-year, ten-year and thirty-year maturities while dropping the requirement to calculate spread and spread duration for one-month, six-month, two-year, three-year, seven-year, and twenty-year maturities.

- For derivatives that have underlying assets that are non-public indices or custom baskets of assets, the SEC has modified its original proposal regarding reporting of the underlying components of such indices or baskets. A tiered reporting structure has been adopted such that (i) if an investment in a non-public index or custom basket makes up more than 1% but less than 5% of a fund's net assets, the fund must report the top 50 components and (ii) if an investment in a non-public index or basket makes up more than 5% of a fund's net assets, all components must be reported. The SEC initially proposed disclosure of all components representing more than 1% of net assets.

- With respect to securities lending, the SEC has replaced the proposed requirement to disclose the terms governing compensation of a securities lending agent, including any revenue split, with a requirement to disclose actual fees paid during the reporting period.

- The SEC has responded to industry requests that certain reported information not become public by agreeing to keep a small number of items confidential. These include the following, and any explanatory notes related to these items:
  - Position-level risk metrics (delta);
  - Country of risk and economic exposure;
  - Position-level liquidity classifications; and
  - A fund's highly liquid investment minimum.

When the new reporting requirements become effective, funds will be required to file Form N-PORT within thirty days of the end of each calendar month and Form N-CEN within 75 days of the end of the fund's fiscal year. With respect for Form N-PORT filings, only those filings made after the month ending the first and third fiscal quarters will be made public (which is why those particular filings must include an exhibit reflecting a schedule of investments akin to current Form N-Q). Many commenters requested that the SEC provide additional details regarding its cybersecurity preparedness to safeguard the non-public information that will be reported on Form N-PORT. However, in the final release, the SEC only briefly addressed this issue, stating that it has experience maintaining confidential information and is working on controls and systems to handle confidential information submitted on Form N-PORT.

The compliance date for the new data reporting requirements will be June 1, 2018 for a "group of related investment companies" with net assets of $1 billion or more, and June 1, 2019 for smaller fund groups. The SEC plans to allow funds to file test filings during a trial period in advance of the compliance date. Notably, all information on Form N-PORT filings made within six months of the June 1, 2018 compliance date will not be made public (other than the portfolio holdings exhibit required to be filed for funds' first and third fiscal quarters that is similar to current Form N-Q filings). The SEC believes that this six-month period will allow filers and the SEC to make any technical adjustments needed to fine-tune the filing process with respect to new Form N-PORT. Additionally, with respect to reporting requirements arising out of the liquidity risk management rule release, funds will have an additional six months (December 1, 2018/2019 for large/small fund groups) before reporting that information.

Examination and Enforcement Implications

The new reporting requirements will result in the SEC having significantly more, and more detailed, information about funds and their portfolios. The SEC openly acknowledges that the new reporting requirements will facilitate examination and enforcement efforts. For example, Form N-CEN will include numerous "Yes" or "No" questions. With respect to such questions, the SEC stated that "staff of our Office of Compliance Inspections and Examinations may rely on responses to flag questions in Form N-CEN to indicate areas for follow-up discussion or to request additional information." One area where this could put a fund on the SEC's radar is with respect to NAV errors, as open-end funds will need to check "Yes" or "No" in response to the question of whether they made any payments to shareholders or reprocessed shareholder accounts as a result of a NAV error.

The volume of detailed information that the SEC will have on each fund could open the door for significant advances in the SEC's ability to compile and analyze information related to a single fund or identify industry trends. Notably, it also will enable the SEC to compare the practices of various funds that pursue similar investment strategies. For example, part of the SEC's rationale for deciding that certain items to be reported on Form N-PORT, such as position-level risk metrics or position-level liquidity classifications, will not be made public was that the public would not be able to compare how different funds evaluate the same investment. The SEC, however, will be able to make these comparisons and included an explicit statement in the instructions to Form N-PORT that it may use such information in examinations, investigations and enforcement proceedings.

Electronic Delivery of Shareholder Reports and a Potential Pocket Veto for the Derivatives and Business Continuity Rules

While the SEC had proposed a rule that would make electronic delivery of fund shareholder reports the default option in the same release in which it proposed to modernize data reporting, the electronic delivery rule has not yet been adopted. In the days leading up to the release of the final rules discussed above, it was reported that Commissioner Piwowar had expressed his belief while speaking at a conference that he did not expect the SEC to be in a position to vote on final rules for two key asset management rulemaking initiatives before a change in presidential administrations—derivatives and business continuity/transition planning.

