Simpson Thacher

Registered Funds Alert

This edition of the Simpson Thacher Registered Funds Alert discusses recent developments in the registered funds industry, including two recent SEC enforcement actions involving allegations of deficiencies in the Section 15(c) process, the inconsistency with which the SEC brings charges against chief compliance officers, the potential impact of a recent Ninth Circuit decision on the ability of shareholders of mutual funds to bring suits against trustees and investment advisers, as well as a Second Circuit decision that may make purchasing loans originated by national banks more complicated. In addition, this Alert discusses a recent administrative proceeding regarding the use of "may" instead of "will" in disclosure documents and reliance on advice from compliance consultants, a recent FAQ regarding ownership rights and the Shanghai-Hong Kong Stock Connect Program, and a summary of our comment letter to the SEC on its proposed amendments to investment company reporting requirements. Finally, we report on notable transactions that occurred in the second quarter of 2015, including M&A transactions and closed-end fund initial public offerings.

September 2015

Recent SEC Enforcement Actions Highlight the Importance of Establishing a Sound Section 15(c) Review Process for Advisers and Trustees

A pair of recent SEC enforcement actions alleged deficiencies in the Section 15(c) approval process. These and other recent enforcement actions demonstrate that the SEC is actively pursuing cases related to the Section 15(c) process and indicate a growing trend of the SEC charging independent trustees in connection with Section 15(c) violations. (click here for full article)

SEC Statements and Recent Enforcement Actions Send Mixed Messages to CCOs

Two recent enforcement actions have involved allegations that an adviser's violations were, at least in part, caused by its CCO, and have drawn strong reactions from several SEC commissioners and SEC Chair Mary Jo White. While Chair White has emphasized that CCOs should not be worried about the SEC "second guessing [their] good faith judgments, but rather when their actions or inactions cross a clear line that deserve sanction," recent SEC enforcement actions appear to show inconsistency in levying allegations against CCOs. (click here for full article)

Ninth Circuit Decision Invites Plaintiffs' Bar to Bring Claims Against Massachusetts Business Trusts, Trustees and Advisers for Violations of Fundamental Investment Policies

An April 2015 opinion from the Ninth Circuit Court of Appeals may open the door for a significant increase in suits by shareholders of mutual funds against trustees and investment advisers. The opinion is seemingly at odds with both federal and state court precedent on key issues, and in the event that the law is not clarified in the near future, there are several steps that mutual funds should consider taking to protect against some of the case's potential implications. (click here for full article)

SEC Loses First Round of Administrative Proceeding Regarding Use of "May" and Reliance on Advice from Compliance Consultants, Appeal Pending

As discussed in a prior Alert, the SEC brought an enforcement action against an adviser partially on the basis that its Form ADV stated that it "may" receive compensation from the broker, which the SEC argued was misleading because it was in fact receiving compensation. An administrative law judge recently dismissed the case, but the SEC staff has appealed the decision to the full Commission. If the dismissal is upheld, it may discourage the SEC from pursuing enforcement actions on scienter-based claims related to issues where an adviser relied on advice of a third-party compliance professional and it calls into question whether saying that a practice "may" occur when in fact that practice actually occurs is a sufficient cause for an enforcement action. (click here for full article)

Second Circuit Decision Has Potential Implications for Purchasers of Loans Originated by National Banks

A recent Second Circuit decision potentially complicates purchasing loans originated by national banks. The decision could affect a wide array of bank-originated loans that are subsequently sold to non-bank investors (such as funds and business development companies). As the industry awaits further guidance from the courts and regulators, there are several steps that purchasers of these loans can take to minimize their exposure. (click here for full article)

Chinese Regulator Clarifies Ownership Rights Relating to Shanghai-Hong Kong Stock Connect Program

The Chinese Securities Regulatory Commission published a "Frequently Asked Questions on Beneficial Ownership" in connection with the Shanghai-Hong Kong Stock Connect Program. The FAQ discusses how foreign investors can exercise their rights as owners of shares purchased through the program.
(click here for full article)

Simpson Thacher Comments on SEC's Proposed Amendments to Investment Company Reporting Requirements

Simpson Thacher & Bartlett LLP submitted a comment letter regarding the SEC's recently proposed rules to modernize existing investment company reporting requirements. Among other topics, we emphasized that the new reporting requirements could unintentionally disturb the competitive equilibrium among investment companies, asset managers, service providers or unrelated third parties and urged the SEC to eliminate from any new disclosure requirements provisions that would compel disclosure of certain types of sensitive information, particularly in respect of private loans that may be owned by bank loan funds.
(click here for full article)

2nd Quarter 2015 Notable Transactions

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

Recent SEC Enforcement Actions Highlight the Importance of Establishing a Sound Section 15(c) Review Process for Advisers and Trustees

Section 15(c) of the Investment Company Act of 1940, as amended (the "1940 Act"), imposes an affirmative duty on a registered fund's board members to request and evaluate, and a duty on the fund's investment adviser to furnish, "such information as may reasonably be necessary to evaluate the terms" of any advisory contract being considered for approval or renewal. A pair of recent SEC enforcement actions highlight the importance of having a sound review and approval process in building a fulsome record upon which trustees can base their approval.

In an action against Commonwealth Capital Management ("Commonwealth") and several trustees of the Commonwealth mutual funds, including two independent trustees, the SEC alleged deficiencies in the Section 15(c) approval process. According to the SEC, the trustees formally requested the information needed to satisfy their duties under Section 15(c), but Commonwealth failed to provide various requested information and some information provided to the trustees was inaccurate. The SEC also alleged that the trustees failed to follow up with Commonwealth with respect to the information that was not provided.

