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Regulatory Update and Recent SEC Actions

REGULATORY UPDATES

Policy Initiatives Set Forth by the U.S. Securities and Exchange Commission's ("SEC") Investment Management Division

On September 28, 2018, Division of Investment Management (the "Division") Director Dalia Blass testified before the House Subcommittee on Capital Markets, Securities, and Investments regarding current activities and initiatives being undertaken by the Division. The Division follows three main principles when developing and implementing policy: (1) improving the retail investor experience; (2) modernizing the Division's regulatory framework and engagement with industry participants; and (3) leveraging resources efficiently. With respect to improving the retail investor experience, the SEC proposed a rulemaking package that would require firms to provide investors with a "relationship summary" highlighting differences between broker-dealers and investment advisers, including services, applicable legal standards, fees, and potential conflicts of interest. The Division also recommended a proposed interpretation reaffirming and clarifying the SEC's views on fiduciary duty standards. As to modernizing disclosure, Blass discussed the SEC's adoption of new Rule 30e-3, which permits funds to make annual and semi-annual performance reports and other required materials accessible online free of charge to the public and allows them to mail a paper notice of the same to investors. Blass also discussed Proposed Rule 6c-11, which would allow certain exchange-traded funds ("ETFs") to operate without applying for individual exemptive orders. Per Blass, exemptive orders can create inconsistencies which may not be realized by investors, and therefore, the proposal aims to combat these inconsistencies and provide a transparent and efficient framework for ETFs that routinely receive such exemptions. Blass also discussed the Division's continuing work on providing recommendations to modernize the way in which business development companies and closed-end funds are offered to the market and to make registration and reporting requirements for business development companies similar to those of other public corporate issuers. Lastly, in an effort to modernize the Investment Advisers Act, Blass discussed how the Division is considering recommendations to reconsider the prohibition on use of testimonials and the rule governing payments for soliciting business on behalf of registered investment advisers.

Mutual Fund Boards Allowed to Rely on Chief Compliance Officer ("CCO") Reports

In a no-action letter released by the SEC, mutual fund boards can now rely on written quarterly CCO reports that affirm transactions relating to affiliated underwriting, cross-trades and affiliated brokerages comply with applicable rules. The no-action letter, released by the Investment Management Division, reversed its position taken in 2010. The Investment Management Division agreed with the request made by the Independent Directors Council in that this is consistent with the SEC's approach in adopting Rule 38-a-1 and would allow boards to avoid duplicating certain functions commonly performed by the CCO. The goal of allowing funds to rely on written quarterly CCO reports, according to the Independent Directors Council, is "to better align the [fund] director responsibilities under [Rules 10f-3, 17a-7 or 17e-1 of the Investment Company Act of 1940 (the "Exemptive Rules")] with the oversight role that the commission has assigned to fund boards with respect to compliance under Rule 38a-1". An additional impact of the no-action letter is that it allows fund directors to focus on conflict of interest concerns raised by affiliate transactions, and whether such affiliate transactions permitted by the Exemptive Rules are in the best interests of the fund and its shareholders. Whether this no-action letter will increase CCO liability and additional due diligence requirements remains an open issue.

SEC Has No Plans to Dictate Cyber Controls

On October 15, 2018, the North American Securities Administrators Association ("NASAA") held a cybersecurity roundtable during which leading experts discussed the latest developments in cybersecurity and how small- and mid-sized investment adviser and broker-dealer firms can help protect critical client information. Rather than dictating specific cyber controls on regulated entities, the SEC plans to evaluate how firms are preparing for cyber breaches. Per Robert Cohen, head of the SEC's Cyber Unit, the most effective way to ensure a firm's compliance is not through specific controls, but "through exams, to see what they're doing and see if they are prepared." Cohen added, "[f]or the commission to dictate you must do this, you must do that, sometimes we'll publicize best-practice issues … but generally, if the commission dictated something, I'd be concerned that it gets out of date really quickly." Cohen cited an action against Voya Financial Advisors Inc. ("Voya"), which was recently charged for violating Regulation S-P or the Safeguards Rule and the Identity Theft Red Flags Rule, as a classic case of being unprepared for cyber breaches and one from which other firms can learn. Although Voya had policies and procedures and controls in place, they were not enforced, which ultimately led to a cyber intrusion that compromised thousands of customers' personal information. Cohen noted that "[t]his case is a reminder to brokers and investment advisors that cybersecurity procedures must be reasonably designed to fit their specific business models," and that firms "must review and update the procedures regularly to respond to changes in the risks they face." As cybersecurity continues to be an issue of importance that requires the attention of regulators, NASAA is considering whether to adopt a model rule, which would provide guidance to advisors and baseline protection for investors. Additionally, NASAA's Investment Adviser Section recently published a model rule for public comment, that will require advisors to adopt policies and procedures regarding information security, and require them to deliver such policy annually to their clients.