The delay of the electronic delivery rule did not sit well with Commissioner Piwowar. In his statement at the open meeting related to the adoption of the liquidity risk management and reporting rules, Commissioner Piwowar said he would "agree to delay" non-essential items and rulemakings if the SEC did not finalize a rule regarding electronic delivery of fund shareholder reports. While he agreed to vote on a consolidated audit trail release, final rules for capital and margin requirements for security-based swap dealers and two other releases that are actively being considered, Commissioner Piwowar did not expressly name derivatives and business continuity/transition planning as those two releases. While purely an exercise in reading tea leaves at this point, Commissioner Piwowar would have the power to effect a form of "pocket veto" given that the SEC currently has only three commissioners. SEC rules state that three commissioners are required for quorum to conduct business (*i.e.*, to vote on rules). By simply declining to attend a meeting, any current commissioner could prevent a vote on any pending rulemaking. This power gives Commissioner Piwowar some leverage to force adoption of the electronic delivery rule in exchange for the derivatives and/or business continuity/transition planning rules. While the results of the presidential election could independently derail the derivatives rule, it is possible to view Commissioner Piwowar's displeasure with the failure to adopt the electronic delivery rule, combined with his public statements that some rules are unlikely to be finalized before Inauguration Day, as a suggestion that he would use his ability to prevent the SEC from achieving quorum to vote on other pending rules.

On November 1, 2016, however, the SEC's Division of Economic and Risk Analysis published a memorandum outlining its economic analysis of certain potential risk-adjusted schedules to determine a fund's derivatives exposure and qualifying coverage assets under the proposed rule's requirements. The release of this memorandum could be an indication that the Chair still intends to call for a vote on a final derivatives rule prior to the end of her term. The memorandum is a direct response to numerous comments suggesting the SEC consider adding some method of accounting for the variance in risk among different asset classes in the final rule. The economic analysis contained in the memorandum appears to generally support the incorporation of risk adjustments and haircuts, which would be a positive development for funds that utilize derivatives. In the SEC press release accompanying the release of the memorandum, the SEC stated it would accept comments on the new economic analysis, but did not provide a deadline.

Money Market Reforms Lay Potential Trap for the Unwary Corporate Treasurer

The SEC's 2014 money market fund reforms went into effect on October 14, 2016. These reforms created three categories of money market funds. The categories of money market funds, and certain key features, are summarized in the table below.

	Retail Prime Funds	Government Funds	Institutional Prime Funds
Net asset value ("NAV") calculation	Stable $1 NAV	Stable $1 NAV	Floating NAV
Potential restrictions on shareholder redemptions	May impose liquidity fees and redemption gates in times of market stress	Generally will not impose liquidity fees or redemption gates	May impose liquidity fees and redemption gates in times of market stress
Investor base	Limited to individual investors (or accounts whose beneficiaries are individual investors)	Available to all investors	Available to all investors
Implications for operating companies	Not an investment option for operating companies	Potential yield limited by requirement to invest 99.5% of assets in cash, US government securities and repurchase agreements collateralized solely by US government securities or cash	Can chase yield to a greater extent than government funds, but floating NAV creates potential for loss of principal

Money market funds have historically been a key tool for operating companies to manage their corporate treasuries, as they can offer yield with a stable $1 NAV. Now that the reforms are in effect, however, prime money market funds cannot offer a stable $1 NAV to corporate entities. As a result, in the weeks leading up to the October 14, 2016 effective date, it was widely reported that prime money market funds were rapidly transitioning their portfolios to government assets in order to qualify as government funds. Setting aside any broader effect on the financial markets, this shift to lower-yielding government assets has caused some corporate treasurers to look for other ways to achieve safe but meaningful yield on cash reserves. By moving corporate cash from money market funds to other types of investments, however, corporate treasurers may accidentally walk into a 1940 Act minefield.

Traditional operating companies must always be mindful of the 1940 Act's definition of an "investment company." Generally speaking, if more than 40% of a company's total assets (excluding cash items and government securities) are "investment securities," the company could be deemed to be an inadvertent investment company and might need to register with the SEC. For purposes of this 40% test, cash items and government securities are neutral, investment securities are commonly referred to as "bad assets" and all other assets are "good assets."

