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Funds and Investment Management

Regulatory Update and Recent SEC Enforcement Actions

REGULATORY UPDATE

FINRA Bar Results from Assertion of Fifth Amendment Right against Self-Incrimination in Criminal Action

On October 5, 2016, the Financial Industry Regulatory Authority ("FINRA") barred an indicted investment adviser, Donald S. Toomer, for violating rules requiring FINRA members to produce relevant information upon request. Toomer was indicted for allegedly taking hundreds of thousands of dollars in kickbacks in return for steering his clients to buy microcap stocks that were the subject of a stock market manipulation scheme. Toomer refused to produce documents to FINRA in response to a request for documents and information, asserting that doing so would violate his Fifth Amendment right against self-incrimination. FINRA rejected Toomer's reliance upon the Fifth Amendment, stating, "It is well established that the constitutional protections under the Fifth Amendment are inapplicable to FINRA proceedings..." Despite the fact that FINRA can share information produced by its members with prosecutors, FINRA still maintains that associated persons must comply with their obligation to cooperate with FINRA requests notwithstanding that they were charged with a crime. According to FINRA, "When an individual becomes registered with a broker-dealer, [that person] agrees to respond to all of FINRA's requests for information. When that individual chooses not to cooperate, [that person] forfeits the right to remain registered."

SEC Is Expected to Increase Examinations of Mutual Fund Advisers as Reported at the National Association of Municipal Advisers Annual Conference

Over the past two years, SEC municipal adviser ("MA") examinations have found various incidents of fiduciary duty and fair dealing violations. As a result, on October 5, 2016, the SEC's Office of Compliance Inspections and Examinations ("OCIE") revealed at the National Association of Municipal Advisers annual conference that it expects to increase MA examinations in 2017. Robert Miller, an OCIE supervisory attorney, noted at the conference that examinations in 2016 uncovered many more occurrences of fiduciary duty violations. Under the Dodd-Frank Act, municipal advisers have the fiduciary duty to consider their state and local government clients' best interests ahead of their own. Miller recalled a situation in which three individuals who worked at an MA while also working at a related broker-dealer engaged in multiple deals while working with a municipality in an advisory role; however, in picking an underwriter for the municipality's deals, the individuals decided to use their own broker-dealer without notifying the municipality of such individuals' relationships with those broker-dealers. This, Miller noted, was a breach of fiduciary duty. The conference also highlighted issues surrounding excessive fees as fair dealing violations and emphasized books and records violations and making sure to register with the Municipal Securities Rulemaking Board.

SEC: Action on Third-Party Exam Rule Failed to Occur in 2016

In September 2016, SEC Chairwoman Mary Jo White stated that the proposal for third-party, independent examinations of registered investment advisers ("RIAs") had been circulated to the other two SEC members—Democrat Kara Stein and Republican Michael Piwowar. On October 13, however, Piwowar stated in an SEC open meeting that he would not support any new SEC proposals until the SEC voted on a separate proposal seeking to facilitate the delivery of mutual fund shareholder reports online. By November 1, it appeared that the third-party exam proposal had stalled because Commissioners Stein and Piwowar had conflicting views regarding cost and effectiveness.

SEC Adopts New Liquidity Risk Management among Mutual Funds and ETFs

On October 13, 2016, the SEC adopted Rule 22e-4 (the "Liquidity Rule"), Rule 30b1-10, and Form N-Liquid under the Investment Company Act of 1940. The Liquidity Rule requires a fund to adopt a liquidity risk management program that is approved by the fund's board of directors/trustees. The liquidity risk management program must include: (1) a mechanism by which to assess, manage, and periodically review a fund's liquidity risk; (2) liquidity classification of fund investments into four liquid categories ("highly liquid," "moderately liquid," "less liquid," and "illiquid" investments); (3) the determination of a "highly liquid investment minimum" that requires a certain percentage of a fund's net assets to be invested in highly liquid securities; (4) a requirement that a fund is limited to investing only 15 percent of fund net assets in illiquid investments; (5) a prohibition on acquiring any additional illiquid investments if the 15 percent limit is reached, and it must take corrective measures to decrease its illiquidity holdings if the fund has more than 15 percent of its holdings in illiquid securities; (6) review of illiquid investments at least monthly with reports to the board if there is a breach of the 15 percent limit and a remediation plan; (7) board review of a written report provided at least annually that discusses the liquidity risk management program; and (8) filing of Form N-Liquid when the fund's level of illiquid investments exceeds 15 percent.

