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Regulatory Update and Recent SEC Actions

REGULATORY UPDATES

SEC Leadership Changes

On April 14, 2021, the U.S. Senate voted to approve President Biden's nomination of Gary Gensler as Chairman of the Securities and Exchange Commission (the "SEC") through June 5, 2021. The vote came after the Senate Banking Committee endorsed Gensler's nomination in March 2021. The confirmation only approves Gensler to serve the remainder of former SEC Chairman Jay Clayton's term, though the Senate Banking Committee has cleared Gensler to serve another five-year term afterward. Gensler served as chairman of the U.S. Commodity Futures Trading Commission from 2009 to 2014, and helped to draft the Sarbanes-Oxley Act as senior advisor to U.S. Senator Paul Sarbanes. In a statement, the SEC's four commissioners said they welcome Gensler "and look forward to working together to execute our vital mission."

The SEC recently announced various other leadership changes, including the appointments of Kelly Gibson as Acting Deputy Director of the Division of Enforcement, Paul Munter as Acting Chief Accountant, and John Coates as Acting Director of the Division of Corporate Finance. Melissa Hodgman was named Acting Director of the Division of Enforcement. Hodgman previously served as Associate Director in the Division.

Satyam Khanna was named Senior Policy Advisor for Climate and ESG, a new SEC position that addresses climate and environmental, social, and governance ("ESG") issues. In his role, Khanna will advise the SEC on ESG matters and advance related initiatives across the SEC's offices and divisions. Khanna was previously a member of the SEC's Investor Advisory Committee, where he served on the Investor-As-Owner Subcommittee, and was a senior advisor to the Principles for Responsible Investment, a United Nations-supported organization that works to promote the incorporation of ESG factors into investment decision-making. Prior to that, he served as counsel to SEC Commissioner Robert J. Jackson Jr.

"I am thrilled that Satyam is returning to the SEC to oversee and coordinate the agency's efforts related to climate risk and other ESG developments, issues of great significance to investors and the capital markets," Acting Chair Allison Herren Lee stated.

SEC Confirms In-Person Meeting Relief Remains in Effect

On January 5, 2021, the SEC issued a public statement confirming the indefinite extension of the relief from in-person voting requirements that the SEC granted to assist boards of directors of registered investment companies and business development companies. The SEC initially granted the in-person board meeting relief in March 2020 in response to COVID-19 as part of a broader set of exemptive orders providing temporary relief from several requirements of the Investment Company Act of 1940 (the "1940 Act") and the Investment Advisers Act of 1940. In June 2020, the SEC extended the conditional relief through at least December 31, 2020 and until the SEC provides at least two weeks' prior notice of withdrawal. Recognizing that restrictions and concerns relating to travel are likely to continue for some time and that directors and meeting participants will need significant lead time to make appropriate travel plans, the SEC indicated that it anticipates providing sufficient advance notice before setting any termination date for the in-person board meeting relief.

SEC Issues No-Action Relief for Custody of Certain Loan Interests

On January 13, 2021, the SEC issued no-action relief to certain registered investment companies and series thereof (collectively, the "Funds"), and their directors and officers, that act as self-custodians and maintain certain loan interests without strict compliance with Rule 17f-2 of the 1940 Act ("Rule 17f-2"). Rule 17f-2 sets forth certain conditions under which a fund may act as self-custodian under Section 17(f) of the 1940 Act ("Section 17(f)"), including the requirements that the fund's investments be (i) deposited in a bank for safekeeping; and (ii) verified by an independent public accountant at least three times a year (two of which must occur on a "surprise" basis).

The no-action relief relates to term or delayed draw corporate loans, which are typically subject to credit agreements under which primary lenders may sell interests in the loan to third parties, such as the Funds. When participating in these loans, the Funds do not receive any securities certificate or other tangible evidence of ownership. As the Funds point out in their no-action request, possession of the loan documents would be of no value to a purported transferee. Instead, the loan interests are reflected on the administrative agent's records for the purpose of identifying the owners of all loan interests and the principal amount of the loan attributable to each.