Because money market funds are registered investment companies, they would be treated as investment securities for purposes of evaluating a company's investment company status but for a no-action letter the SEC issued in 2000 that allows money market funds that seek to maintain a stable $1 NAV to be treated as "cash items" instead. In its FAQs related to money market reform, the SEC clarified that this no-action relief extends to institutional prime money market funds that will have a floating NAV as a result of the reforms. Accordingly, money market fund shares are neutral in the 40% test, instead of being bad assets.

Other forms of "safe" investments, such as ultra short term bond funds, could be bad assets. In addition, a private fund that relies on an exemption from the 1940 Act, such as Section 3(c)(7), may commit to following the investment limitations imposed on money market funds under Rule 2a-7 under the 1940 Act. Such a fund is simply a privately offered money market fund. The SEC's 2000 no-action letter, however, does not extend "cash item" treatment to such a private fund (although the SEC acknowledged that such funds were interchangeable with 1940 Act-registered funds in a rule relaxing some of the pyramiding limitations under Section 12(d) in 2006), and therefore it would be a bad asset unless the SEC issues additional guidance.

Until now, corporate treasurers have been able to park cash reserves in money market fund shares with a stable $1 NAV and achieve some yield (albeit negligible over the past few years) without any impact on the company's 40% test. As yields on government money market funds, which are now the only stable $1 NAV option for operating companies, have declined, treasurers may be considering other options and should be mindful of the impact those options could have on the company's inadvertent investment company status.

Adviser's Connection to Bond Scam Highlights the Limitations of Section 15(c) Inquiries

A key question in the recent AXA excessive fee trial (discussed in our prior Alert) was whether the funds' board should have hired independent consultants or obtained additional independent information to verify information provided by the funds' adviser during the contract renewal process under Section 15(c) of the 1940 Act. While the judge's decision in the AXA case did not find that the board received inaccurate or misleading information, and noted the board had appropriately consulted with consultants and other information providers, some uncertainty remains for boards regarding what boards should do when they think the adviser may have lied to or misled the board. A recent example (albeit an extreme one) may provide some insight.

Burnham Funds

On September 29, 2016, shareholders of what were previously known as the Burnham Funds (the "Funds") approved a new advisory contract with a new investment adviser, bringing a formal end to the Funds' separation from their former adviser, Burnham Asset Management ("Burnham"). The separation has been underway since May 11, 2016, when Federal Bureau of Investigation ("FBI") agents arrested a group of individuals and charged them with orchestrating an audacious and complex fraud scheme. The SEC simultaneously filed civil charges against the same individuals. The alleged fraud involved the individuals obtaining control over multiple registered investment advisers and broker-dealers in order to funnel over $43 million dollars towards the purchase of sham bonds. Though the Funds were not directly the victims of the alleged fraud, four of the seven facing charges were affiliated with Burnham, including one member of the adviser's board.

Within a week of the FBI and SEC leveling their accusations publicly, the Funds' board of trustees determined not to renew Burnham's advisory contract, which was set to expire shortly thereafter, and established an interim advisory agreement with a new investment adviser while the Funds sought shareholder approval of new advisory agreements. Interestingly, it appears that the Funds' independent trustees suspected a potential link between the adviser and the alleged mastermind of the fraud two years before the accusations came out, which raises questions, particularly in light of the recent AXA case, about when a board should verify information provided by an adviser in connection with annual Section 15(c) process.

The Scam

As the SEC describes events in its civil complaint, the alleged mastermind behind the sham bond scheme was Jason Galanis, son of the infamous John Galanis who received a 27-year prison sentence in 1988 for multiple counts of racketeering, tax fraud, securities fraud, bank fraud and bribery. Jason himself had earned notoriety in his own right in 2007 when he agreed to a five-year ban from serving as an officer or director of a publicly traded company as part of a settlement with the SEC stemming from the agency's charges that he filed false accounting information for a company in which he owned a significant stake.