SEC Promotes New Associate Enforcement Director

On October 14, 2016, Melissa Hodgman was promoted to associate director of the SEC's Enforcement Division. Hodgman previously worked in the SEC's Market Abuse unit in 2010 and was promoted to assistant director in 2012. Hodgman will succeed Stephen L. Cohen, who left the SEC after 12 years.

SEC Examination Office to Shift Focus to Investment Advisers

On October 17, 2016, Mark Wyatt, director of OCIE, discussed several changes effective January 1, 2017. OCIE will focus on the rapidly increasing number of investment advisers while enhancing its oversight of the Financial Industry Regulatory Authority ("FINRA"). Most notably, there will be a 20 percent increase in staff in the investment adviser/investment company examination program as a result of over 2,000 new advisers having registered with the SEC over the past two years. With more resources allocated toward this program, the SEC will be more reliant on FINRA than in the past, and in doing so, OCIE will augment its supervision over FINRA. OCIE will also focus on newly registered advisers in order to assess their compliance capabilities. Additionally, OCIE, in conjunction with the newly established Office of Risk and Strategy, will continue to improve and develop its data analytics and other technology tools in order to identify risks among SEC-registered companies.

> ***"Unlike our broker-dealer registrant population, there is no self-regulatory organization over investment advisers. We want to make sure OCIE is doing our utmost to expand our reach into this key population, and I believe our recent redeployment of staff puts us in the best position to do that."***
>
> ***– Mark Wyatt***
> ***Director of Office of***
> ***Compliance Inspections and Examinations***

Exchange Traded Funds ("ETF") Expected to Be Focal Point of SEC Review

There have been growing concerns that significant flows into ETFs may be a source of intensifying volatility throughout financial markets. As a result, the SEC intends to examine virtually every facet of the ETF industry. ETFs continue to gain in popularity as traditional mutual funds have overwhelmingly underperformed, yet continue to charge higher fees to potential investors. ETFs, on the other hand, attempt to mimic market returns much like stocks, corporate bonds, or oil, while offering investors a cheaper means to bet on the market. Nonetheless, the SEC believes that the ETF industry's growth, complexity, and growing influence in the marketplace raises red flags for regulators.

SEC Chief of Staff: Chief Compliance Officers ("CCO") Must Have Broader Skill-Set

At the 2016 National Society of Compliance Professionals' national conference held on October 19, 2016, SEC Chief of Staff Buddy Donohue alluded to the need for CCOs to have broader skills in order to keep pace with the demands the role now requires. Donohue mentioned that CCOs should have expertise in technology, operations, markets, risk, and auditing. He noted that because the business and economic environment within the investment management industry has dramatically changed, especially with respect to the shift from active to passive management as the maturation of businesses continues to slow down, resources allocated toward compliance must be granted accordingly. With respect to technology, Donohue highlighted robo-advisers, online trading, and automated internal systems, stating, "The expertise required by compliance in a more automated environment is quite different from that required in a more traditional, manual setting. The ability to understand and effectively monitor the technology and related systems that are being developed and employed is a considerable challenge that will occupy a growing share of CCOs' time and attention." To that end, Donohue also recognized that technology appears to be outdated throughout the industry and it is the compliance officers' duty to understand where improvements to technology are needed. CCOs, Donohue concluded, must prioritize developing and maintaining the necessary technical requirements to meet the current changing demands of the marketplace.