Depository Trust & Clearing Corporation ("DTCC") to Launch Centralized Communication Service

On October 15, 2018, the DTCC announced that it will launch a new, on demand, real time, centralized communications service for the mutual fund industry. The service was launched by DTCC's Wealth Management Services Division in late 2018. The service, called MF Info Xchange, will help centralize the delivery and receipt of time-critical mutual fund notifications and alerts that usually require communications from funds to their intermediary partners. Some notable features of the service include a dynamic web interface that provides real-time notifications, automation of existing manual processes, and an event calendar for intermediates on which to view important events, among other things.

Chris Robinson, Vice President of Operations, National Financial Services, LLC, stated "We are very encouraged and excited to see DTCC step in to help lead the industry toward streamlining the communications between funds and firms. It is hard to believe in today's technology age, 'Blast Faxing' is still a common communication methodology," Robinson continued, "By standardizing the messaging (types and formats), we expect to more effectively organize, prioritize and manage fund events and data changes. Centralizing the distribution to 'the street' and warehousing all communications on a single platform should also increase fund confidence that every firm has been notified of their important changes. This is a win-win for everyone. We are optimistic that this will be a huge leap forward."

Dalia Blass Remarks at the Independent Directors Council's ("IDC") 2018 Fund Directors Conference

On October 16, 2018, Dalia Blass, Director of the SEC's Division of Investment Management, spoke at the IDC's 2018 Fund Directors Conference. Blass discussed the goals of the Board Outreach Initiative and several key takeaways that have been learned through the outreach. The first takeaway is that there is a commonality among what directors believe should be the boards' function and areas where there are existing requirements that are not serving investors as well as they should be. Common questions posed by directors with respect to their oversight: (1) Are we seeing the quality of service we expect from the fund's service providers? (2) Are the costs of the fund reasonable? (3) Is the fund delivering the performance that investors expect? These questions are important to consider because they represent what an investor would ask if it was in the board room. Blass noted that the second common takeaway is participating in the right conversations—meaning that while many legal requirements have caused some concern, directors aren't looking for a way to escape the requirements; rather, directors want to make sure they are having the correct conversations and ensuring that their time is spent on matters that would provide the most value and on inquiries that are more likely to reveal problems. This was shown through the cross-trading rule, which requires boards to make a quarterly determination that all cross-trades of each fund were made in compliance with the rule. Directors recognized the importance of the rule, but did not feel that reviewing pages of data for individual trades was the smartest use of time. Instead, the directors should be focused on questions such as: (1) Why is a fund crossing? (2) How does that compare to similar funds in the complex? (3) When the trade-by-trade data is analyzed as a whole, is there a change or a trend that's noteworthy? Additionally, a common theme was that directors felt it is important to track and discuss macroeconomic issues that may impact the fund and related service providers in order to respond to market trends and developing issues. The third takeaway noted by Blass is that technology is coming to the board room. Boards are now considering how technology can improve their effectiveness, with something as simple as allowing for virtual meetings, to using tools that provide analyses that could help directors identify areas of focus and analyze trends and sift through information in ways that humans cannot. The last two takeaways gained by Blass through the outreach are that training matters, and directors want clarity from regulators regarding their responsibilities, but not at the cost of effectiveness. With respect to education, learning opportunities for boards have proven useful as fund directors can gain a practical understanding of their oversight role. While a new director may have quality experience in his or her professional field, being a director presents its own challenges, history, language, and law. With respect to clarity of responsibilities, directors are looking for principles rather than checklists. Directors pointed to the fund compliance rule, Rule 38a-1, as an example of how compliance, management, and boards should interact. As this is a principles-based rule, this strengthens the hand of fund boards and compliance personnel, allowing funds the flexibility to tailor compliance policies and procedures to the needs of that particular fund. Through the outreach, the Division of Investment Management has developed an informal framework to provide guidance when considering board responsibilities. The framework consists of the following four questions, which the Division of Investment Management will consider when developing recommendations for board involvement or reevaluating existing obligations: (1) Should a given regulatory action require board engagement, and if so, what is the policy goal for the board's involvement? (2) When the staff recommends board involvement, is it necessary to require a specific board action or can the focus instead be on the goal and leave the means to the board? (3) Are the board responsibilities prescribed consistent with the board's oversight and policy role? (4) Are the board responsibilities clear, up-to-date, and consistent with other regulatory actions? When answering these questions, the staff's goal is to lean in favor of answers that empower boards to follow robust lines of inquiry.