In their no-action request, the Funds noted that although they deliver the loan documents to their custodian for safekeeping, the practice does little to further the underlying purposes of Section 17(f). The Funds sought to discontinue such delivery and to obtain no-action relief to permit them to self-custody the documents without complying with Rule 17f-2, subject to certain conditions, including:

- Only a limited number of authorized personnel of the Funds would provide instructions to the Funds' custodian and the administrative agents;
- Passwords or other appropriate security procedures would be used to ensure that only properly authorized persons can transmit such instructions;
- The Funds would reconcile settled loan interests to the records of the administrative agents on a regular basis (*i.e.,* at least monthly);
- Loan interests would be titled or recorded at the administrative agents in the name of a Fund (not in the name of the Fund's investment adviser);
- Neither the Funds nor their investment advisers would be affiliated with the administrative agents; and
- Each Fund would adopt policies and procedures reasonably designed to prevent violation of the above conditions, as part of the Fund's compliance program under Rule 38a-1 of the 1940 Act.

The SEC granted the no-action relief subject to the representations described in the no-action request. In addition, while not included as an express condition, the SEC noted that they were granting relief in part because of the Funds' representations that they would comply with certain audit requirements, including being subject to an annual audit during which an independent public accountant will verify all of the investments of each Fund (including its investments in the loan interests) and reconcile the loan interests to the Fund's account records.

Executive Order Prohibiting Investments in Chinese Military Companies Takes Effect

The scrutiny surrounding investments in Chinese companies continued in the first quarter of 2021. During her confirmation hearing in January 2021, Treasury Secretary Janet Yellen indicated a continuation of the former administration's tough stance on China, but stressed the importance of working with allies to address China-related concerns.

Executive Order 13959 (the "Executive Order"), which prohibits investors from engaging in transactions involving securities of any Communist Chinese military company (a "CCMC"), took effect on January 11, 2021. Thirty-one companies were identified as CCMCs on lists issued by the Department of Defense in June and August of 2020 (the "CCMC List"). The former administration set a January 28, 2021 deadline for the ban on transactions involving securities of entities whose names closely match, but do not exactly match, the name of a CCMC, but on January 27, 2021, the Biden administration extended that date to May 27, 2021. For purpose of the Executive Order, a transaction is defined as the purchase for value of any publicly traded security and applies to shares in such companies, as well as shares held indirectly through investment vehicles, such as exchange traded funds. Investors are permitted to engage in otherwise prohibited transactions in order to divest their existing holdings of CCMCs until November 11, 2021. Transactions in securities of a company that is subsequently designated as a CCMC will be prohibited 60 days after such designation, and investors will have a year to divest their existing holdings in the company.

In addition, on January 21, 2021, China's three biggest telecommunications companies requested that the New York Stock Exchange (the "NYSE") review its decision to delist the companies' shares, a decision that the NYSE made following the issuance of the Executive Order.

SEC Reacts to GameStop Short Squeeze

On January 27, 2021 and January 29, 2021, the SEC issued statements regarding the extreme price volatility of certain stocks' trading prices in late January, noting that it was closely monitoring the situation and stood ready to take aggressive enforcement action in the event that market manipulation was found to have taken place. The SEC's statements came after retail investors banned together on the Internet forum WallStreetBets to dramatically push up the prices of a handful of stocks, including GameStop and AMC, in order to cause a short squeeze on hedge funds. The buying rally caused Gamestop's share prices to rise from around $17 per share at the beginning of January 2021, to a record high of $483 on January 28, 2021. However, the price dropped by almost 73 percent in less than two hours after Robinhood and other trading platforms like TD Ameritrade and Charles Schwab suspended their customers' ability to purchase shares of the stocks being targeted, citing their inability to post sufficient collateral at clearing houses to execute their clients' orders. Robinhood is facing more than 30 civil lawsuits and proposed class actions over its decision to block users from buying shares of the companies involved. The lawsuits filed against Robinhood allege that retail investors were prevented from making purchases that would drive up the prices of targeted stocks while hedge funds and other short sellers were able to depress the prices with no such prohibitions. Lawmakers have called for an SEC investigation into Robinhood's decision to cut off trades, and the House Committee on Financial Services and Senate Banking Committee have held hearings on the incident.