> ***"[A] very real challenge for compliance departments and personnel—both today and in the future—will be to ensure that they have the funding necessary for discharging their critical function as well as the technological and other resources that are essential to their success."***
>
> ***– Buddy Donohue, SEC Chief of Staff***

Risk Alert Issued by OCIE on Dodd-Frank Whistleblower Protection Rule

On October 24, 2016, after a recent wave of enforcement actions charging violations of Dodd-Frank Act Rule 21F-17, OCIE issued a Risk Alert for registered broker-dealers and investment advisers regarding compliance with the whistleblower protection rule. Rule 21F-17 states that "no person may take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement." The Risk Alert highlighted various documents OCIE intends to review, such as compliance manuals, ethics codes, employment agreements, severance agreements, and the like, to ensure compliance with the rule. Recently, the SEC has pursued enforcement actions against companies whose confidentiality and severance agreements included restrictive language (such as language providing that an employee may forfeit his or her benefits by informing the SEC of any company violations) that was viewed to impede both current and former employees from notifying the SEC about potential securities law violations. OCIE's Risk Alert warns that in conducting a compliance review under Rule 21F-17 it intends to analyze provisions that may limit the types of information an employee may provide to the SEC. OCIE will also look to whether the aforementioned documents contain any provisions that require employees to represent themselves as having not assisted in any SEC- or securities-related investigations in such documents.

Office of Innovation Seeks to Develop Financial Technology throughout Banking Industry

On October 26, 2016, the Office of the Comptroller of the Currency ("OCC") announced the formation of the new Office of Innovation, which will help banks and other financial companies develop new financial technology products and services. The new office will begin operations in the first quarter of 2017 and will allow banks and other firms to promote and advance new financial technology. Financial technology, or "fintech," encompasses anything from bitcoin to block chain technology and other forms of payment processing. The Office of Innovation will welcome banks and other fintech firms to visit and discuss new developments, laws, and regulations in order to ensure compliance with the same prior release and implantation. OCC Counsel Beth Knickerbocker will lead the Office of Innovation and will have offices in Washington, D.C., San Francisco, and New York.

The SEC's Challenge of Analyzing "Big Data"

On October 28, 2016, SEC Commissioner Kara M. Stein addressed concerns about the challenges faced by the SEC with respect to acquiring, analyzing, and utilizing data effectively, and maintaining adequate technology to do so. Commissioner Stein alluded to the growth and development of the SEC's Division of Economic Research and Analysis ("DERA"), as well as new advancements in two analytics systems known as "MIDAS" and "CAT." DERA was created in 2009 and seeks to incorporate economics and data analytics while developing policy, rulemaking, enforcement, and

examination procedures for the SEC. MIDAS stands for Market Information Data Analytics System and analyzes all orders as well as modifications and cancellation of those orders on the national exchanges while aggregating as much public trading information as possible. CAT, or Consolidated Audit Trail, focuses on both non-public and public trading data, and captures the execution of trades as well as information about traders involved in those trades. Commissioner Stein also recommended the establishment of an "Office of Data Strategy," which would be responsible for coordinating data strategy to have data experts coordinate with the SEC's policy, exam, and enforcement offices.

> ***"Just as the telegraph ushered in a new information era, the spread of data and data tools is changing how information is used and shared. The promise is tremendous, and if the SEC can successfully harness the new technology, investor protection, financial stability, and the markets will all benefit."***
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> ***– Kara M. Stein, SEC Commissioner***

DERA Publishes Findings on New Derivative Rule Proposal

On November 2, 2016, the SEC's Division of Economic Research and Analysis released new economic analysis about proposed Rule 18f-4 on a fund's use of derivatives and addressed requests for risk-adjusted approaches to limits and changes to asset-segregation requirements. Last December, DERA proposed a restriction on funds' use of derivatives and sought to require funds to establish risk-management measures. In doing so, fund boards would be required to authorize such programs and approve of a derivatives risk manager. According to DERA's analysis, many commenters suggested that the proposal measure derivative exposure using notional amounts adjusted in order to more accurately reflect the associated risks. Furthermore, the analysis recommended that the SEC adopt risk-based adjustments derived from standardized schedules. Lastly, DERA stated that commenters also proposed that funds be permitted to retain a range of assets as qualifying coverage assets as well as cash and cash equivalents subject to "haircuts" to the value of these additional assets.