SEC Plan May Make Differentiating Exchange Traded Funds Easier

Under a new proposal that has been put before the SEC that is designed to bring ease to the distinction between ETFs and other investments, issuers would no longer be able to label their products "ETFs" unless certain criteria set forth in a comment letter from the regulatory Fixed Income Market Structure Advisory Committee are met. Under the criteria, leveraged products and those that promise inverse exposure by mirroring an index would no longer be eligible. Under the proposal, in order to be considered an ETF, a product would need to comply with the proposed rule or be structured as a unit investment trust like some older funds. Non-qualifying products would be classified either as ETNs, exchange-traded commodities (*i.e.*, products based around physical commodities and futures contracts) or exchange-traded instruments (*i.e.*, products that incorporate leverage or caps an investor's upside or downside performance). The proposal hopes to help investors develop an understanding as to the characteristics of a fund and help safeguard the investment and avoid substantial losses in times of market volatility.

Proposed SEC Regulation Best Interest Could Ease Requirements to Bring Enforcement Actions

The SEC has proposed Regulation Best Interest to bring ease to enforcement actions by regulators against brokers whose activities could subordinate interests of the client for the enrichment of their own interests. Some believe that the proposed regulation will only require broker-dealers to mitigate and disclose conflicts of interests while continuing to give advice colored by the conflicts. However, "the requirements addressing conflicts of interest included in the proposed Regulation Best Interest are stronger than those required by an investment advisor's fiduciary duty to its client," stated SEC Commissioner Hester Peirce. Pierce noted that financial advisors are only required to disclose conflicts, and under the proposed regulation, the broker dealer would be required to disclose and at least mitigate any material conflict of interest it may have with its client. Also proposed is an enhancement to the existing Customer Relationship Summary form which digitalizes the form, and thus, promotes a more interactive and more informative investment tool rather than the less useful legal language-based form currently in use.

SEC Publishes Cyber Crime Report Focusing on Accounting Controls

An SEC report, known as a "21(a) report," regarding business e-mail compromise ("BEC") attacks was published in October 2018. Such attacks occur when an employee is contacted by an individual purporting to be an executive at the firm with instructions to wire funds relating to a false transaction while using contact mechanisms seemingly legitimate to eliminate suspicion. The reports function as a warning to public companies and their counsel based on the Enforcement Division's investigation of nine publicly-traded companies that were victims of such attacks, costing millions of dollars. Though the SEC did not bring charges against the victims, it used them as examples to alert issuers and market participants and create awareness of the existence of cyber-related threats or manipulated electronic communications. Unlike previous cybersecurity guidance, the SEC's BEC report does not focus on an issuer's disclosure obligations. Rather, the focus is on Section 13(b)(2)(B) of the Securities and Exchange Act, requiring issuers to devise and maintain a system of internal accounting controls to provide reasonable assurances that, among other things, (i) transactions are executed in accordance with management's general or specific authorization and (ii) access to assets is permissible only in accordance with management's general or specific authorization. As a result of the BEC report, the SEC may well take action against issuers whose internal controls are deemed insufficient even where vulnerability does not render the issuers' financial reports misleading. The report suggests that internal controls may be in need of reevaluation in light of the emerging risks arising from cyber-related frauds.

