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CFTC

CFTC Issues Advisory on Compliance with Gramm-Leach-Bliley Act Security Safeguards

On February 26, the Division of Swap Dealer and Intermediary Oversight (DSIO) of the Commodity Futures Trading Commission issued Advisory 14-21 to provide futures commission merchants, commodity trading advisors, commodity pool operators, introducing brokers, retail foreign exchange dealers, swap dealers and major swap participants (covered entities) with best practices for complying with Title V of the Gramm-Leach-Bliley Act and Part 160 of the CFTC's regulations protecting privacy of customer financial information. For these purposes, CFTC regulations define a "customer" to mean an individual that obtains a financial product or service from the covered entity that is to be used primarily for "personal, family or household purposes," which includes obtaining brokerage or advisory services. Part 160 of the CFTC's regulations requires, among other things, that covered entities adopt policies and procedures to address administrative, technical and physical safeguards for the protection of customer records and information. The Advisory recommends several best practices that, in the view of DSIO, should be incorporated in a covered entity's written information security and privacy program.

CFTC Advisory No. 14-21 is available here.

INVESTMENT COMPANIES

SEC Issues Guidance on Aggregate Advisory Fee Rates for Multi-Manager Funds

In February 2014, the Securities and Exchange Commission's Division of Investment Management released a Guidance Update to clarify when a mutual fund using a "multi-manager structure" must obtain shareholder approval for primary and subadvisory advisory fee rates (aggregate advisory rates) paid by the fund. A multi-manager structure is one in which a primary investment adviser selects subadvisers that act as day-to-day portfolio managers. A mutual fund using a multi-manager structure may obtain relief from Section 15(a) of the Investment Company Act under an exemptive order from the SEC (multi-manager order). Section 15(a) requires an investment manager of a registered investment company to have a written contract approved by shareholders, and the contract must include all compensation terms for the investment adviser. Under a multi-manager order, a subadviser may serve under a contract that has not been approved by shareholders, though the primary adviser's fee rate and the aggregate advisory rate remain subject to shareholder approval.

The Guidance Update confirms that funds with multi-manager structures must obtain shareholder approval for any increase in the aggregate advisory rate, whether they employ the "traditional" or "direct-pay" multi-manager model. In the traditional model, the primary adviser contracts with the subadvisers and compensates subadvisers from its primary advisory fee. In the "direct-pay" model, the fund contracts with and compensates directly the primary adviser as well as each separate subadviser. All potential multi-manager order applicants are required to include an "aggregate fee condition," which states that any change to a subadvisory or primary contract that results in an increase in the aggregate advisory rate must be approved by shareholders. The Guidance Update grants relief from shareholder approval in three situations in the direct-pay model context: (1) in hiring its first subadviser, the fund lowers the primary adviser's rate such that the aggregate advisory rate does not increase; (2) the fund pays an additional subadviser a rate that is no higher than that of either (a) the subadviser it is replacing or (b) an existing subadviser that could have covered the assets allocated to the new subadviser; and (3) the fund increases an existing subadviser's rate but decreases the primary adviser's rate commensurately.

To read the full text of the Guidance Update, click here.

LITIGATION

Supreme Court Rules that the Securities Litigation Uniform Standards Act Does Not Preempt State Law Claims

This week, the US Supreme Court narrowed the scope of the preemption provisions of the Securities Litigation Uniform Standards Act (SLUSA), which bars certain state law-based securities class actions. As a result, securities fraud class claims against secondary actors, such as accountants, lawyers and investment advisers, which are barred under the federal securities laws, may proceed under state law.