Election Outlook on the "Fiduciary Rule"

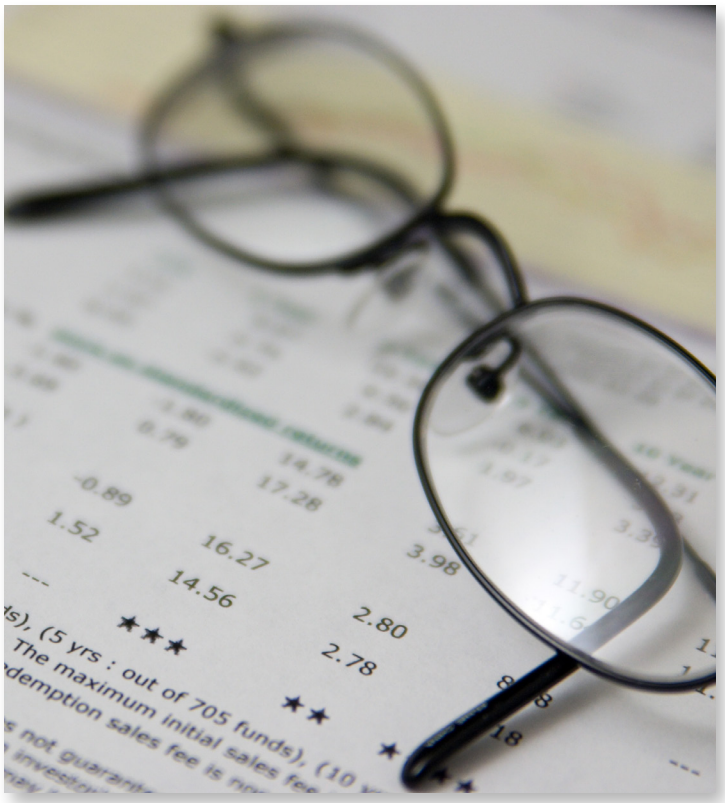
In Spring 2016, the Department of Labor ("DOL") modified the definition of a "fiduciary" to include brokers and other advisers who offer retirement and investment advice for a fee, requiring these advisers to serve in the best interests of their clients. Although the new definition will not be effective until April 10, 2017, the presidential election results have led to increasing uncertainty regarding the rule's future. This is because opponents of the rule—predominately Republicans—argue that broadening the definition of a fiduciary will burden retirement savers by limiting access to financial advice. The Obama administration and other proponents of the new rule counter that misconstrued retirement advice has cost families and savers roughly $17 billion per year while driving down annual returns on retirement savings by a full percentage point. With political uncertainty looming, Democrats have been devising ways in which the new rule can still be enacted, whether it be a Democrat-led filibuster in the Senate to counteract a Republican-led measure to stall or kill the rule entirely, or a bi-partisan compromise of a pared-down fiduciary rule. In any event, with the new administration, we may see the rule's execution date—April 10—postponed.