Division of Investment Management Director Issues Remarks at Investment Company Institute Conference

On October 25, 2018, the SEC published remarks made by Blass at the Investment Company Institute Securities Law Developments Conference. The remarks focused on three areas for the Division of Investment Management: fund disclosure, fund use of derivatives, and staff guidance. With respect to fund disclosure, Blass noted that the Division of Investment Management is seeking opportunities to improve the quality and usefulness of information that investors receive about funds and advisers. In this regard, the Division of Investment Management has met with individual investors and developed new and simpler ways for investors to provide feedback to proposals that directly affect them. In addition to informal outreach, Blass noted that the SEC has taken concrete rulemaking steps, including having sought feedback by the end of October 2018, on improving the content, design and delivery of fund disclosure. Blass stated that while the SEC supports innovation, it is the asset managers, their counsels, data aggregators and other service providers that will play a central role in improving the investor experience. Blass provided guidance for improving fund disclosure. The first suggestion was to tell a clear story. Risk factors should be listed in order of priority and relevance to a fund (not just alphabetically) and disclosure should be revisited each year to ensure that it continues to match what the fund is actually doing. Another suggestion was to write clearly and concisely—with a focus on simplicity and clarity. Finally, Blass encouraged engagement with the Division of Investment Management Staff on disclosure—what is working and what can be improved. Blass' next topic of discussion was derivatives rulemaking. Blass stated that the Division of Investment Management is working toward a recommendation for a re-proposal regarding funds and derivatives but has not yet settled on an approach. Blass described a few of the questions with which the Division of Investment Management is grappling, including how to honor the policy of the Investment Company Act of 1940 while providing sufficient flexibility for products that develop continually? Blass encouraged sponsors, scholars, risk managers and others to share their thoughts on an approach to derivatives rulemaking. Finally, Blass spoke briefly about staff guidance, reiterating that all staff statements are nonbinding on the Commission. The Division of Investment Management will continue to review whether prior staff statements should be modified, rescinded or supplemented in light of market or other developments. Blass noted that the Division staff remains available to advise and assist.

Office of Compliance Inspections and Examinations ("OCIE") issues Risk Alert on Cash Solicitation

On October 31, 2018, OCIE issued an alert for the purpose of providing investors, investment advisers and market participants with the most common deficiencies relating to Rule 206(4)-3 (the "Cash Solicitation Rule") under the Investment Advisers Act of 1940 (the "Act"). The intention is to assist investment advisers in identifying potential issues and implementing effective compliance programs. Investment advisers registered under the Act are prohibited from paying, either directly or indirectly, a cash fee to anyone soliciting clients for the adviser unless certain conditions are met, including, but not limited to, the fee payment being made pursuant to an underlying contractual agreement. There are additional requirements when the solicitor is not a partner, officer, director or employee of the adviser or any entity controlled thereby (*i.e.*, a third-party solicitor). Issues observed by OCIE prompting the alert involved instances where third-party solicitors did not provide the required solicitor disclosure documentation to prospective clients, or provided incomplete solicitor disclosure documentation by failing to detail the relationship between the solicitor and adviser and the terms of compensation between the parties. OCIE also observed that advisers may have had conflicts implicating other provisions of the Act, such as fiduciary duties pursuant to Sections 206(1) and 206(2) of the Act. In response to the OCIE investigations, many advisers have begun to amend disclosure documents and solicitation agreements as well as overall compliance policies in order to achieve best practices with respect to the Cash Solicitation Rule.