On January 30, 2021, the SEC issued an alert that warned investors about the significant risks of trading based on social media. On February 8, 2021, the SEC issued guidance recommending enhanced disclosures when raising capital during volatile periods, including reported short squeezes and periods of strong and atypical retail investor interest, whether on social media or otherwise. The SEC noted that raising capital under these types of circumstances requires specific, tailored disclosures about market events and conditions, the company's situation, and the potential impact on investors.

SEC Requests Comment on Potential Money Market Fund Reform

On February 4, 2021, the SEC published a request for public comment on potential reform measures to improve the resilience of money market funds, as highlighted in a report of the President's Working Group on Financial Markets issued in December 2020. The report discusses prior money market fund reforms, the evolution of different types of money market funds since the 2008 financial crisis, and the stress experienced in certain short-term funding markets in March 2020 related to the COVID-19 pandemic. The report concludes that more work is needed to reduce the risk that structural vulnerabilities in prime and tax-exempt money market funds will lead to or exacerbate stresses in short-term funding markets, and discusses various reform measures to be considered by policymakers. These include: (i) removal of the tie between money market fund liquidity and fee and gate thresholds; (ii) reform of the conditions for imposing redemption gates; (iii) minimum balance at risk requirements; (iv) money market fund liquidity management; (v) countercyclical weekly liquid asset requirements; (vi) floating net asset value requirements for all prime and tax-exempt money market funds; (vii) swing pricing requirement; (viii) capital buffer requirements;

(ix) requirement for liquidity exchange bank membership; and (x) new requirements governing sponsor support. The SEC noted that commenters are also invited to discuss other approaches to money market fund reforms.

"Money market funds play a significant role in our short-term funding markets, and they are utilized by both large institutions and individual retail investors," said Acting Chair Allison Herren Lee. "Comments received will assist the SEC and other relevant financial regulators in further analysis of potential reforms."

New DOL Fiduciary Rule for Investment Advice Takes Effect

In what some consider a surprising move, the Department of Labor (the "DOL") allowed a controversial Trump administration final rule on providing investment advice to retirement plan participants to take effect as scheduled on February 16, 2021 (the "DOL Fiduciary Rule"). This new DOL Fiduciary Rule replaced the DOL fiduciary rule relating to retirement savings investment advice adopted during the Obama administration, which was struck down by a federal appeals court in 2018 in a lawsuit brought by the financial industry. Many had expected the Biden administration to postpone or revise the new DOL Fiduciary Rule, which was adopted near the end of the prior administration in December 2020. The DOL Fiduciary Rule permits investment advisors, broker-dealers, insurance companies, banks, and investment professionals working under them ("Investment Professionals") to receive compensation from the mutual funds and investment firms that they recommend, which could otherwise be in violation of the prohibited transaction provisions of the Employee Retirement Income Security Act ("ERISA"), subject to certain standards and requirements. The definition of fiduciary under ERISA is expanded to include financial institutions and investment professionals with non-discretionary authority that make recommendations about rollovers and IRA investments. As a result of this expanded definition, such investment professionals would be prohibited from receiving compensation for their advice or recommendations unless they qualify for the exemption under the new DOL Fiduciary Rule. As well as being subject to best interest, fiduciary and disclosure standards imposed by the SEC and FINRA, Investment Professionals are required to abide by "impartial conduct standards" with three key components: (i) investment advice must be in the best interest of the investor and must not place any other interests ahead of that interest; (ii) compensation paid for such advice must be reasonable; and (iii) statements made with respect to the transaction must not be materially misleading. Investment Professionals who meet these standards may receive a variety of payments from mutual funds and investment firms, including 12b-1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue-sharing payments from investment providers or third parties. The DOL provides that temporary enforcement relief will remain in place until December 20, 2021, so long as investment advice fiduciaries are working diligently and in good faith to comply with "best interest" and other impartial conduct standards. On April 13, 2021, the DOL released guidance on interpreting the new rule.