In another action against Kornitzer Capital Management ("Kornitzer") and the individual serving as both chief financial officer and chief compliance officer, the SEC alleged that inaccurate and incomplete profitability information was provided to the board of a mutual fund complex advised by Kornitzer in connection with the Section 15(c) process.

The Commonwealth action underscores the importance of a sound review and approval process in discharging the board's and the adviser's duties under Section 15(c). The SEC alleged numerous examples of the trustees requesting specific information and receiving no response or an incomplete response. Trustees often rely on their independent counsel to craft and review their requests for information. Trustees, including in consultation with counsel, may conclude that information requested may not be ultimately necessary in order for them to act on the approvals or renewals of advisory contracts they are considering. While the SEC does not speculate as to the reasons why the Commonwealth trustees and/or their counsel did not follow up with Commonwealth for any missing or incomplete information, there are a few factors that generally help to facilitate a sound 15(c) process.

First, a sound process cannot take place overnight. The process should be structured to allow enough time for both (i) an investment adviser to prepare a fulsome response to the trustees' request for information and (ii) the trustees and their counsel to review the adviser's response and ask appropriate follow-up questions. Second, it is important for the adviser to explain, and the trustees to understand, the source and methodology behind certain types of information. The Commonwealth and Kornitzer actions both include allegations that the advisers failed to provide adequate context or explanation regarding certain information provided to the trustees. For example, in providing information related to profitability, Kornitzer allegedly intentionally provided an inaccurate explanation of its methodology for allocating expenses, such as employee compensation, among its advisory clients. Commonwealth allegedly provided some comparative fee/expense information pulled from a standard industry database, but failed to explain that certain information might not be an appropriate comparison and did not remove the information. Third, if information is not available with respect to a particular request, trustees should document that the fact that the information was not received was not an impediment to their approval or renewal, in light of all relevant factors. For example, in the Commonwealth matter, the adviser was waiving all advisory fees for the periods covered by the allegedly faulty 15(c) process. If the minutes of meetings or disclosure to shareholders had noted that the waiver influenced the trustees' decision not to follow up on certain requests, it would seem that an enforcement action could only be brought when the trustees' determination failed to meet the standards of the business judgment rule. Put another way, the question of what is "reasonably necessary" to make a determination is one where the judgment of trustees should be entitled to deference.

The Commonwealth and Kornitzer actions are the latest enforcement actions indicating that the SEC is pursuing cases related to the Section 15(c) process. Additionally, the Commonwealth action is part of a growing trend of the SEC charging independent trustees in connection with Section 15(c) violations. In light of the foregoing, trustees and advisers should evaluate their own processes and consider whether there is any room for improvement.

SEC Statements and Recent Enforcement Actions Send Mixed Messages to CCOs

As mentioned above, the Kornitzer enforcement action was brought against the adviser's CCO as well as the adviser itself. In addition to Kornitzer, two other recent enforcement actions have involved allegations that an adviser's violations were, at least in part, caused by its CCO, illustrating a trend that has sparked significant debate within the ranks of the SEC and seemingly drawn a target on the backs of CCOs.

The first case, settled in April 2015, involved a prominent investment manager (the "Firm") and its CCO. The SEC alleged that a portfolio manager of certain private funds, registered funds and separately managed accounts advised by the Firm, had engaged in outside business activity, of which the Firm and its CCO were aware, that created a conflict of interest but was not disclosed to the funds' boards or investors. The SEC alleged that the failure to disclose this conflict of interest violated Section 206(4) and Rule 206(4)-7 under the Investment Advisers Act of 1940, as amended (the "Advisers Act") and Rule 38a-1 under the 1940 Act, and that the violations were caused by the CCO. We addressed some of the compliance lessons from this action in a separate client memorandum.

A second case, settled in June 2015, involved SFX Financial Advisory Management Enterprises, Inc. ("SFX") and its CCO. An employee of SFX allegedly misappropriated funds from multiple client accounts, and the CCO allegedly failed to implement SFX's compliance procedures, did not conduct an annual compliance review and caused a material misstatement in SFX's Form ADV.

These cases have sparked strong reactions from several SEC commissioners and SEC Chair Mary Jo White. Commissioner Daniel Gallagher issued a statement shortly after the SFX settlement to explain his rationale for voting against both settlements. Commissioner Gallagher stated that "[b]oth settlements illustrate a Commission trend toward strict liability for CCOs" and expressed his belief that the responsibility for implementation of compliance policies and procedures rests with the advisory entity, not the CCO.

Commissioner Luis Aguilar responded by issuing his own statement, saying that he believes that CCOs must be supported and that the SEC is not targeting CCOs who "do their jobs competently, diligently, and in good faith to protect investors." He also cited a subsequent SEC enforcement action involving Pekin Singer Strauss Asset Management, Inc. ("Pekin"), in which the SEC alleged violations of Pekin and its top executives for failing to provide adequate resources to Pekin's CCO, who was not a party to the enforcement proceedings. Additionally, Commissioner Aguilar noted that CCOs are not usually targeted in enforcement actions against advisers and investment companies, but those actions that have included CCOs involved situations where a CCO held multiple positions within an adviser. He notes that those cases are usually either egregious or involve actions of CCOs unrelated to their compliance functions. Chair White echoed Commissioner Aguilar's sentiments in a July speech before the SEC's Compliance Outreach Program for Broker-Dealers. She emphasized that CCOs should not be worried about the SEC "second guessing [their] good faith judgments, but rather when their actions or inactions cross a clear line that deserve sanction."