The fraud that prompted the Funds' board to decline renewing Burnham's advisory contract began in March of 2014 with Jason Galanis allegedly enlisting the help of his father to meet with the Wakpamni Lake Community Corporation ("WLCC"), a corporation affiliated with the Oglala Sioux Nation, at a Native American economic development conference in Las Vegas. The elder Galanis, claiming to be a representative of Burnham Securities (a broker-dealer affiliated with Burnham), convinced WLCC to become the issuer of limited recourse bonds that he claimed Burnham had already developed. In reality, at that time the Galanises were not yet formally affiliated with Burnham.

Soon after they had a willing issuer, the FBI alleges that the Galanises and their co-conspirators moved to seize control over Burnham. Thankfully for the Funds' investors, it appears it was just Burnham Securities, the broker-dealer affiliate of Burnham, that the conspirators wanted to control to facilitate the fraud. The SEC complaint details how the FBI believes the Galanises enlisted Devon Archer, a respected Yale graduate and former adviser to John Kerry, to be the front man for the Burnham acquisition. Archer and other co-conspirators then directed their newly owned broker-dealer to serve as the placement agent for the sham tribal bonds, as the elder Galanis had already convinced WLCC they would. Concurrently to the takeover of Burnham, the Galanises are said to have used similar methods of disguised ownership to acquire control of two other investment advisers and to install another co-conspirator as CEO. The co-conspirators then used the funds of clients advised by the two advisers to purchase over $43 million of the tribal bonds for which Burnham Securities served as placement agent without disclosing the conflict of interest and despite the fact that the bonds fell outside of the investment parameters of many clients.

The Galanises had allegedly already convinced WLCC that the proceeds from the sale of the bond would be placed with an investment manager that would invest the proceeds to generate annuity payments sufficient to pay the interest on the tribal bonds and provide additional funds to the WLCC to be used for tribal economic development purposes, so the WLCC was not expecting a large payout from the issuance. The FBI alleges that rather than reinvesting the money, the conspirators misappropriated the funds from the first issuance for personal uses such as purchases from Valentino and Yves Saint Laurent, to expand their "corporate empire," and even to pay John Galanis' defense attorneys for charges that arose out of a separate scheme.

But things began to fall apart for the alleged schemers shortly thereafter. In September of 2015, fraud charges were brought against Jason and John Galanis and several other co-conspirators in connection with a separate scheme involving the collapse of a formerly NYSE-listed financial institution. In December 2015, the SEC filed suit against one of the advisers controlled by the co-conspirators, alleging that the investment adviser had placed client funds in the illiquid tribal bonds without disclosing the conflict of interest among the

adviser's owners. And then in May 2016, the seven conspirators were charged in the tribal bond scheme. Soon thereafter, Jason Galanis' bail was revoked after he sent threatening text messages to a former friend he thought was cooperating with the FBI. In July, Jason and John Galanis each pled guilty to securities fraud related to the collapse of the NYSE-listed financial institution. In October, the shares of yet another company collapsed after revelations that the Galanises had seized control of it too.

The Involvement and Response of the Funds' Board

When the Galanises and their co-conspirators moved to seize control of Burnham Securities in 2014, they also acquired Burnham, the Funds' adviser, which brought the Funds' board into play. Under a provision of the Funds' advisory contract that is required under Section 15 of the 1940 Act, a change of control of Burnham would result in the automatic termination of the existing advisory contract. As with any change of control transaction, the Funds' board and Burnham had to go through a contract approval process to vet the new owners of the adviser and understand the impact the change of control could have on the Funds.

In their 2014 proxy materials seeking shareholder approval of new advisory agreements in connection with the change of control, the Funds' board reported to their shareholders that "[t]hroughout the [contract review] process, the Trustees had numerous opportunities to ask questions of and request additional materials from the Adviser and [Archer]. . . . The Independent Trustees also met separately with Devon Archer and with management of the Adviser on three different occasions." The proxy statement also noted that the board had considered the reputation of the acquiring party (Archer) and representations that the investment and other personnel at Burnham would remain in place after the change of control.

As described above, the SEC alleges that the Galanises purposefully used Archer as a front man to disguise their involvement with the acquisition of Burnham. Interestingly, the recent FBI allegations reveal that the Funds' independent trustees had their suspicions about a link between Devon Archer and Jason Galanis, even in 2014. According to the SEC complaint, the Funds' independent trustees "sought 'iron clad assurance(s)' from Archer . . . that Jason Galanis would 'not be involved with any Burnham entities' or have an 'interest of any kind, direct or indirect, in any of the Burnham entities or their successors, that he will not source deals to the Burnham entities and that the Burnham entities will not invest with or in, directly or indirectly, any business or enterprise in which Mr. Galanis has any association, affiliation or investment . . . .'" The SEC complaint goes on to state that Archer provided the requested assurances in a letter to the independent trustees in September of 2014. The proxy materials did not discuss any potential link between Archer and Galanis to shareholders, and the SEC complaint does not provide any further detail about what might have prompted the Funds' independent trustees to ask Archer for such assurances.

