

**CLIENT ALERT: SEC CHAIRMAN CHRISTOPHER COX MAKES FIRST
APPEARANCE BEFORE THE SENATE BANKING COMMITTEE**

Yesterday, Christopher Cox made his maiden appearance as Chairman of the Securities and Exchange Commission before the Senate Banking Committee during a hearing entitled “A Review of Current Securities Issues.” Not surprisingly, the Chairman, the only witness invited to this hearing, seemed very comfortable in the setting, a reflection of his familiarity with Congress and the members of the Committee, with many of whom he worked during his years as a member of Congress representing the 48th district of California.

The discussion during the hearing centered around various topics, most notably SEC initiatives designed to improve issuer disclosure, the operation and regulation of nationally recognized statistical rating organizations, the changing market exchange landscape both in the United States and abroad, the effects of the Sarbanes-Oxley Act of 2002 on the U.S. capital markets, and the relative increase in the number of initial public offerings of securities listed outside the United States. The question-and-answer portion of the hearing also focused on a number of matters of particular relevance to the investment management industry, such as hedge funds, soft dollars and short selling.

In his testimony, Chairman Cox singled out improving disclosure for the benefit of individual investors as a key priority of his tenure. Among the disclosure initiatives being actively pursued by the SEC are encouraging the use of plain English rather than boilerplate in every document intended for retail investors, and replacing long, hard-to-follow disclosure documents with easy-to-navigate, Web-based disclosure that allows investors to find relevant information easily. He also cited as important goals reducing the complexity of accounting rules and regulations, and applying the SEC’s antifraud efforts to scams that target older Americans.

Members of the Committee sought Chairman Cox’s views on various topics during the hearing’s question-and-answer rounds. Senator Richard Shelby (R-AL), Chairman of the Senate Banking Committee, for example, asked whether the Committee should address the level of concentration among national credit-rating agencies and their status as self-regulated entities. In response, Chairman Cox said that the SEC would need additional legislative authority to fully regulate the credit-rating agencies, but that some of these agencies could be regulated under the antifraud provisions of the Securities Exchange Act of 1934 and, to the extent the agencies are registered with the SEC as investment advisers, under the Investment Advisers Act of 1940.

A subject that drew significant interest among the members of the Senate Banking Committee was the changing landscape of self-regulatory organizations that operate market exchanges. Some members of the Committee expressed concern over the New York Stock Exchange’s becoming a for-profit entity, and the potential for conflicts between the exchange’s fiduciary duty to its shareholders and its regulatory responsibility to the market. Other members expressed concern over the regulatory effect of a non-U.S. entity’s potentially assuming control over a U.S.

self-regulatory organization. Chairman Cox acknowledged that oversight of self-regulatory organizations is one of the challenges faced by the U.S. securities market regulatory structure, which, he noted, has been in place for seven decades and does not contemplate transactions involving changes in exchange ownership, particularly international ownership.

Two issues considered together during the hearing were the effect on the U.S. capital markets of the Sarbanes-Oxley Act and the reduction in initial public offerings of shares listed in the United States relative to those initial public offerings listed abroad. Some members of the Committee, based in part on information provided by venture capitalists, wondered whether companies are choosing not to list their shares on U.S. exchanges because of high regulatory costs. Chairman Cox did not argue with those who claimed that companies face higher regulatory costs in the United States as compared to other jurisdictions. He instead asserted that the SEC will not “race to the bottom” when it comes to regulation. He explained that the SEC will seek to find ways to implement regulations, including those under Sarbanes-Oxley, that benefit investors without overly burdening issuers. Some members of the Committee seemed to have concluded that a hostile U.S. regulatory environment was the reason behind only four of the top 25 IPOs of 2005 being listed in the United States. Senator Paul S. Sarbanes (D-MD), the ranking Democratic member of the Senate Banking Committee, on the other hand, downplayed the implication that regulation, including Sarbanes-Oxley, has had a negative effect on IPO activity in the U.S., asserting that last year’s largest IPOs were mostly privatizations of government-owned entities, which, for political and geographical reasons, list their shares in their countries of origin.

Senator Sarbanes introduced hedge funds into the hearing’s discussion, asking Chairman Cox whether the SEC has the resources and the required authority to investigate and bring enforcement actions in this area. Chairman Cox responded affirmatively, pointing to the census information on hedge funds being collected by the SEC through the new hedge fund adviser registration rule. The rule, according to the Chairman, is helping the SEC and its professional staff understand the hedge fund population and develop the expertise to inspect hedge fund advisers. Senator Chuck Hagel (R-NE), chairman of the Banking Committee’s Subcommittee on Securities and Investment, took the opportunity during the hearing to announce that his subcommittee will be holding a hearing on hedge funds on May 16, 2006. Senator Hagel then asked Chairman Cox for a status report on the court challenge to the hedge fund adviser registration rule. Chairman Cox reiterated a commitment he has made before to the rule as originally written, noting that the number of hedge fund advisers registered with the SEC has more than doubled since the rule came into effect. The Chairman acknowledged that some hedge fund advisers appear to be holding out on registering pending the court challenge. The Chairman went on to say, however, that this group of advisers represents only a small percentage of the overall hedge fund manager universe.

Among other issues of particular relevance to the investment management industry raised by members of the Committee was mutual fund disclosure. Senator Shelby inquired specifically about the current status of mutual fund disclosure. Chairman Cox confirmed that the SEC will be seeking to ensure that mutual funds use plain English and interactive data when communicating with their investors. Chairman Cox added that the SEC can do much to enhance

mutual fund disclosure and to improve through new technologies the availability of mutual fund data.

Soft dollars took center stage at the hearing when Senator Charles E. Schumer (D-NY) asked Chairman Cox whether the SEC has encountered problems in finalizing the soft dollars interpretive release. Chairman Cox responded simply by saying that the SEC is currently working on the release.

Senator Robert F. Bennett (R-UT) questioned the practice of naked short selling and the potential for market manipulation by short sellers. The Senator specifically called for additional scrutiny of potentially manipulative transactions. In response to Senator Bennett's comments, Chairman Cox pointed to the improvements that have been made by the SEC with respect to monitoring and regulating short selling transactions, including Regulation SHO. The Chairman then expressed his willingness to work with the Senator to address potential market manipulation by short sellers.

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