Chair White's attempt to reassure CCOs, however, begs the question of where that "clear line" is drawn. For instance, what separates the Pekin case from the other two cases? Pekin includes allegations of compliance failures including (i) missing annual compliance reviews, (ii) undetected compliance violations, (iii) misleading Form ADV disclosures and (iv) not adequately disclosing conflicts of interest to clients. Similar allegations can be found in one or both of the other two cases (but notably, neither case includes all four alleged compliance violations). The main distinction between Pekin and the other two cases is that the SEC placed significant emphasis on the fact that Pekin's CCO was wearing multiple hats and asked for additional resources to help him fulfill his compliance responsibilities. There is an acronym for the message these actions seem to prescribe for CCOs—CYA—that cannot be written out for the sake of propriety.

Ninth Circuit Decision Invites Plaintiffs' Bar to Bring Claims Against Massachusetts Business Trusts, Trustees and Advisers for Violations of Fundamental Investment Policies

An April 2015 opinion from the Ninth Circuit Court of Appeals may open the door for a significant increase in suits by shareholders of mutual funds against trustees and investment advisers. By approving novel interpretations of the law to allow claims for breach of contract and breach of fiduciary duty, as well as finding that shareholders are third-party beneficiaries to an agreement between a fund and its adviser, the Ninth Circuit gave shareholders potentially powerful new tools that the plaintiffs' bar will likely seek to exploit. There are several steps that mutual funds should consider taking to protect against some of the case's potential implications.

In *Northstar Financial Advisors, Inc.*, the Ninth Circuit allowed a financial advisor that managed over 200,000 shares of a mutual fund to proceed with claims for breach of contract and breach of fiduciary duty directly against the fund's trust, trustees, and investment adviser for their alleged failure to operate the fund in compliance with two of its fundamental investment policies. The fundamental policies stated (i) the fund was seeking to track a particular bond index and (ii) the fund would not invest 25% or more of its assets in any one industry, and could only be removed or changed upon approval by shareholders. The plaintiffs alleged that the violation of these fundamental policies exposed the fund and its shareholders to losses in the tens of millions of dollars.

The fund in question was a series of a Massachusetts business trust. The Ninth Circuit applied Massachusetts law to the contract and fiduciary duty claims and, pursuant to a clause in the investment adviser's contract, applied California law to the shareholders' claims as third-party beneficiaries of that contract. It remains to be seen whether the Ninth Circuit's opinion will stand and, if so, whether it will be adopted by other courts. A petition for certiorari has been made to the U.S. Supreme Court to appeal the decision and, of course, courts in Massachusetts could settle what Massachusetts law says on these issues by deciding new cases brought in state court. But, while *Northstar* is not legally binding on any federal court outside of the Ninth Circuit or on the courts of the states whose laws it purports to apply, other courts may choose to adopt the Ninth Circuit's reasoning, and future plaintiffs may try to find ways to bring their claims in federal courts in the Ninth Circuit.

The *Northstar* opinion came to several potentially important conclusions. First, the court held that by having fundamental investment policies approved by shareholder vote through a proxy statement, and by incorporating the approved policies into the fund's prospectus and registration statement going forward, the fund and the trust created a contract with each shareholder. Read broadly, the language in the opinion indicates that violation of any fundamental investment policy, even if approved by a sole initial shareholder of a fund, may give rise to a breach of the contract claim.

Second, the Ninth Circuit declared that mutual funds "are essentially puppets of the investment adviser" and held that under Massachusetts law shareholders could bring their claims directly against the fund's trustees, bypassing a demand on the board of directors and a derivative suit.

Finally, the court held that the shareholders of the fund were third-party beneficiaries to the investment advisory contract between the investment adviser and the fund, and could file a claim against the investment adviser for breach of contract for violating the fundamental policies.

The *Northstar* opinion is seemingly at odds with both federal and state court precedent on key issues and, should other suits be brought under these theories, defense counsel would need to mount a vigorous defense based on these contradictions. For example, the opinion states that Massachusetts law requires a shareholder filing a direct suit to show that his or her injury is distinct from that of the shareholders generally, or that it was connected to a violation of the shareholder's contractual rights (including voting rights). The court then assumed, however, that Massachusetts would adopt a change in that law articulated by Delaware courts in 2004, eliminating the requirement that a plaintiff's injury be distinct from that of other shareholders.[1] The Massachusetts Supreme Judicial Court does not appear to have ever cited that case in the intervening eleven years, nor has the Massachusetts legislature explicitly adopted that change in the law. The Ninth Circuit's concept of fiduciary duty in mutual funds is also difficult to reconcile with other federal decisions, including *Goldstein v. SEC*, which determined that an investment adviser to a hedge fund cannot owe

1. *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004).

a fiduciary duty to both the fund and the fund's investors because the adviser would "inevitably face conflicts of interest,"[2] and *Burks v. Lasker*, in which the Supreme Court noted that Congress, in enacting the 1940 Act, placed a great deal of trust in the hands of the independent directors of investment companies.[3]

In the event that *Northstar* is not overturned by the Supreme Court or its interpretation of Massachusetts law is not clarified by the Massachusetts courts or Attorney General, however, mutual funds could potentially take several steps to mitigate the risk of similar suits. Although Section 13(a) of the 1940 Act requires a majority vote of a fund's shareholders to deviate from or change certain investment policies, including diversification, borrowing and concentration policies, trustees could be given as much control as possible over investment policies. Additionally, funds may consider adding explicit declarations to their prospectuses and registration statements that they are not contracts and do not create contractual rights or obligations. Funds and investment advisers might consider including clauses in new advisory contracts stating explicitly that there are no third-party beneficiaries to make it even clearer that shareholders are not beneficiaries of the contract and should not be able to sue the adviser directly for breach of its contract with the fund.