New Jersey Solicits Public Comments on Fiduciary Rule Focused on Investor Protections

In the fall of 2018, the New Jersey Bureau of Securities released for public comment a proposed rule that would require all financial advisers in New Jersey to put their clients' best interests ahead of their own when providing investment advice and making investment recommendations. This state fiduciary rule would affect broker-dealers, agents, investment advisors and their representatives, which Governor Murphy hopes will create "the strongest investor protections in the nation." Meetings were held in Newark on November 2 and November 9 to solicit comments on the proposed rule. The state is contemplating making it a dishonest or unethical practice for broker-dealers and other investment professionals to not act as fiduciaries when making client recommendations with respect to investment strategies for the purchase, exchange or sale of any securities, including, but not limited to, investment advisory services. The proposal aims to address the lack of investor protections, noting that the investor remains without adequate controls in place for protection from broker-dealers, who under suitability standards are permitted to consider their own best interests before the investor. Since financial advisors and broker dealers are not held to the same standard of care with respect to investor interests, the proposal would amend the state rules to include a fiduciary standard for broker-dealers and other financial professionals. This would also align New Jersey with the best interest regulation currently contemplated by the SEC, which has indicated a hope to address the fiduciary rule by September 2019, the same time the Labor Department has indicated it would appeal the Appellate court decision which removed its own fiduciary rule. Along with New Jersey, Nevada has already finalized a fiduciary rule, which also focuses on the behavior of financial advisers by requiring them to act in the best interests of their clients instead of simply disclosing whether they are fiduciaries. However, the regulations that would implement the rule have not yet been proposed. Whether other states follow New Jersey's and Nevada's footsteps will be interesting to watch in the coming months.

OCIE Reviews Registered Investment Companies

OCIE announced that it conducted a number of examinations focusing on mutual funds and ETFs (collectively, the "Funds") to evaluate current industry practices and regulatory compliance in areas that are of importance to retail investors. As these Funds are the primary investment vehicle for many retail investors, OCIE made such examinations a priority. The focus includes: (1) index funds tracking custom-built indexes; (2) smaller and/or thinly traded ETFs; (3) mutual funds with higher allocations to securitized assets; (4) funds with aberrational underperformance relative to their peer groups; (5) advisers new to managing mutual funds; and (6) those advisers who provide advice to both mutual and private funds that have similar strategies and/or are managed by the same portfolio managers. In its examinations, OCIE focused on: (1) evaluating the policies and procedures of Funds/advisers to ensure they are properly designed to handle risks and conflicts, which would include Funds' boards' oversight of the compliance program; (2) Funds' disclosures in their prospectuses and other filings/shareholder communications, and disclosures by the advisers to the Funds' boards, regarding such risks and conflicts; and (3) processes in place used by Funds, their advisers and their boards who have oversight, especially with respect to risks and conflicts. The key purpose of these examinations is to target circumstances in which retail investors could be disadvantaged and ensure registrants are meeting their regulatory and other legal obligations. OCIE encourages registrants to reflect upon those policies, procedures, practices currently in place and consider improvements in their own programs to keep ahead of the curve in a changing environment and to respond appropriately. Pete Driscoll, head of OCIE, has indicated that in addition to the above, in 2019, OCIE will prioritize cybersecurity processes, the cryptocurrency space, and advisers who borrow from their clients.

SEC Co-Directors Examine Crypto-Asset Approach and Impact Of Supreme Court Decisions

The SEC's (the "Commission") Division of Enforcement has attempted to take reasonable approaches in addressing violations in the crypto asset space without hindering innovation. Co-Directors of the Division, Stephanie Avakian and Steven Peikin, have noted that the Division of Enforcement's Cyber Unit is monitoring the space, focusing on situations where investors do not have adequate disclosure about the crypto products in which they are investing. To date, many of the crypto actions brought involve outright fraud, but the staff is beginning to bring other types of actions, such as failing to register and the operation of unregistered digital exchanges. Peikin noted that the Division of Enforcement has been careful about engaging in regulation by enforcement and that the Division of Enforcement's work in this space has been incremental and has progressed logically. Avakian and Peikin then discussed recent Supreme Court decisions (*i.e.*, *Kokesh vs. SEC* and *Lucia v. SEC*) and how the decisions have made an impact on enforcement. In *Kokesh*, the Supreme Court ruled that the SEC's imposition of disgorgement is a penalty that is subject to a five-year statute of limitations. In *Lucia*, the Supreme Court ruled that administrative law judges are officers of the United States and therefore must be appointed by the full Commission. With respect to *Kokesh*, Peikin noted this case has had a big impact on the Division of Enforcement, resulting in it foregoing approximately $900 million in disgorgement. Avakian added that the Division of Enforcement is now more mindful of the age of a case before deciding to proceed and noted that if the misconduct is four years old, the enforcement staff will likely pass on it. With respect to *Lucia*, Avakian noted that this case has also had a big impact as it has caused more than 200 cases to come back to the Division of Enforcement, creating a sizeable backlog. Lastly, Peikin and Avakian discussed the success of the share class selection disclosure initiative implemented in February 2018, whereby the enforcement staff agreed to recommend favorable settlement terms for investment advisers who self-report their failure to make required disclosures relating to their selection of mutual fund share classes that paid an adviser fee when lower-cost share classes were available. As such conduct is very hard for the Division of Enforcement to detect, the initiative has generated numerous reports and has allowed the Commission to return money to investors.