Ceresney, Head of SEC Enforcement Division, Steps Down

On December 8, 2016, Andrew Ceresney, head of the SEC's Enforcement Division, announced that he would step down by the end of 2016. The announcement was made a few weeks after SEC Chairwoman Mary Jo White declared that she planned to step down when President Obama leaves office in January. Ceresney has left behind a legacy that involved a record number of enforcement actions and fines. The SEC revealed that it had filed over 2,850 enforcement actions resulting in more than $13.8 million in sanctions throughout Ceresney's four-year tenure. Under Ceresney, the Enforcement Division broadened its focus to include areas such as financial reporting and public finance. In doing so, the SEC established a "first-ever" policy requiring admissions of wrongdoing in cases involving egregious fraud. The Enforcement Division also handed down groundbreaking enforcement actions involving retaliation against whistleblowers, resulting in $57 million in bounties in 2016. Under Ceresney's term, the SEC created the Center for Risk and Quantitative Analysis, which advises the SEC in developing data analytics for detecting and investigating misconduct. Ceresney also faced significant criticism as the SEC drastically increased its use of administrative courts—from 21 percent in 2010 to 76 percent in 2015—in bringing enforcement actions against public companies. Steven Avakian, the former deputy director of the SEC's Enforcement Division, will replace Ceresney as acting director upon Ceresney's departure.

New SEC Rules May Require Investment Firms to Defend Investments in Less Liquid Loans

On December 14, 2016, the SEC announced new rules that may permit the agency to ask mutual fund managers to justify their reasoning for investing in less liquid products such as loans. In October 2016, the SEC adopted liquidity risk management rules for open-end mutual funds and ETFs. Consequently, the SEC has been highly critical of long settlement times as possible liquidity risks, and thus, seeks to ensure that funds are able to meet redemption requests in a timely fashion. Under the new liquidity rules, funds must classify each investment made into four separate buckets ("highly liquid," "moderately liquid," "less liquid," and "illiquid" investments) based on the length of time it will take to convert the investment into cash without considerable change in value. The SEC considers loans to be a less liquid investment because loans can be theoretically sold within seven days, yet take more than seven days to close.



SEC ENFORCEMENT ACTIONS

In the Matter of Raymond James & Associates Inc. (Admin. Case number 3-17531*)* and *In the Matter of Robert W. Baird & Co. Inc.* (Admin. Case number 3-17532)

On September 8, 2016, the Securities and Exchange Commission ("SEC") announced settlements with two investment advisory firms for their failure to comply with wrap fee programs. The SEC uncovered that Raymond James & Associates ("Raymond James") and Robert W. Baird & Co. ("Robert Baird") failed to implement adequate policies necessary to determine how much each firm charged its clients in commissions when sub-advisers "traded away" commissions with broker-dealers outside of wrap fee programs. Generally, investors who partake in wrap fee programs pay the sponsoring advisory firm a "wrap fee," a fixed percentage of the investor's assets held within its account covering the services provided by the sponsoring firm, such as investment advisory, asset allocation, and brokerage services. Without the information related to the wrap fees, it was impossible for clients of Raymond James and Robert Baird to know the amount of commissions they paid or for the investment advisers of those firms to determine whether the wrap fee programs were suitable for clients. The SEC concluded that both firms violated

Section 206(4) of the Investment Advisers Act of 1940 as well as Rule 206(4)-7. Without admitting or denying the charges, both Raymond James and Robert Baird settled with the SEC, agreeing to pay $600,000 and $250,000, respectively, as penalties.

> ***"Costs are a critical factor when firms determine whether a particular investment product or strategy is suitable for a client. Baird and Raymond James lacked policies and procedures to consider an entire category of cost information and didn't fully evaluate whether these wrap fee programs were a good fit for their clients."***
>
> ***– Andrew Ceresney***
> ***Director the SEC's Division of Enforcement***

In the Matter of Laurence I. Balter d/b/a Oracle Investment Research (Admin. Case number 3-176140)

On October 4, 2016, the SEC charged investment adviser Laurence I. Balter and his firm, Oracle Investment Research ("Oracle"), with breaching their fiduciary duty owed to clients. The SEC alleged that Balter "cherry-picked" profitable trades for his personal account instead of for client accounts while assuring clients that he would not "double dip" on both management and advisory fees. According to SEC director Jina L. Choi, Balter allegedly earned over one-half million dollars by advising retired and nearly-retired investors who maintained separately-managed accounts with Oracle as he simultaneously served as an investment adviser to the Oracle Mutual Fund. Initially, Balter filed forms with the SEC stating that all client trades would be made prior to any personal transactions by the adviser. In early 2012, however, Balter began executing trades for both himself and for Oracle clients through a single, comprehensive account without pre-allocating the trades. In doing so, Balter allegedly paid himself both management and advisory fees after assuring clients that he would not do so. Additionally, Balter's investments changed the classification of the Oracle Mutual Fund from a "diversified" to a "non-diversified" company, which resulted in significant losses for investors. The SEC found that Balter made material misstatements through misrepresenting the Oracle Mutual Fund as a diversified company in addition to the aforementioned fiduciary breaches.