Less than two years later, Archer and the Galanises had been arrested and Burnham's involvement in the alleged tribal bonds scheme was made public. The Funds' board moved quickly to replace Burnham. They reportedly had delivered a Section 15(c) packet to the replacement adviser within just two days of the tribal bond arrests, and had determined not to renew Burnham as adviser within a week. According to the eventual proxy to approve the new investment adviser, "no assets of the Funds were compromised [in the tribal bond scheme]. However, the allegations raised serious concerns for the Board and raised questions about whether certain representations made by Burnham and its affiliated persons as a condition to the Board's prior approvals of the Current Advisory Agreement had been complied with."

Analyzing a Close Call

This case represents a worst-case example of the dangers inherent in relying on assurances from interested parties when performing due diligence as part of the Section 15(c) process. While we do not have full information on what transpired between the parties, the proxy materials and complaint strongly suggest that something in the Funds' board's diligence hinted at a connection between Archer and Galanis, given that they reportedly asked Archer to confirm that Galanis would not be involved in anything having to do with Burnham. To the credit of the Funds' board, it did not simply gloss over whatever hinted at the potential connection; rather it sought assurances from Archer that whatever link they had uncovered was not true. Archer provided those assurances, but the SEC complaint alleges that he was lying to the Funds' board and that he was working in concert with Galanis the entire time.

Because we are only privy to publicly available information, we do not know what further steps, if any, the Funds' board took to gain comfort that Galanis was not involved before or after requesting a letter from Archer. If we hypothetically suppose that the board wished to take further action, however, it does provide a potentially instructive thought experiment to ask, what more could they have done?

In the AXA case, the plaintiffs pointedly questioned whether the board received information from any parties unaffiliated with the adviser, or ever hired a third party to verify information provided by the adviser. The decision in that case implies that a board's diligence does not hinge on whether it fact-checks information provided by the adviser, so long as it has no reason to believe it false or misleading. In our hypothetical here, however, it is not clear, even with the benefit of 20/20 hindsight, that the board could reasonably have done any additional diligence that would have changed the outcome. While the board apparently had enough reason to request clarification about the makeup of Burnham's new ownership group, it is difficult to argue that this is the type of situation in which an external consultant should be hired to verify the information provided by the adviser because it appears it would have been next to impossible, short of hiring a private investigator, for the board to unearth the alleged fraud in this instance. If the board so distrusted information and representations provided by an adviser that it thought it might need to hire a private investigator, it is unlikely the board would have voted to approve or renew an advisory contract in the first place.

While the Burnham Funds appear to have escaped without significant financial harm, if FBI and SEC allegations are correct, the clients of the two other investment advisers were not so lucky. As boards already know, they should consider utilizing consultants, outside counsel and other resources to the extent they deem necessary to verify information provided by advisers if they have reason to question such information. If a material misrepresentation or fraud does materialize, boards can look to the Burnham situation as an example of how to respond quickly and ensure there is no disruption in the management of the funds overseen by the board.