It may also be possible to use a fund's trust instruments to limit expressly the fiduciary and contractual rights owed to shareholders. In support of its declaration that trustees owe a fiduciary duty to shareholders of the fund in *Northstar*, the Ninth Circuit quoted a journal article saying that "[t]he familiar standards of trust fiduciary law protect trust beneficiaries of all sorts, regardless of whether the trust implements a gift or a business deal (*unless, of course, the terms of the transaction expressly contraindicate*)."[4] This implies that trusts can structure (or restructure) their declarations of trust to contract around the issues raised by the Ninth Circuit's decision. Some states, like Delaware, specifically provide by statute that a trust may limit or eliminate a trustee's fiduciary or other duties or liability for breach of contract or duties in its governing document, so long as it does not limit or eliminate the implied covenant of good faith and fair dealing.

As a general matter, fund contracts include forum selection and choice of law clauses, specifying the law that will govern any dispute and in which court litigation will take place. Unless and until *Northstar* is overruled or Massachusetts law is clarified or changed, it may be advisable to designate a forum outside of the Ninth Circuit in new advisory contracts. Incorporating a change of forum in an existing advisory contract may be more difficult, as it could be considered a material change that requires shareholder approval under the 1940 Act, but if a contract is slated for shareholder approval for any other reason, advisers and funds could consider changing the forum as well, with appropriate disclosure regarding the reasons for the amendments.

2. 451 F.3d 873, 881 (D.C. Cir. 2006).

3. 441 U.S. 471, 484–85 (1979).

4. John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 166 (1997) (emphasis added).

SEC Loses First Round of Administrative Proceeding Regarding Use of "May" and Reliance on Advice from Compliance Consultants, Appeal Pending

As discussed in a prior Alert, on September 2, 2014, the SEC initiated administrative proceedings against the Robare Group ("Robare"), a Houston-based investment advisory firm, seemingly related to its widely reported "distribution in guise" sweep examination. The SEC alleged that Robare violated Sections 206(1), 206(2) and 207 of the Advisers Act, by failing to disclose in its Form ADV an alleged hidden fee arrangement with a broker that compensated Robare for investing client assets in certain mutual funds through the broker's platform. Notably, some of the language at issue in Robare's Form ADV stated that it "may" receive compensation from the broker, which the SEC argued was misleading because it was in fact receiving compensation.

In June 2015, an administrative law judge (the "ALJ") dismissed the SEC's case against Robare by finding that the Division of Enforcement failed to carry its burden of proof (the "Initial Decision"). Specifically, the ALJ separated the time period in question into two segments, pre-2005 and post-2005. During the post-2005 period, Robare's clients received the participating broker's agreement, which the SEC conceded sufficiently disclosed the potential conflicts under the commission program. Emphasizing that the overriding goal of the Advisers Act was full disclosure by advisers, the ALJ concluded that disclosure through an adviser's Form ADV was not the only means to disclose adequately conflicts to clients. The ALJ also specifically pointed to Form

ADV's instructions, which provide that conflicts may be disclosed "to clients in [the firm's] brochure or by some other means." Thus, the only timeframe in question as to whether Robare adequately disclosed the program's conflicts was pre-2005, during which Robare accepted approximately 150 clients who were not provided the broker's agreement. Additionally, the ALJ disagreed with the SEC's assertion that use of the term "may" was misleading with respect to Robare's receipt of payments from the broker, as the parties were free to terminate the payments (with notice) after an initial period.

Scienter and intent are required elements of any violation based on Section 206(1) and 207, respectively; however, scienter can be shown through both intent as well as an extreme departure from the ordinary standard of care. Significantly, the ALJ's decision acknowledged, "*for purposes of this matter*, ... investment advisers operate in an uncertain regulatory environment in respect to disclosing potential conflicts of interest." Noting that many firms, especially small to mid-sized firms, consult third-party compliance professionals, a practice the SEC itself has acknowledged as acceptable, the court concluded that the relevant standard of care entails the consultation and application of the professional's advice regarding a firm's disclosure obligations. Additionally, the ALJ acknowledged that reliance on compliance professionals as well as counsel demonstrates good faith and shows an absence of the intent to defraud required for a Section 206(1) violation. In the same vein, the court found that Robare's good faith reliance on compliance professionals as well as its own diligence demonstrated a lack of willfulness as required for any Section 207 violation.

Even though a Section 206(2) violation requires only a demonstration of negligence, or a failure to exercise reasonable care, the ALJ found that Robare's diligence and use of compliance professionals demonstrated that Robare did use reasonable care. Accordingly, the court found that the SEC provided no evidence of Robare breaching the standard of care, an essential element to the SEC's Section 206(2) violation.

The SEC staff appealed the Initial Decision to the full Commission on June 26, 2015, asserting that the decision "shifts the burden of fully disclosing a conflict of interest from an investment adviser, who has a fiduciary duty to and a relationship with its clients, to a compliance consultant (who has no such connection)." Robare's motion for summary affirmance of the Initial Decision was also recently denied on August 12, 2015. The SEC staff's brief in support of the petition for review is scheduled to be filed by September 11, 2015, and Robare's brief in opposition is scheduled to be filed by October 12, 2015. Arguments will commence shortly thereafter.

If the Initial Decision is upheld, it may discourage the SEC from pursuing enforcement actions based on scienter where an adviser consulted a third-party compliance professional and followed their advice in connection with the conduct giving rise to an alleged violation. Furthermore, the comments from the ALJ regarding the meaning of the word "may" is in direct contrast to positions that we are aware have been taken by the SEC staff in communications with registrants in several contexts. Specifically, it calls into question whether saying that a practice "may" occur when in fact that practice actually occurs is a sufficient cause for an enforcement action (although we continue to believe that it is a good practice to affirmatively disclose the occurrence of a practice if it is actually taking place).