In the Matter of Dupree Financial Group, LLC (Admin. Case number 3-17616)

Dupree Financial Group, LLC ("Dupree") hired external compliance consultants in 2010 and 2013 to develop a compliance program, and also required its CCO to conduct and review its compliance procedures and policies. However, Dupree appointed its administrative assistant, who lacked substantial and relevant compliance experience, to act as its CCO. Upon investigation, the SEC found that Dupree did not conduct a single annual compliance review from 2010 through 2014. The SEC concluded that Dupree violated Rule 206(4), which prohibits fraudulent or deceptive business practices, as well as Rule 206(4)-7, which requires firms to maintain and conduct adequate compliance reviews no less than annually. Dupree settled with the SEC agreeing to pay a $25,000 fine, to be censured, and to cease and desist from any future violations.

In Re: OM Group Inc. Stockholders litigation (Case No. 11216-vcs, Del. Ch.)

On October 12, 2016, Vice Chancellor Joseph R. Slights, III, of the Court of the Chancery of the State of Delaware, dismissed a class action suit against the board members of OM Group Inc. ("OM"), with respect to its $1 billion buyout by Apollo Global Management ("Apollo"). According to the Vice Chancellor, the directors' decision to be bought out was protected by the "business judgment rule," which protects directors' business decisions so long as the decisions were informed, and the directors acted in

good faith and considered the best interests of the corporation. In June 2015, shortly after OM's announcement of Apollo's buyout, six complaints challenging the merger were filed. The challenging shareholders argued that OM's directors rushed too quickly into a potential deal with Apollo in the hopes of avoiding a proxy fight with activist investor FrontFour Capital Group LLC ("FrontFour"), which had criticized OM's performance since 2013, and publicly demanded OM cut costs, reduce executive pay, and consider changes to OM's board. OM's merger agreement with Apollo contained a provision stating that OM's board would dissolve prior to the deal's closing. Allegedly, this maneuver was put in place to prevent FrontFour from seeking any of its potentially value-adding plans. The shareholders also argued that OM's board hurried the post-agreement "shop around" period without giving potential buyers enough thought and impulsively rejected superior offers. Ultimately, the court determined that the business judgment rule protected the OM board's buyout decision.

In the Matter of Calvert Investment Management Inc. (Admin. Case number 3-17630)

On October 18, 2016, Calvert Investment Management ("Calvert") announced that it will pay $3.9 million in penalties to the SEC for incorrectly valuing bonds held by its various mutual funds as well as roughly $18 million in reimbursement to shareholders for an improperly charged sub-transfer agent fee. According to the SEC, between March 18, 2008, and October 28, 2011, Calvert's mutual funds obtained over $1.8 billion in complex, illiquid bonds. Given the complexity of these bonds, Calvert incorrectly calculated the fair value of the bonds through a third-party analysis. However, this analysis was inherently flawed as it failed to consider particular indicators, including the prices at which Calvert's mutual funds traded the bonds, as well as failing to account for the bonds' future cash flows. As such, the fair value price was much higher than what the funds had actually paid for the bonds. Because of this inadequate valuation, Calvert's mutual funds sold and then redeemed shares at significantly overstated net asset values leading to higher fees in return. Calvert settled with the SEC by paying the aforementioned penalties and agreeing to undertake a self-administered distribution to shareholders affected by this mishap.

SEC v. David R. Bergstein (Case number 1:16-cv-08701, S.D.N.Y.)