The issue before the Court was the reach of the SLUSA statutory requirement that the state law class action concern "a misrepresentation or omission of *a material fact in connection with* the purchase or sale of a covered security," *i.e.,* a security "listed or authorized for listing on a national securities exchange" (emphasis added). Before the Court were consolidated state law-based class actions brought against various law firms, investment advisers and insurance brokers, which allegedly aided or concealed Allen Stanford's multibillion dollar Ponzi scheme involving the sale of certificates of deposits. The CDs issued by Stanford's bank, Stanford International Bank, were admittedly *uncovered securities*, but the plaintiffs alleged that they were misled to believe the CDs were backed by *covered securities*, *i.e.,* marketable stocks and bonds.

The Court held, in a 7-2 decision, that under SLUSA the "fraudulent misrepresentation or omission is not made 'on connection with' . . . a 'purchase of sale of a covered security' unless it is material to a decision by one or more individuals (other than the fraudster) to buy or sell a 'covered security.'" The plaintiffs had alleged that they were misled to believe that Stanford International Bank was using their investments to purchase marketable assets to ensure the liquidity of their CD investments, when in fact Stanford was using the funds to finance an opulent lifestyle, pay off other investors and make speculative real estate investments in the Caribbean. The Court found that these allegations were not enough to satisfy the requisite "in connection with" and "materiality" elements of SLUSA. The Court explained that the misrepresentations by Stanford (the fraudster) concerned his bank's purchase (in truth, non-purchase) of publicly traded assets (covered securities), and did not concern the plaintiffs' purchase of the CDs (uncovered securities). Justice Breyer, writing for the majority, emphasized that the Court's interpretation of "in connection with" was consistent with SLUSA and other federal securities laws.

The dissent disagreed, arguing that the majority's narrow interpretation of the language of SLUSA was inconsistent with the Court's prior precedent holding that the "in connection with" requirement is broadly construed and requires only that the fraud "coincide" with the covered security transaction. The dissent also raised a concern that the ruling would have an adverse effect on the market by limiting the Securities and Exchange Commission's enforcement powers under § 10(b) of the Securities Exchange Act, which uses the same "in connection with" language as the SLUSA. The dissent also raised concerns that the ruling stripped "essential protections for our national securities market" and will drive up legal costs by exposing secondary actors to liability, which had been blocked by the Court's prior decisions. The majority responded that neither the dissent nor the SEC could point to any prior SEC enforcement action that would have been barred based on the majority's reading of SLUSA. Indeed, the SEC and Department of Justice had successfully prosecuted claims resulting in a prison sentencing for Stanford and a $6 billion forfeiture order.

Chadbourne & Parke LLP v. Troice et al., No. 12-79 (US February 26, 2014).

New York Attorney General Announces Agreement with Firms to Stop Cooperating in "Insider Trading 2.0"

New York's Attorney General Eric T. Schneiderman announced this week that he reached interim agreements with 18 Wall Street firms that they will not participate in surveys by elite investment firms that seek to get an analyst's assessment of public companies before that information is publicly released. Attorney General Schneiderman, who dubs the practice "Insider Trading 2.0," claims it puts the larger market at an unfair disadvantage and potentially subjects the banks to liability under New York's anti-fraud Martin Act. The agreements were reached without any litigation being brought by the New York Attorney General's office.

In September 2013, after reaching an agreement with Thomson Reuters, which was selling investors access to market-moving University of Michigan surveys minutes before the information was made available to the public, Attorney General Schneiderman expressed concern about this practice, noting that it could give traders who viewed the surveys a sneak peek into forthcoming analyst reports. Then, a January 2014 investigation into a survey by BlackRock, the world's largest asset manager, revealed that many of the analyst survey questions were designed to capture analyst views, and the timing and structure of the surveys allowed BlackRock to obtain early information that could be used to front-run future analyst revisions.

The participating banks in the interim agreements, which were effective immediately and to be fully implemented by early March 2014, agreed to instruct their research analysts to not respond to the surveys. Attorney General Schneiderman applauded the participating firms for their leadership and cooperation, adding, "our markets will only be fair and healthy if everyone plays by the same rules."

Attorney General Schneiderman's February 26, 2014 press release is available here.

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