

ICI/U.S. Chamber of Commerce File Lawsuit Challenging CFTC Amendments to Rule 4.5

On April 17, 2012, the Investment Company Institute (“ICI”), together with the U.S. Chamber of Commerce, filed a complaint in U.S. District Court for the District of Columbia (“DC Circuit”) challenging the Commodity Futures Trading Commission’s (“CFTC”) recent amendments to Rule 4.5 under the Commodity Exchange Act (“CEA”). The Rule 4.5 amendments will require many investment advisers to mutual funds and exchange-traded funds – which are already required to register with the U.S. Securities and Exchange Commission (“SEC”) – to dually register with the CFTC as commodity pool operators (“CPOs”).

Central to the filed complaint is the notion that investment companies and their advisers are already among the most highly regulated entities in the financial industry – overseen by four separate federal securities laws and by FINRA, under regulations applicable to broker-dealers and underwriters and distributors of investment company securities. The complaint alleges that the Rule 4.5 amendments were adopted by the CFTC without the agency having first conducted the requisite cost-benefit analysis, in violation of the CEA. In recent years, the failure to conduct an appropriate cost-benefit analysis argument has seen considerable success in the DC Circuit. The DC Circuit has vacated several rules promulgated by the SEC where that agency “neglected its statutory obligation to assess the economic consequences of its rule,” and failed to adequately account for the extent to which the professed benefits of a rule were already provided for by an existing regulatory regime.

The complaint requests that the DC Circuit vacate the Rule 4.5 amendments and related provisions and seeks an injunction against the CFTC and all its officers, employees and agents from implementing, applying or taking any action under the amendments.

“Investment Adviser Oversight Act” Mandates Advisers Register with an SRO

On April 25, 2012, Congress introduced the “Investment Adviser Oversight Act of 2012” (the “Bill”) that will require State and Securities and Exchange Commission (“SEC”) registered investment advisers to register with a self-regulatory organization (“SRO”). The purported purpose of the Bill is to increase investor protection by allowing SROs to perform oversight on the investment advisory industry to enforce “business conduct standards.” The Bill provides for several exceptions from SRO registration including, but not limited to, investment advisers to mutual funds, advisers to private funds, affiliated investment advisers to those otherwise exempt from registration, and advisers that are already members of another national investment adviser association registered with the SEC.

The Bill tasks the SRO with enforcing the standards of the Investment Advisers Act of 1940, as amended. To aid the SRO, the Bill provides a framework for regulation by an SRO including procedures for approval of registration, procedures for approval of rules and rule changes, discipline of members, final disciplinary sanctions and their review, review of denial of membership, compliance standards, and enforcement authority of the SEC.

The Dodd-Frank Wall Street Reform and Consumer Protection Act mandated that the SEC evaluate existing regulatory standards regarding investment adviser examination, enforcement and oversight. In January 2011, the SEC released the results of a study and cost-benefit analysis, which included three proposals for oversight of the investment adviser industry: 1) additional SEC oversight; 2) creation of a new SRO; or 3) expansion of the Financial Industry Regulatory Authority (“FINRA”) purview to cover investment advisers in addition to broker-dealers. Although the Bill does not name FINRA as the SRO for investment advisers, FINRA has expressed interest in regulating the investment adviser industry and recently performed their own cost-benefit analysis.

HIGHLIGHTS

ICI and U.S. Chamber of Commerce Challenge CFTC Rule 4.5 Amendments

Congress Pursuing SRO Oversight of Investment Advisers

SEC and CFTC Define Terms under Title VII of Dodd-Frank Act

Despite Opposition, SEC Continues to Pursue Money Market Fund Reform

New Rules for Regulating Derivatives and Swap-Related Terms Adopted by the SEC

On April 18, 2012, the U.S. Securities and Exchange Commission ("SEC") together with the Commodities Futures Trading Commission ("CFTC") adopted new rules (the "New Rules"), to define terms related to the regulation of over-the-counter swaps.

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") granted the SEC the authority to regulate "security-based swaps," and defined relevant terms. The New Rules seek to further define the terms "swap dealer," "security-based swap dealer," "major security-based swap participant" and "eligible contract participant" provisioned under Title VII of the Dodd-Frank Act. The New Rules regulate reporting and recordkeeping requirements, as well as daily trading records requirements for swap dealers ("SDs") and major swap participants ("MSPs"). The New Rules also address conflicts of interest policies and procedures for SDs and MSPs and Chief Compliance Officer Rules for SDs, MSPs, and Futures Commission Merchants.

The New Rules also specify certain exemptions which exclude from the SD analysis (as well as the MSP analysis) security-based swaps between counterparties that are majority-owned affiliates. The SEC further clarified the distinction between dealing activities and non-dealing activities which include legitimate hedging transactions, mutual funds and pension funds. The New Rules also offer exemption from the definitions of SD and security-based swap dealer for entities who engage in a *de minimis* amount of swap dealing. The *de minimis* rule exemption would be dependent on the participant's level of security-based swap dealing and would be phased in over time. The New Rules are set to become effective June 4, 2012.

Debate on Money Market Reform Intensifies

In the face of increased bipartisan political opposition and criticism from the Investment Company Institute ("ICI") and the U.S. Securities and Exchange Commission (the "SEC"), SEC Chairman Mary Schapiro, continues to face an uphill battle to increase regulation on the \$2.6 trillion money market industry. Chairman Schapiro aims to increase investor protection by requiring money market funds to maintain a capital buffer and to define redemption provisions, as well as consider potential approaches to implement a floating NAV. The SEC's commissioners remain divided on the money

market fund proposals, as evidenced by Commissioner Luis Aguilar's recent questioning of Chairman Schapiro's approach to address the perceived "structural weakness" in money funds.

As of May 2, 2012, 33 legislators from both sides of the political aisle have signed on to an opposition letter sent to Chairman Schapiro. Law makers are principally concerned that the increased regulation will drive investors to unregulated or overseas markets, and decrease the demand for certain short-term debt securities utilized by local and state governments to finance their infrastructure projects. However, as publicized in its April 26 comment letter to the SEC, Fidelity Investments released its 2011 research survey findings in an attempt to dissuade regulator reform. Fidelity found that 75% of the firm's customers understood that money market funds are not guaranteed by the government. Further, approximately 81% answered in the affirmative that they understood the funds' underlying securities fluctuate in value based upon market conditions. Despite these results, the International Organization of Securities Commissions voiced concern that the stable \$1.00 NAV fosters expectations of investor protection and suggests parallels to federally insured deposit accounts.

The Financial Stability Oversight Council ("FSOC") has indicated they may step in to regulate money market funds if the SEC is unable to reach an agreement, by officially designating them as "systematically important."

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