M&A Transactions

Acquiror	Acquired or Target Company	Type of Transaction and Status
Legg Mason, Inc., a global asset management firm with approximately $718 billion AUM	**Financial Guard LLC**, a leading online investment adviser	Acquisition of an 82% majority interest (terms not disclosed)
Minella Capital Management LLC, a private equity firm established in 2007	**W.E. Donoghue & Co.**, a registered investment adviser specializing in tactical strategies with over $1.6 billion AUM	Acquisition of a majority interest (terms not disclosed)
Boston Advisors LLC, a boutique investment management firm with approximately $4.5 billion AUM	**Weyland Capital Management**, an investment advisory firm with approximately $175 million AUM	Acquisition (terms not disclosed)
People’s Securities, Inc., a subsidiary of People's United Bank, N.A., a commercial and retail bank, with approximately $40 billion in assets	**Gerstein Fisher**, an independent boutique investment management firm that integrates academic research into quantitative portfolio structuring and investment solutions	Acquisition (terms not disclosed)
Victory Capital, the global asset management division of Wells Fargo & Company, with approximately $51 billion AUM	**Analytic Investors, LLC**, an investment firm with approximately $15 billion AUM	Acquisition (terms not disclosed)
Tiedemann Wealth Management, a New York-based wealth adviser with approximately $9 billion AUM	**Presidio Capital Advisors**, a San Francisco-based wealth adviser and subsidiary of The Presidio Group with approximately $4 billion AUM	Acquisition (terms not disclosed)
Pathstone Federal Street, a multi-family office with approximately $7 billion AUM	**Convergent Wealth Advisors**, a multi-family office with approximately $3 billion AUM	Acquisition (terms not disclosed)
F.A.B. Partners, a Jersey-based investment platform backed by a select group of sophisticated, global and long term oriented investors	**CIFC LLC**, a private debt manager specializing in secured U.S. corporate loan strategies	Acquisition for approximately $333 million in cash
AllianceBernstein L.P., a global investment firm with approximately $492 billion AUM	**RASL**, which is jointly owned by Ramius LLC (the investment division of Cowen Group, Inc.) and the two principals of RASL	Acquisition (terms not disclosed)

M&A Transactions *(continued)*

Acquiror	Acquired or Target Company	Type of Transaction and Status
United Capital Financial Advisers, LLC, a financial life management firm	**Westport Resources**, a registered investment adviser specializing in wealth management for a select group of individuals, families, municipalities and not-for-profit organizations across the Northeast	Acquisition (terms not disclosed)
WSFS Financial Corporation, a multi-billion dollar financial services company	**Powdermill Financial Solutions LLC**, a multi-family office	Acquisition of assets (terms not disclosed)
Pavilion Financial Corporation, an employee-owned, investment services firm	**Jeffrey Slocum & Associates, Inc.**, an investment adviser with approximately $125 billion AUM	Acquisition (terms not disclosed)
GMP Capital Inc., an independent diversified financial services firm headquartered in Toronto, Canada	**FirstEnergy Capital Corp.**, a provider of financial advisory and investment services to a broad range of corporate clients and sophisticated investors in the global energy sector	Acquisition for total consideration of $98.6 million
American Beacon Advisors, Inc., a provider of investment advisory services to institutional and retail markets	**Crest Investment Partners, LLC**, an independent registered investment advisory firm providing quantitative, fundamentally-driven investment solutions to institutional and individual clients	Acquisition (terms not disclosed)
RMB Capital, an independent financial services firm with more than $5.2 billion AUM	**Greenwood Investment Management, Inc.**	Acquisition (terms not disclosed)
Aston Hill Financial Inc., an asset management company which advises retail mutual funds, closed end funds, hedge funds and segregated institutional funds	**Front Street Capital**, an investment manager which offers a diverse range of investments, including growth, income and tax-minded portfolios offered as mutual funds, hedge funds, and flow-through limited partnerships	Merger (terms not disclosed)
Segal Rogerscasey, the SEC-registered investment consulting wing of The Segal Group	**The Marco Consulting Group**, a consulting firm that specializes in multiemployer benefit plans	Acquisition of assets (terms not disclosed)

Closed-End Fund Initial Public Offerings

Nuveen High Income November 2021 Target Term Fund (NYSE: JHB)

Amount Raised (Inception Date):	$500 million (August 26, 2016)
Investment Objective/Policies:	The Fund's investment objectives are to provide a high level of current income and to return $9.85 per share (the original net asset value ("NAV") per common share before deducting offering costs of $0.02 per share) to holders of common shares on or about November 1, 2021 (the "Termination Date"). The Fund will attempt to strike a balance between the two objectives, seeking to provide as high a level of current income as is consistent with the Fund's overall credit performance, the declining average maturity of its portfolio strategy and its objective of returning the original NAV on or about the Termination Date.
Managers:	Nuveen Fund Advisors and Nuveen Asset Management
Book-runners:	Book-runners: Morgan Stanley, UBS Investment Bank, Wells Fargo Securities and Nuveen Securities

RiverNorth/DoubleLine Strategic Opportunity Fund, Inc. (NYSE: OPP)