On November 9, 2016, the SEC charged former movie producer David R. Bergstein for orchestrating two fraudulent schemes whereby he allegedly defrauded investors in 2011 and again in 2012. According to the SEC's complaint, Bergstein absconded with millions of dollars from hedge fund investors and used the money to fund his extravagant lifestyle. In 2011, Bergstein allegedly misappropriated approximately $2.3 million that was intended for investments in medical billing businesses, but instead was used to help Weston Capital Asset Management ("Weston") obscure the true nature of the transaction from Weston's investors. In the second scheme, Bergstein allegedly stole $3.5 million of funds in a similar fashion. Bergstein is charged with violating Section 10(b) of the Securities Exchange Act as well as Rules 10b-5(a) and (c) and aiding and abetting violations by Weston of Section 206 of the Investment Advisers Act of 1940 and Rule 206(4)-8.

In the Matter of School Business Consulting, Inc. and Terrance Bradley (Admin. Case number 3-17288) and *In the Matter of Keygent LLC, Anthony Hsieh, and Chet Wang* (Admin. Case number 3-17287)

In 2010, Keygent LLC ("Keygent"), a registered municipal adviser which advised school districts and community colleges, contracted with School Business Consulting, Inc. ("SBCI"), a consulting group for school districts seeking to hire municipal advisers, and SBCI's principal, Terrance Bradley, to serve on Keygent's advisory board. Pursuant to their agreement, Bradley was responsible for advising Keygent on business development, strategy, and other policy-related issues. As he solicited clients for Keygent, Bradley informed school officials of his business relationship with Keygent and recused himself from the interview process. However, during the municipal adviser hiring process for five of SBCI's school district clients, SBCI allegedly provided confidential information to Keygent, and Bradley drafted (or assisted in drafting) the request for quotation ("RFQ") documents used by the five school districts at issue to initiate the hiring process. Candidates for the municipal adviser position were told not to make contact with anyone at the district other than the single official specified in the RFQ in order for the school districts to be able to control the information disseminated to the candidates and to ensure an even playing field throughout the selection process. Bradley allegedly provided confidential information to Keygent which could have given Keygent an advantage in the competitive hiring process for the five school districts. The SEC concluded that SBCI had acted as a municipal adviser under Section 15B(e)(9) of the Exchange Act as it had solicited a municipal entity by directly receiving compensation from Keygent in exchange for soliciting school districts during the selection and bidding processes. As such, the SEC charged Keygent with violating its fiduciary duty under Section 15B(c)(1) and MSRB Rule G-17. Earlier this year, the SEC reached a settlement with Keygent, which agreed to cease and desist from committing or causing any future related violations of the Exchange Act as well as pay a $30,000 civil fine.

SBCI agreed to a similar cease and desist, accepted a censure, and also agreed to pay a $30,000 penalty. Bradley also agreed to a cease and desist, to be barred from the industry, to be banned from serving or acting as an employee, officer, or director of an investment adviser or a registered investment company, and to pay a $20,000 civil fine. Most notably, these enforcement orders represent the first time the SEC has ever enforced the municipal adviser anti-fraud provisions of the Dodd-Frank Act. We expect more enforcement actions in the municipal market space, particularly against municipal market participants. A new specialized unit within the SEC's Enforcement Division known as the "Public Finance Abuse Unit" was recently established to tackle such matters.

Zalmanoff v. Hardy et al. (Case number 12912, Del. Ch.)

On November 17, 2016, Samuel Zalmanoff, an investor in the business development company Equus Total Return Inc. ("Equus"), filed a putative class action suit against the firm because of its recently proposed equity compensation plan. In 2014, Equus announced a two-step reorganization plan. First, it planned to conduct a partial stock swap with MVC Capital Inc. ("MVC"), which closed in 2014. It then sought to consolidate or merge the two companies, which has yet to occur. Zalmanoff claims that because Equus rarely makes any new investments and has over 60 percent of its assets sitting in cash, the newly proposed equity incentive plan for directors and officers is baseless, wasteful, and would give officers and directors options to purchase up to 25 percent of the company's stock at market price—a 39 percent discount on reported net asset value. Zalmanoff also argues that Equus's board failed to get approval from a majority of unaffiliated stockholders, nor did it request an exception from the SEC to move forward with the proposal.