Second Circuit Decision Has Potential Implications for Purchasers of Loans Originated by National Banks

The Second Circuit's June 2015 decision in *Madden v. Midland Funding, LLC*, potentially complicates purchasing loans originated by national banks. Interpreting the National Bank Act ("NBA"), the court held that an assignee of a loan originated by a national bank could not rely on federal NBA preemption to avoid liability under state usury laws if the assignee was not itself a national bank. If interpreted broadly, the Madden decision could affect a wide array of bank-originated loans that are subsequently sold to non-bank investors (such as funds and business development companies).

Federal law permits national banks to "take, receive, reserve, and charge" interest at the rate allowed by the state where the bank is located.[5] It also provides the exclusive cause of action for usury claims against national banks, and therefore completely preempts analogous state-law usury claims.

In *Madden*, a New York resident plaintiff opened a credit card account with a national bank. Subsequently, the national bank amended the credit card agreement to permit the bank to charge an interest rate that, while permissible under the law of the bank's home state of Delaware, exceeded the limit set by New York law. After the plaintiff defaulted,

5. *See* 12 U.S.C. § 85.

the national bank charged off plaintiff's $5,000 remaining balance as a bad debt and sold the account to the defendant Midland, which is not a national bank. Midland subsequently sent a letter to the plaintiff seeking to collect on her debt and applying the interest rate that exceeded the New York limit.

The plaintiff filed a putative class action alleging that Midland had violated the federal Fair Debt Collection Practices Act and New York law by charging a usurious interest rate. Midland responded that the NBA preempted the plaintiff's claim because a national bank had originated the debt. The district court initially decided in favor of Midland but, on appeal, the Second Circuit reversed.

The Second Circuit recognized that while the Supreme Court has held that NBA preemption may extend to operating subsidiaries and agents of national banks when those entities effectively exercise the powers of the national bank, that authority does not extend to Midland as an unrelated entity that merely purchased the debt. Thus, although NBA preemption applies to claims arising out of alleged violations of state usury laws, Midland was not entitled to rely upon NBA preemption because it was not a national bank. In vacating the district court judgment for Midland, the Second Circuit reasoned that applying NBA preemption to encompass Midland under the circumstances presented "would create an end-run around usury laws for non-national bank entities that are not acting on behalf of a national bank."

In the weeks since the decision, commentators have criticized the economic conclusions the Second Circuit relied upon in its opinion. In particular, the opinion noted that the application of state usury laws to third-party assignees of bank-originated loans would not prevent or "significantly interfere" with the exercise of national bank powers, which the court noted includes the power to sell debt for a fee. To the contrary, critics argue that if for any reason non-national bank purchasers are unable to enforce the terms of a loan according to the pre-sale terms between the bank and borrower, there could be a chilling effect on the bank-originated debt market. Further, the viability of related activities such as certain types of securitizations and originate-to-sell business models may have to be reevaluated entirely. The potential for the application of criminal usury statutes from states such as New York and Florida will also increase the price of the transactions as buyers begin to factor greater legal risks into their pricing models.

While state usury laws do not apply to all loans—for example, New York usury laws only apply to loans of less than $2.5 million—as the industry awaits further guidance from the courts and regulators, investors purchasing debt, such as bank loan funds, can take certain steps to minimize their exposure. To begin, it may be beneficial to review existing and pending loan purchase agreements for potential violations of usury laws in states where borrowers reside, starting with the Second Circuit states (New York, Connecticut, and Vermont). Further, a preference for transactions where the originating bank retains some aspect of ownership or other continuing interest in loans sold may also avoid many of the complications potentially introduced by the *Madden* decision.

Chinese Regulator Clarifies Ownership Rights Relating to Shanghai-Hong Kong Stock Connect Program

In November 2014, China launched the Shanghai-Hong Kong Stock Connect ("Stock Connect"), which allows foreign investors to trade shares listed on the Shanghai Stock Exchange ("SSE Shares"). While the launch of Stock Connect was greeted with enthusiasm, many investors have expressed concerns about the legal regime governing the program. In particular, there has been doubt over whether Chinese law recognizes the concept of beneficial ownership, and if the concept is recognized, whether investors can enforce their ownership rights.

Under the rules governing Stock Connect, the SSE Shares acquired by foreign investors are held in an omnibus account with Hong Kong Securities and Clearing Company Limited ("HKSCC"). Governed by a civil law system, China traditionally lacked the concepts of beneficial ownership and trusts. Therefore, initially it was unclear whether HKSCC merely holds the SSE Shares in trust for investors, and whether investors have beneficial ownership in the SSE Shares.

In response to investor concerns, the Chinese Securities Regulatory Commission (the "CSRC") published a "Frequently Asked Questions on Beneficial Ownership" in May 2015. In the FAQ, the CSRC identifies the basis for nominee shareholding under Chinese law and concludes that, for purposes of the Stock Connect, overseas investors "are entitled to proprietary interests" in the SSE Shares held through HKSCC. These investors must exercise their rights over the SSE Shares, such as the right to participate in shareholders' meetings and the right to receive dividends, through HKSCC as the nominee holder.

With regard to the question of enforcement, the CSRC acknowledges there is some legal ambiguity: "Mainland law does not expressly provide for a beneficial owner under the nominee holding structure to bring legal proceedings, nor does it prohibit a beneficial owner from doing so." Nonetheless, based on its interpretation of China's civil procedure, the CSRC stated its position that a foreign investor "may take legal action in its own name in Mainland courts," as long as the investor can "provide evidential proof of direct interest as a beneficial owner."

Simpson Thacher Comments on SEC's Proposed Amendments to Investment Company Reporting Requirements

As noted in a prior Alert, the SEC recently proposed rules to modernize existing investment company reporting requirements. The proposed rules would require monthly reporting and drastically expand the scope of information required to be reported. On August 11, 2015, we submitted a comment letter regarding the proposal. Our main comment was that while any modernization effort would be expected to impose *administrative* and *compliance* burdens on investment companies, the proposed reforms may impose material *competitive* burdens on funds and investment advisers, particularly those employing alternative investment strategies.