Updated FAQ Released By SEC For Guidance On Forms N-PORT And N-CEN

The SEC released new FAQ guidance with respect to investment company reporting reforms to modernize the reporting of information on Forms N-PORT and N-CEN, which were adopted in October 2016 and revised in December 2017. The guidance clarified compliance dates for both forms, explaining that for form N-PORT, larger entities (*i.e.*, funds with net assets greater than or equal to $1 billion) have a compliance date of June 1, 2018, and must file reports on Form N-PORT no later than 30 days after the end of each month. Under the modified approach, rather than filing each month, larger entities will maintain the information required to be included in Form N-PORT in their records until April 1, 2019. Smaller fund groups, however, are not required to prepare and maintain as a record the information required on Form N-PORT, and will now submit their first reports by April 30, 2020. For Form N-CEN, the compliance date is June 1, 2018 for all funds and such funds must report within 75 days of the fund's fiscal year end. For both Forms N-PORT and N-CEN, compliance should be based on reporting period end date.

SEC Adopts New Rules Requiring Broker-Dealers To Provide More Information To Investors On Order Handling

On November 2, 2018, the SEC announced that it will adopt amendments requiring broker-dealers to disclose additional information to investors with respect to the way investors' orders are handled. In particular, the SEC has amended Rule 606 of Regulation NMS to now require a broker-dealer to provide a customer who places a "not held" order a report containing a standardized set of individualized disclosures detailing the broker-dealer's handling of the customer's orders. Such reports are not required to be provided automatically, but only upon request by the customer placing the "not held" order. The amendment seeks to provide customers with information about average rebates and fees the broker received from, and paid to, trading venues, which the SEC hopes will help investors better understand how brokers handle their orders. In order to minimize the implementation costs associated with the new disclosure requirement, the Commission adopted two exceptions, one at the firm-level and the other at the customer-level, both of which target small broker-dealers.

"In the eighteen years since the Commission originally adopted its order handling and routing disclosure rules, technology and innovation have driven significant changes in the way that our equities market functions and investors transact," said Chairman Jay Clayton. "This rule amendment will make it easier for investors to evaluate how their brokers handle their orders and ultimately make more informed choices about the brokers with whom they do business."

Rule Changes for Fund of Fund Arrangements proposed by SEC

On December 19, 2018, the SEC proposed a new rule aimed at enhancing and streamlining the regulatory framework currently in place for fund of funds arrangements, which are funds that are created when a fund invests in shares of another fund. If adopted, the rule changes would allow funds to acquire shares of other funds that are in excess of the limits provided for in the Investment Company Act without getting an individual exemptive order from the SEC. The proposed rule requires funds to comply with certain conditions in order to rely on the rule, such as conditions restricting funds' ability to improperly influence other funds, charge duplicative and excessive fees, or create overly complex structures (***e.g.***, three-tier fund of funds structures). Compliance with these conditions is designed to enhance investor protection. In connection with the above, the SEC is proposing to rescind Rule 12d1-2 as the proposed rule changes create a new, comprehensive exemptive rule for funds of funds to operate. Public comment for the proposed rule changes will last 90 days.