Amount Raised (Inception Date):	$210 million (September 30, 2016)
Investment Objective/Policies:	The Fund's investment objective is current income and overall total return. The Fund seeks to achieve its investment objective by allocating its managed assets among the two principal investment strategies: the Tactical Closed-End Fund Income Strategy and the Opportunistic Income Strategy. The Tactical Closed-End Fund Income Strategy will seek to (i) generate returns through investments in closed-end funds, exchange-traded funds and business development companies that invest primarily in income-producing securities, and (ii) derive value from the discount and premium spreads associated with closed-end funds. The Opportunistic Income Strategy will seek to generate attractive risk-adjusted returns through investments in fixed income instruments and other investments, including agency and non-agency residential mortgage-backed and other asset-backed securities, corporate bonds, municipal bonds, and real estate investment trusts. At least 50% of the Managed Assets allocated to this strategy will be invested in mortgage-backed securities.
Contingent Conversion Feature:	The Fund's Charter provides that, during calendar year 2021, the Fund will call a shareholder meeting for the purpose of voting to determine whether the Fund should convert to an open-end management investment company. If approved by shareholders, the Fund will seek to convert to an open-end management investment company within 12 months of such approval. If not approved by shareholders, the Fund will continue operating as a closed-end management investment company.
Managers:	RiverNorth Capital Management and DoubleLine Capital
Book-runners:	Wells Fargo Securities, BofA Merrill Lynch and UBS Investment Bank

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

Rajib Chanda is a Partner in the Washington, D.C. and New York offices of Simpson Thacher & Bartlett LLP. Rajib’s practice focuses on all aspects of issues facing registered investment advisers and sponsors of registered funds. Rajib has particular experience working with alternative asset managers seeking to access retail investor channels through mutual funds, business development companies, closed-end funds, exchange-traded funds and permanent capital vehicles. He also works extensively with more traditional registered fund sponsors and works closely with the firm’s asset management M&A group on transactions involving registered advisers and funds. In addition, Rajib provides counsel to boards of registered funds, and has substantial experience advising companies on issues relating to social media and cybersecurity.

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

Sarah Cogan is a Partner in the New York office of Simpson Thacher & Bartlett LLP and Head of the Firm’s Registered Funds Practice. Sarah’s practice encompasses all aspects of the registered funds industry and she represents closed-end investment companies, open-end mutual funds, investment advisers and independent directors of investment companies. She has a particular expertise in advising underwriters and sponsors in offerings by closed-end funds and business development companies. In addition, Sarah advises fund clients on corporate and securities law, including investment management, regulatory, compliance and M&A matters.

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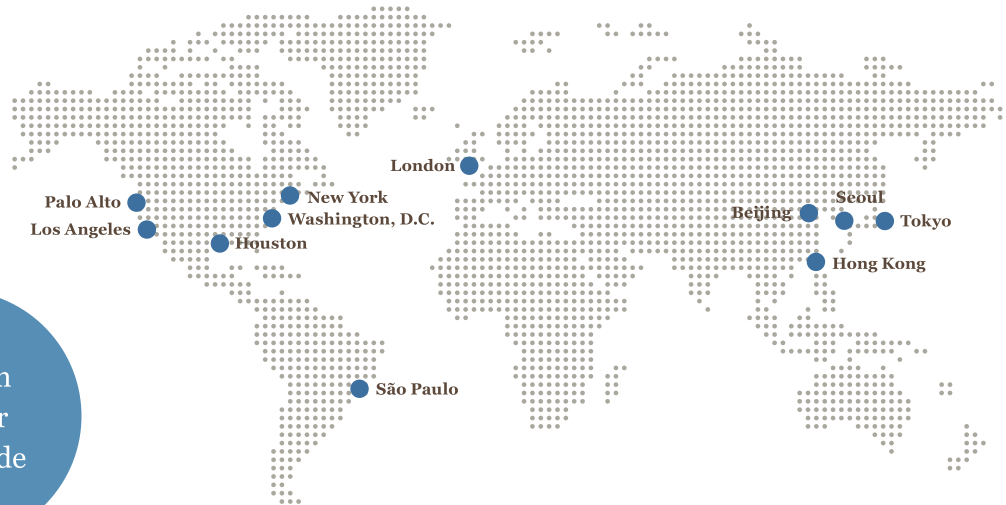

Simpson Thacher Worldwide

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