Our assumption is that the SEC does not intend for the proposed new reporting requirements to disturb the competitive equilibrium among investment companies, asset managers, service providers or unrelated third parties. Accordingly, we urged the SEC to eliminate from any new disclosure requirements provisions that would compel disclosure of certain types of sensitive information. In this regard, our comments addressed four areas of concern:

- Disclosure of whether a debt security is in default, or otherwise distressed, would impose a competitive burden on funds that hold private loans. The disclosure could disrupt fund management and the private loan market.
- Reporting of position-level information regarding derivatives would place an unintended competitive burden on investment companies and asset managers that employ alternative investment strategies, as such detailed information is more likely to cause investor confusion than improve investor understanding.
- Disclosure of portfolio-level interest rate risk, credit spread risk and duration would pose a competitive risk that an investment strategy could be reverse-engineered, especially for fixed-income funds that hold a relatively low number of positions.
- Disclosure of securities lending "splits" in financial statements could disrupt the securities lending market, thereby imposing a competitive burden on investment companies and securities lending agents alike.

In addition to our comments regarding the imposition of competitive burdens, we addressed four other topics in our comment letter:

- We noted that some of the new information that would be required to be reported regarding derivatives and convertible securities may not be readily available or easily obtainable.
- We urged the SEC to provide additional details regarding cybersecurity and the safekeeping of confidential reported information prior to finalizing the new reporting requirements.
- We discussed our belief that the SEC's burden estimates are not realistic given the frequency and volume of new reports.
- We suggested an improvement to proposed Rule 30e-3 that would allow investors to opt for electronic notification of the availability of shareholder reports in addition to receiving reports electronically.

We will closely monitor developments related to the SEC's proposals, and provide additional updates in future Alerts, as relevant.

2nd Quarter 2015 Notable Transactions

M&A Transactions

- **Beacon Trust Company** announced the completion of its acquisition of **The MDE Group, Inc.**, a nationally ranked, SEC-registered investment advisor based in Morristown, NJ and its affiliate, **Acertus Capital Management, LLC**. As of the closing date, the assets under management of the combined entities were approximately $2.5 billion.

- **AMG Wealth Partners, LP**, a subsidiary of **Affiliated Managers Group, Inc.** (NYSE: AMG), announced the completion of its investment in **Baker Street Advisors, LLC**, a San Francisco-based wealth management firm that provides customized wealth management and comprehensive investment advisory solutions to individuals, families and foundations. Founded by Jeff Colin in 2003, the firm advises on approximately $6 billion in assets.

- **ALPS, a DST Company** that provides products and services to the financial services industry, announced it has agreed to acquire asset manager **Red Rocks Capital LLC**, a leader in listed private equity and other private asset investments. The closing of the transaction is expected to occur in the second half of 2015. The purchase price of up to $65 million will consist of a combination of up-front cash consideration and performance-related contingent consideration. The transaction will be funded using a combination of cash and short-term borrowings on revolving credit lines.

- **Focus Financial Partners, LLC**, the leading international partnership of independent wealth management firms, announced that **Classic Capital**, based in Short Hills, NJ, has merged with **Buckingham Asset Management**, a Focus partner firm headquartered in St. Louis, MO. The merger brings Buckingham additional scale and increases its total locations to eight.

- **Lightyear Capital LLC**, a private equity firm specializing in financial services investing, announced that an affiliated investment fund signed a definitive agreement to purchase a majority equity stake in **Wealth Enhancement Group**, an independent wealth management firm with $4.7 billion in client assets. Financial terms of the transaction were not disclosed. Under the terms of the agreement, an investment fund affiliated with Lightyear Capital will purchase the equity stake currently held by **Norwest Equity Partners**, a Minneapolis-based middle market investment firm. A number of employees of Wealth Enhancement Group will continue to hold a stake in the firm.

- **UniCredit, Santander Asset Management** and affiliates of **Warburg Pincus** and **General Atlantic** signed a preliminary agreement to combine **Pioneer Investments** and **Santander**. The combined firm will have approximately €400 billion in assets under management and a presence in over 30 countries. The preliminary agreement contemplates the establishment of a holding company, with the name Pioneer Investments, which will control Pioneer's operations in the United States along with the combination of Pioneer and Santander's operations outside the United States.

- **Hillspire LLC**, an entity that serves as an investment vehicle for Google Inc.'s Executive Chairman Eric Schmidt and his family, bought a 20% stake in New York-based hedge fund firm **D.E. Shaw Group**. Hillspire purchased the stake from Lehman Brothers Holdings Inc. for approximately $500 million. Lehman Brothers Holdings Inc. had previously purchased its stake for approximately $750 million in 2007.

- **Samsung Asset Management Co., Ltd, Korea**, the largest asset manager in Korea, signed a Memorandum of Understanding for a strategic alliance with **Reliance Capital Asset Management**, part of Anil Ambani's Reliance Capital and India's largest asset manager.

- **JHS Capital Advisors LLC**, a registered securities broker dealer and registered investment adviser providing personalized client services for investors nationwide, announced it has signed a definitive agreement to have its retail assets acquired by **Ameriprise Financial**. The JHS retail brokerage and investment advisor network consists of approximately 150 advisors in offices around the country, and retail assets in excess of $4.1 billion.

- **Wunderlich Investment Company** announced the acquisition of **Fiduciary Financial Services of the Southwest**, a privately-held independent investment advisory firm based in Dallas, Texas, with over $400 million in assets under management. Fiduciary Financial will operate as a registered investment adviser subsidiary of WIC.