"Mutual funds, exchange-traded funds (ETFs) and other types of funds have become increasingly important for Main Street investors to save for retirement and meet their other financial goals," said SEC Chairman Jay Clayton. Clayton further stated, "[t]hese funds invest in other funds for a variety of reasons, including to achieve asset allocation or diversification in an efficient manner, as well as to hedge and otherwise manage risk. However, depending on the size of the investments, funds may be required to seek an exemptive order, causing costs and delays, and resulting in a regulative regime where substantially similar fund of funds arrangements may be subject to different conditions. This proposal would create a consistent, rules-based framework for fund of funds arrangements while providing robust protections for investors."

OCIE Announces Examination Priorities for 2019

On December 20, 2018, OCIE announced its examination priorities for 2019, the focus of which will be on six different categories: (1) compliance and risk in registrants responsible for critical market infrastructure; (2) matters of importance to retail investors, including seniors and those saving for retirement; (3) FINRA and MSRB; (4) digital assets; (5) cybersecurity; and (6) anti-money laundering programs. SEC Chairman Jay Clayton said, "OCIE continues to thoughtfully approach its examination program, leveraging technology and the SEC Staff's industry expertise. As these examination priorities show, OCIE will maintain its focus on critical market infrastructure and Main Street investors in 2019." While the six categories listed above will be OCIE's focus in 2019, this list is not exhaustive and will not be the only issues OCIE addresses throughout the year.

ENFORCEMENT ACTIONS AND CASES

Redus-Tarchis v. New York Life Investment Management LLC ("NYLIM") (Case No. 14-7991, D.N.J.)

The plaintiff in this case alleged that the investment adviser and manager of four mutual funds was taking excessive management fees. The fees in question were calculated as a percentage of each fund's assets under management ("AUM"), which were then "blended," meaning that the rate is reduced for AUM exceeding various dollar-amount "breakpoints" within each fund. On October 10, 2018, the District Court of New Jersey granted summary judgment to NYLIM, ruling that the annual management fees charged by NYLIM were not excessive in light of the six ***Gartenberg*** factors: (1) the nature, extent and quality of the services provided by the adviser to the mutual fund; (2) the profitability to the adviser of managing the fund; (3) "fall-out" benefits; (4) economies of scale; (5) how the adviser's fee structure compares with those of other similar funds; and (6) the independence and conscientiousness of the directors. Specifically, the Court held that Section 36(b) of the Investment Company Act of 1940 does not "prohibit an investment adviser from making a profit, nor does it regulate the level of profit" but rather requires plaintiffs to demonstrate that "the Funds were so profitable that their fee could not have been negotiated at arm's length." Further, the court ruled that plaintiff's allegation that the board failed to assess NYLIM's service on a fund-by-fund basis or in the aggregate is a relatively minor dispute, and therefore not evidence of the board's independence or the quality of the information it considered.

***In the Matter of Fifth Street Management, LLC* ("FSM") (File No. 3-18909)**

On December 3, 2018, FSM agreed to settle SEC charges arising out of an enforcement action relating to a variety of issues, including some initially raised during an examination of FSM by the OCIE in October 2015. FSM provides investment advisory services to FSM affiliated companies, including two business development companies ("BDCs"), two collateralized loan obligation ("CLO") funds, and a private hedge fund. According to the SEC Order, FSM violated multiple sections of the Act and caused FSM-affiliated BDCs to violate several sections of federal securities laws by (1) misallocating adviser compensation and overhead expenses of nearly $1.3 million to FSM-affiliated BDCs; (2) failing to reasonably conduct quality control reviews of the FSM-affiliated BDCs' quarterly valuation models—resulting in inaccurate portfolio company valuations which allowed the FSM-affiliated BDCs to trade at higher prices; and (3) failing to protect material non-public information when FSM's investment professionals performed work for both the FSM-affiliated BDCs and the FSM-affiliated hedge fund. Without admitting or denying the findings of the Commission, FSM agreed to be censured, pay disgorgement of nearly two million dollars, and civil penalty of $1.65 million. This Order reveals that the SEC will continue to focus on proper allocation of expenses, appropriate valuation, and strict adherence to compliance policies and procedures.