National Association for Fixed Annuities ("NAFA") v. U.S. Department of Labor ("DOL") et al. (Case number 1:16-cv-01035, D.D.C.)

On November 23, 2016, U.S. District Judge Randolph D. Moss rejected NAFA's appeal for a preliminary injunction seeking to block the DOL's new interpretation of the term "fiduciary." In early November, Judge Moss determined that the DOL's revision to the pre-existing definition of fiduciary was within the department's statutory authority. According to the new definition, a fiduciary is now considered one who renders investment advice for a fee, and therefore must act in his or her client's best interests. NAFA contended that this new interpretation could have unintended consequences with respect to relationships that are not fiduciary in nature. Judge Moss rejected this argument. The DOL's new definition of fiduciary is scheduled to be phased in beginning in April 2017.

In the Matter of Pacific Investment Management Co. LLC ("Pimco") (Admin. Case number 3-17701)

On December 1, 2016, Pimco settled with the SEC for $20 million after an investigation uncovered that the investment management firm misled investors regarding the performance of an ETF that it manages. The SEC's investigation concluded that Pimco overstated the value of this ETF by relying on an outside pricing service and released misleading explanations as to why the ETF had been successful. Pimco bought small pieces of mortgaged-backed securities called "odd lots," which generally sell at a discount. Pimco then marketed these odd lots at higher prices through a third-party pricing service that overvalued its performance. The SEC asserted that this pricing strategy added as much as 54 percent to the ETF's monthly output and that Pimco merely afforded the public ambiguous explanations as to why the ETF performed so well. Thus, Pimco failed to disclose a reasonable basis for a potential investor to believe that the price accurately reflected the fund's true value. Pimco agreed to settle with the SEC, paying over $1.3 million in disgorgement plus interest and an $18.3 million penalty without admitting any liability.

New York v. Brian J. Keenan (Sup. Ct. New York County, Case number 04875/2015)

On December 8, 2016, former financial adviser Brian Keenan of Train, Babcock Advisors LLC ("Babcock") pled guilty to one count of grand larceny and will serve a 28 to 84 month sentence for taking $1.6 million out of three trusts he managed. According to Manhattan District Attorney Cyrus R. Vance, Jr., Keenan created a checking account in his own name and a separate account in the name of a trust beneficiary, yet denied the trust beneficiary access to the account. From 2007 to 2012, Keenan used the accounts to withdraw funds from the trusts for personal use. In December 2015, a grand jury indicted Keenan on the larceny charge in addition to eight counts of forgery.

SEC v. Cody (Case number 1:16-cv-12510, D. Mass.)

On December 12, 2016, the SEC charged Richard Cody, an investment adviser and former broker representative, with violating Section 10(b) of the Exchange Act and Sections 206(1) and 206(2) of the Advisers Act. In 2009, Cody started Boston Investment Partners, LLC, which managed roughly 100 advisory accounts with over $14 million in assets by 2015. According to the

SEC's Complaint, Cody allegedly misrepresented the value of three retirement accounts by assuring clients that their accounts were doing well, yet the accounts had substantially declined in value. In doing so, Cody falsely claimed that withdrawals from the accounts could not be made because these funds were invested in an annuity which blocked withdrawals, and when insufficient funds became available, Cody wired money into the client bank account from other sources in order to mask the investment account's reduced value. Additionally, Cody provided his clients with tax filings encompassing false values as he continued to misrepresent the value of the accounts. This was not Cody's first run-in with a regulatory authority. In 2008, FINRA brought an action against Cody alleging that he engaged in unsuitable and excessive trades; he was ultimately suspended in a decision upheld on appeal. The SEC's action against Cody is currently pending.

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