- **Westaim Corporation**, a publicly traded Canadian investment company, announced its entrance into a non-binding term sheet to acquire **Arena Investors, LLC**, a U.S. based investment firm specializing in asset-oriented credit investments. The term sheet also provides for the establishment and capitalization of a new, specialty finance company to be named **Arena Finance Company**. Westaim is expected to finance **Arena Finance Company** with $200 million.

- **FolioMetrix LLC** announced that it will merge with **American Independence Financial Services, LLC** to create a new company, **RiskX Investments, LLC**, offering an array of risk-intelligent investment solutions. The transaction is expected to close in September 2015. Deal terms were not disclosed. RiskX will manage, post-merger, approximately $1.1 billion in funds and separately managed accounts, comprised of the American Independence Funds (single-manager sub-advised funds and separately managed accounts) and the FolioMetrix Rx Fund Series (multi-strategy tactical mutual funds).

- **Blackstone Group LP** announced its acquisition of a minority stake in Illinois-based **Magnetar Capital Partners**. Blackstone bought the stake through its Strategic Capital Holdings fund, which has raised more than $3 billion to buy minority stakes in alternative-investment firms.

- **Fortress Investment Group LLC (NYSE:FIG)**, a leading, diversified global investment management firm, and **Mount Kellett Capital Management LP**, a private, multi-strategy investment firm, announced they reached an agreement for an affiliate of Fortress to become co-manager with Mount Kellett of the Mount Kellett investment funds and related accounts (collectively, the "Funds"). Mount Kellett affiliates will continue to serve as general partner of the Funds. Additionally, affiliates of Fortress will become special limited partners of the Funds. Financial terms of the transaction were not disclosed.

- **Aberdeen Asset Management PLC** announced it entered into an agreement to acquire **FLAG Capital Management, LLC**, a manager of private equity and real asset solutions with offices in Stamford, CT, Boston, MA, and Hong Kong. As of December 31, 2014, FLAG managed assets of approximately $6.3 billion of invested and committed capital on behalf of its broad client base.

- **Ohio National Financial Services** acquired the remaining ownership interest in **Fiduciary Capital Management**, an asset management firm based in Wallingford, Connecticut. As of December 31, 2014, Ohio National had a total of $41.1 billion in assets under management.

- **UMB Financial Corporation**, a financial holding company headquartered in Kansas City, Missouri, announced the completion of its acquisition of **Marquette Financial Companies** in an all-stock transaction. As part of the acquisition, UMB acquired **Marquette Asset Management**, which provides private asset management to individuals, families and institutions, based in Minneapolis, Minnesota. UMB also acquired eight Marquette bank branches in the Phoenix area and five branches in Ft. Worth, Dallas and Denton, Texas.

- **Habib Bank Limited Asset Management**, the asset management subsidiary of Habib Bank Limited, announced that it would acquire 100% of the shares of **Pakistan Industrial Credit and Investment Corporation Asset Management Company Limited**.

- **Washington Trust Bancorp, Inc.**, a bank holding company, announced that it agreed to acquire **Halsey Associates, Inc.**, an investment advisory firm based in New Haven, Connecticut. Washington Trust will acquire all of the outstanding shares of Halsey capital stock for consideration consisting of cash and Washington Trust common stock.

- **Hunt Companies, Inc**., through its wholly-owned subsidiaries, has completed an investment in **Amber Infrastructure Group Holdings Limited**, headquartered in London, England. Hunt acquired a fifty percent (50%) ownership of Amber Infrastructure with an ability to appoint a majority of directors of Amber's holding company.

- **Stifel Financial Corp.** announced its entrance into a definitive purchase agreement to acquire **Barclays' Wealth and Investment Management, Americas franchise** in the U.S. As of May 31, 2015, Barclays had approximately 180 financial advisors in the U.S. managing approximately $56 billion in total client assets. In addition, Barclays' business had balance sheet assets of approximately $1.4 billion and client loans of approximately $1.5 billion held through Barclays' clearing firm. Barclays' advisory business is concentrated in New York and 11 other major metropolitan cities in the U.S. As part of this agreement, Stifel will be the U.S. private wealth distribution partner for certain of Barclays' equities and credit new issue securities in the U.S.
- **BlackRock, Inc.** entered into a definitive agreement to acquire **Infraestructura Institucional**, Mexico's leading independently managed, infrastructure investment firm, expanding BlackRock's infrastructure capabilities in Mexico.
- **First Republic Bank**, a leading private bank and wealth management company, and **Constellation Wealth Advisors**, one of the nation's foremost independent wealth advisors, announced that First Republic Investment Management, Inc., a wholly-owned subsidiary of First Republic, would purchase Constellation Wealth Advisors for approximately $115 million, subject to the satisfaction of certain closing conditions.
- **Federated Investors, Inc.** announced the completion of its acquisition of certain assets of **Touchstone Advisors, Inc.** Federated is an investment manager with $355.8 billion in assets under management as of March 31, 2015. With 130 funds and separately managed account options, Federated provides investment management services to more than 7,700 institutions, including corporations, government entities, insurance companies, foundations and endowments, banks and broker/dealers.
- **Neuberger Berman**, one of the world's leading private, employee-owned investment managers, announced an agreement with **Merrill Lynch Alternative Investments LLC,** the alternative investment business of Bank of America Corp., whereby Neuberger Berman will acquire the management rights to certain Merrill Lynch traditional non-registered and 40-Act-registered private equity fund of funds.
- **Sun Life Financial Inc.** announced that it reached an agreement to acquire **Prime Advisors Inc.**, an investment management firm specializing in customized fixed income portfolios, with approximately $13 billion in assets under management. Sun Life is an international financial services organization with $813 billion in assets under management.