***In the Matter of American Portfolios Advisors, Inc.* ("APA") (File No. 3-18946)**
***In the Matter of PPS Advisors, Inc. ("PPS") and Lawrence Nicholas Passaretti* (File No. 3-18947)**

On December 21, 2018, the SEC announced it had settled charges against two New York-based investment advisers and the CEO of one of the advisers who selected mutual fund share classes inconsistent with their disclosures to clients. The firms and the CEO will collectively pay more than $1.8 million, which will be returned to harmed investors. According to the SEC's orders, APA, PPS, and PPS CEO and CIO, Lawrence Nicholas Passaretti, invested advisory clients in mutual fund share classes that paid 12b-1 fees to the firms' investment adviser representatives (IARs), even though less expensive share classes of the same funds were available. The SEC found that APA and PPS failed to disclose conflicts of interest, violated their duty to seek best execution, and failed to implement policies and procedures designed to prevent violations of federal securities laws in connection with their mutual fund share class selection practices. "Advisers must be vigilant in disclosing all conflicts of interest arising from compensation received based on investment decisions made for clients," said C. Dabney O'Riordan, Chief of the SEC Enforcement Division's Asset Management Unit. Without admitting or denying the findings, APA, PPS, and Passaretti consented to cease-and-desist orders, and APA and PPS consented to censures.

***In the Matter of WealthFront Advisers, LLC, f/k/a WealthFront, Inc.* ("Wealthfront") (File No. 3-18949)**
***In the Matter of Hedgeable, Inc.* ("Hedgeable") (File No. 1-18950)**

On December 21, 2018, computer automated investment advisers Wealthfront and Hedgeable agreed to settle SEC charges relating to the misleading of consumers. According to the SEC Orders, Wealthfront, one of the nation's largest "robo-advisers," made false promises to actively monitor wash sales, secretly paid bloggers for referrals, and retweeted accounts that posed conflicts of interest all without complying with applicable disclosure and documentation requirements. Hedgeable similarly disseminated false and misleading marketing materials and performance data. Specifically, Hedgeable inflated its ability to outperform competitors by improperly manipulating and computing information and failed to maintain sufficient documentation to substantiate its performance claims. While neither Wealthfront nor Hedgeable admitted or denied the SEC charges, both agreed to pay civil penalties of $250,000 and $80,000, respectively, and agreed to be censured. C. Dabney O' Riordan, chief of the SEC's asset management unit, said in a statement that "Technology is rapidly changing the way investment advisers are able to advertise and deliver their services to clients, [but] regardless of their format, however, all advisers must take seriously their obligations to comply with the securities laws, which were put in place to protect investors."

U.S. Securities and Exchange Commission's Annual Report from the Division of Enforcement

On November 2, 2018, the Division of Enforcement's Annual Report was released to the public, giving an overview of the Division's work during Fiscal Year ("FY") 2018. In FY 2018, the Commission brought 821 enforcement actions. The majority of the cases concerned securities offerings; a large number of cases concerned investment advisory issues, as well as issuer reporting/accounting and auditing. Other cases involved broker-dealer misconduct, insider trading, and market manipulation. All told, parties in the Commission's actions and proceedings were ordered to pay a total of $2.506 billion in disgorgement of ill-gotten gains and $1.439 billion in civil penalties. The Commission listed several noteworthy enforcement actions, including but not limited to charges against:

- Ameriprise Financial Services Inc. for recommending and selling higher-fee mutual finds shares to retail retirement account customers and for failing to provide sales charge waivers, and for failing to safeguard retail investors assets from theft by its representatives;

- The entity formerly known as Yahoo! Inc. for misleading investors by failing to disclose one of the world's largest data breaches in which hackers stole personal data relating to hundreds of millions of user accounts;

- Moody's Investors Service Inc. for internal control failures and failing to clearly define and consistently apply credit rating symbols;

- The New York Stock Exchange and two affiliated exchanges with regulatory failures in connection with multiple episodes, including several disruptive market events;

- 56 individuals who allegedly misappropriate or traded unlawfully on material, nonpublic information; and

- 54 entities and 94 individuals for failing to report/disclose information relating to revenue and expense recognition problems, faulty valuation and impairment decisions, misappropriation through accounting misrepresentations, inadequate internal controls, and misconduct by financial reporting gatekeepers (***e.g.***, Elon Musk and Tesla Inc., Sea World Entertainment Inc., and Elizabeth Holmes and Theranos Inc.)

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