

SEC's ETF Exemptive Application Process Swifter

According to a report released by *Ignites* on March 6, 2013, the U.S. Securities and Exchange Commission (the "SEC"), appears to be accelerating the rate at which exchange traded funds' ("ETFs") "exemptive relief" applications are reviewed and subsequently approved. As most ETFs are registered as open-end investment companies under the Investment Company Act of 1940 (the "'40 Act"), as amended, firms must request and the SEC must grant, exemptive relief from '40 Act requirements before an asset manager may launch an ETF. As ETFs fundamentally operate differently from open-ended investment companies, asset managers typically request exemptive relief from '40 Act statutory requirements including direct redemption of shares, completion of all transactions in redeemable securities at the next calculated Net Asset Value (the "NAV"), and certain restrictions of Affiliated Persons transacting with the registered fund.

Traditionally, ETF exemptive applications take at least nine months to one year for SEC processing and notice. However, Emerging Global Advisors, a firm based out of New York, reported that it plans to launch an ETF and gained notice of SEC exemptive relief just seven weeks later. Gaining SEC notice is a final step before approval. According to *Ignites*, the SEC's expedited approval process appears to apply only for those exemptive applications which mirror a recently ordered application, and not an application containing new or unusual information. The movement is believed to be a direct result of a lengthy and time-consuming SEC initiative to produce a standard format for the ETF exemptive application process.

As many hope that the recent pace will progress toward a streamlined SEC review process, the SEC's standardizing and streamlining of granting ETF exemptive relief may foreshadow a codification of exemptive relief. During a March 7, 2013, speech to the Investment Management Institute in New York, SEC Division of Investment Management Director Norm Champ confirmed that SEC plans to codify exemptive relief. The SEC proposed codification back in 2013; however, the SEC did not move beyond the comment process.

The *Ignites* article may be accessed at the following link:

http://www.ignites.com/c/484361/54241/speeding_lengthy_reviews?referrer_module=emailMorningNews&module_order=0&code=WW1WdWfRnRhVzR1ZEM1a2IyaGxjb11Udwd2JXOXlaMkZ1TG1OdmJTd2dNakUzTmpteE1pd2dNVE14TURZMU1qVTRPQT09.

To read Norm Champ's remarks in full, please visit: <http://www.sec.gov/news/speech/2013/spch030713nc.htm>.

White House Asks Gensler to Stay at CFTC

With Gary Gensler's first term as leader of the Commodity Futures Trading Commission (the "CFTC") set to expire in December 2013, U.S. President Barack Obama has asked Gensler to serve a second term at the helm of the U.S. derivatives regulator according to a Reuters report. However, according to sources speaking to Reuters on a condition of anonymity, Gensler remains undecided given his interest in another position within the administration.

Under Mr. Gensler's tenure, dating back to May 2009, the CFTC expanded its power base to include oversight of the \$650 trillion swaps market as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Additionally, as evidenced by the CFTC's investigation of the Libor interest rate scandal, the CFTC under Gensler's leadership collected \$257 million in fines in 2007 and more than \$1 billion to date in 2013.

More information on a potential second term for Mr. Gensler may be found at: <http://www.reuters.com/article/2013/03/06/us-obama-cftc-gensler-idUSBRE92502B20130306>

HIGHLIGHTS

SEC accelerates pace in approving ETF exemptive applications

Obama asks Gensler to serve second CFTC term

SEC review finds custody-related problems with 140 investment advisers

SEC requests quantitative and economic analysis to consider regulatory harmonization for broker-dealers and investment advisers

SEC Issues Risk Alert to Advisers with Custody

On March 4, 2013, the Office of Compliance Inspections and Examinations of the U.S. Securities and Exchange Commission (the “SEC”), released a National Exam Program (the “NEP”) Risk Alert addressing what it deemed were “widespread and varied non-compliance” of Rule 206(4)-2 under the Investment Advisers Act of 1940, as amended, (“Rule 206(4)-2”). Rule 206(4)-2, commonly referred to as the “custody rule,” protects advisory clients from the potential misuse or misappropriation of both client funds and securities.

The SEC deems registered investment advisers to have custody of client assets if it holds, directly or indirectly, client funds or securities or has any authority to obtain possession of either. To ensure compliance, Rule 206(4)-2 prescribes including, but not limited to:

- **“Qualified custodian” requirement:** An investment adviser with custody must maintain client funds and securities in a separate account at a qualified custodian, such as bank or a broker-dealer;
- **Written notifications:** The client must provide the name and address of the qualified custodian and the manner in which the client funds or securities are being held, and distribute account statements on a quarterly basis;
- **Annual surprise exams:** Investment advisers with custody of client assets must undergo an annual surprise examination by an independent public accountant followed by the filing of Form ADV-E 120 days after the date of the exam; and
- **Distribution of audited financials:** For advisers to pooled investment vehicles, the adviser must distribute audited financial statements to investors in the pooled investment vehicles annually.

In their review, the NEP identified errors including commingled client, proprietary, and employee assets and failure to conduct surprise-exams throughout the year. “Because the safeguarding of assets is central to investor protection, it is critical that investment advisers follow our rules when they maintain custody of their clients’ funds,” stated SEC Chairman Elisse Walter. Carlo di Florio, director of the SEC’s Office of Compliance Inspections and Examinations continued, “We take deficiencies in this area very seriously and want to put advisers on alert about the importance of complying with the custody rule. It is a key component of our investment adviser examination program.”

The full NEP Risk Alert may be accessed at:

<http://www.sec.gov/about/offices/ocie/custody-risk-alert.pdf>.

SEC Requests Information to Assess Standards of Conduct and Regulatory Obligations for Broker-Dealers and Investment Advisers

On March 1, 2013, the U.S. Securities and Exchange Commission (the “SEC”) requested certain quantitative data and economic analyses to assist in a study of the standards of conduct and regulatory obligations for both broker-dealers and investment advisers. Regulated under the Investment Advisers Act of 1940 (the “Advisers

Act), investment advisers are fiduciaries to their clients. Alternatively, a broker-dealer, whose conduct is subject to regulation under the Securities Exchange Act of 1934 (“Exchange Act”) and the rules of applicable self-regulatory organizations, is not considered a fiduciary to its customers.

Citing the increasingly blurred lines between full-service broker-dealers and investment advisers, the SEC acknowledges confusion amongst retail customers employing broker-dealers and investment advisers regarding the differing regulatory approaches and duties that flow from these entities. “Studies have shown that few investors realize that the standard of care they receive depends on the type of investment professional they use. And often investors do not know which type of financial professional they are relying on,” noted SEC Chairman Elisse B. Walter. “This request for information will help us in our ongoing consideration of alternative standards of conduct for certain broker-dealers and investment advisers, as well as potential harmonization of other aspects of regulation in this area.” In order to consider a uniform fiduciary standard of conduct and potential regulatory harmonization, the SEC specifically seeks data and other information including:

- Investor returns generated under the existing regulatory regimes;
- Security selections of broker-dealers and investment advisers as a function of their respective regulatory regimes;
- Characteristics of investors who invest on the basis of advice from broker-dealers, invest on the basis of advice from an investment adviser, or invest utilizing both channels;
- Investor perceptions of the costs and benefits under each regime; and
- Investors’ ability, and the associated cost to investors, to bring claims against their broker-dealer or investment adviser under their respective regulatory regimes.

The SEC press release may be read at:

<http://www.sec.gov/news/press/2013/2013-32.htm>.

The full release may be accessed at:

<http://www.sec.gov/rules/other/2013/34-69013.pdf>.

For more information, please speak to your relationship manager or visit jpmorgan.com/wss.

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