Closed-End Fund Initial Public Offerings

AllianzGI Diversified Income & Convertible Fund (NYSE: ACV)

- Amount Raised: $280 million
- Investment Objective/Polices: The Fund's investment objective is to provide total return through a combination of current income and capital appreciation, while seeking to provide downside protection against capital loss. Under normal market conditions, the Fund will seek to achieve its investment objective by investing in a combination of convertible securities, debt and other income-producing instruments and common stocks and other equity securities. The Fund will normally invest at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of convertible securities, income-producing equity securities and income-producing debt and other instruments of varying maturities. It is expected that substantially all of the Fund's debt instruments and a substantial portion of its convertible securities will consist of securities rated below investment grade or unrated but determined by Allianz Global Investors U.S. to be of comparable quality (sometimes referred to as "high yield securities" or "junk bonds"). The Fund also expects to normally employ a strategy of writing (selling) covered call options on the stocks held in the equity portion of the portfolio (the "Option Strategy"). The Option Strategy is designed to generate gains from option premiums in an attempt to enhance amounts available for distributions payable to the Fund's shareholders.
- Managers: Allianz Global Investors Fund Management LLC and Allianz Global Investors U.S. LLC
- Book-runners: Merrill Lynch, Pierce, Fenner & Smith Incorporated, Wells Fargo Securities, LLC, Citigroup Global Markets Inc. and RBC Capital Markets, LLC

Eagle Growth & Income Opportunities Fund (NYSE: EGIF)

- Amount Raised: $127.5 million
- Investment Objective/Polices: The Fund's investment objective is to provide total return through a combination of current income and capital appreciation. The Fund seeks to achieve its investment objective by investing, under normal market conditions, at least 80% of its Managed Assets (as defined in the prospectus) dividend or other income paying equity securities and debt securities, excluding securities that distribute a return of capital, original issue discount bonds and payment-in-kind ("PIK") debt instruments. Debt securities may include, but are not limited to, below investment grade securities (commonly known as "high-yield" securities and "junk" bonds), notes, bonds, and convertible bonds. The Fund may invest up to 20% of its Managed Assets in a combination of below investment grade securities and debt instruments that generate PIK interest. Initially, the Fund expects to invest up to 15% of its Managed Assets in securities of master limited partnerships ("MLPs"), generally in the energy sector, and may invest up to 25% of its Managed Assets in preferred equity securities. The Fund may write (sell) covered call options with respect to up to 40% of its Managed Assets to seek to generate current income.
- Managers: Four Wood Capital Advisors LLC, Eagle Asset Management, Inc. and Recon Capital Partners, LLC
- Book-runners: Raymond James & Associates, Inc. and Stifel, Nicolaus & Company, Incorporated

Tekla World Healthcare Fund (NYSE: THW)

- Amount Raised: $580 million
- Investment Objective/Polices: The Trust's investment objective is to seek current income and long-term capital appreciation. Under normal market conditions, the Trust expects to invest at least 80% of its Managed Assets in U.S. and non-U.S. companies engaged in the healthcare industries ("Healthcare Companies"), including equity securities, convertible securities and debt securities. The Trust will concentrate its investments in the healthcare industries. A company will be deemed to be a Healthcare Company if, at the time the Trust makes an investment in a company, 50% or more of such company's sales, earnings or assets arise from or are dedicated to healthcare products or services or medical technology activities. Healthcare Companies may include companies in one or more of the following sub-sectors: pharmaceuticals, biotechnology, managed care, life science and tools, healthcare technology, healthcare services, healthcare supplies, healthcare facilities, healthcare equipment, healthcare distributors and healthcare REITs. Tekla Capital Management LLC (the "Investment Adviser") determines, in its discretion, whether a company is a Healthcare Company.
- Manager: Tekla Capital Management LLC
- Book-runners: Wells Fargo Securities, LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Morgan Stanley & Co. LLC, UBS Securities LLC and Ameriprise Financial Services, Inc.

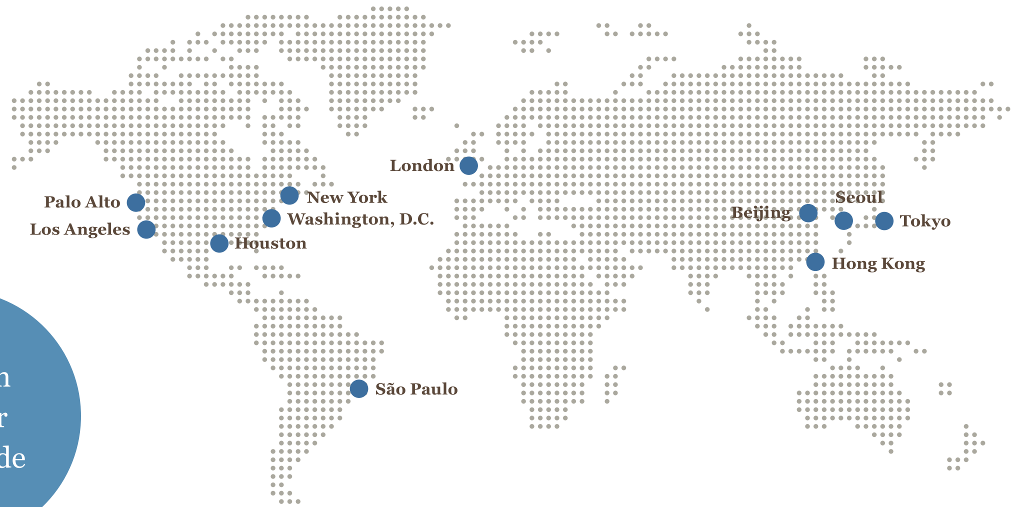
Simpson Thacher's dynamic, long-standing Registered Funds Practice encompasses all aspects of the investment management business. Our practice is multidisciplinary—it brings together such other areas as securities, mergers and acquisitions, banking, tax and ERISA.

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

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

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.

Simpson
Thacher



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