SEC Issues Guidance on Digital Asset Securities

On February 26, 2021, the SEC's Division of Examinations issued a risk alert intended to assist investment advisers, broker-dealers, exchanges, and transfer agents in developing and enhancing their compliance practices relating to digital asset securities, and to outline areas of focus for its upcoming examinations. Areas of focus addressed in the alert include: (i) portfolio management, specifically a firm's classification of digital assets as securities and the mitigation of risks, such as security breaches and money laundering; (ii) books and records practices and requirements; (iii) custody issues; (iv) disclosure of the unique risks associated with the complexity and technology underlying digital assets in all types of media, including marketing materials and fund documents; (v) pricing, with a focus on the unique valuation challenges for digital assets; and (vi) compliance issues, including how firms calculate assets under management and how they characterize the digital assets in the pooled vehicles they manage.

The alert also identified issues for broker-dealers, including the safekeeping of funds, registration requirements and anti-money laundering ("AML") regulations. The alert noted that certain aspects of distributed ledger technology can present unique challenges to the implementation of a robust AML program and warned that the SEC has observed inadequate AML procedures and controls. The alert further noted that advances in distributed ledger technology have introduced innovative methods for facilitating electronic trading in digital asset securities and reminded interested parties that a platform that operates as an exchange must either register as a national securities exchange or operate under an exemption. Finally, the SEC noted that it would examine registered transfer agents for their compliance with SEC rules.

Newly Named SEC Division of Examinations Announces FY 2021 Examination Priorities

On March 3, 2021, the SEC's Division of Examinations (formerly known as the Office of Compliance Inspections and Examinations ("OCIE"))("EXAMS" or the "Division") announced its 2021 examination priorities, noting a greater focus on climate-related risks. EXAMS will also focus on conflicts of interest for brokers and investment advisers, and risks relating to financial technology ("FinTech"). Specific examination priorities include the following:

- **Registered Funds, Including Mutual Funds and ETFs.** The Division will continue to review the compliance and governance practices of registered funds, with a focus on disclosures to investors, valuation, filings with the SEC, personal trading activities, and contracts and agreements. In focusing on valuation, the Division will review for investments in market sectors that experienced, or continue to experience, stress due to the pandemic, such as energy, real estate, and products, such as bank loans and high yield corporate and municipal bonds. The Division will also focus on mutual funds' liquidity risk management programs to determine whether they are reasonably designed to assess and manage the funds' liquidity risk, and on the implementation of required liquidity classifications, particularly in light of recent market stress due to the pandemic. The Division will continue to prioritize examinations of mutual funds or exchange traded funds ("ETFs") that have not previously been examined or have not been examined in a number of years, with a focus on fund compliance programs and financial condition, particularly where funds have instituted advisory fee waivers. In addition, the Division will focus on compliance with exemptive relief, including for the newly created non-transparent, actively managed ETFs, and funds' and advisers' disclosures and practices related to securities lending. The Division also plans to review money market funds' compliance with stress-testing requirements, website disclosures, and board oversight.

- **Registered Investment Advisers.** The Division will continue to review the compliance programs of registered investment advisers, including whether their policies and procedures are reasonably designed, implemented, and maintained. The Division will continue to prioritize examinations of registered investment advisers that have not been examined for a number of years to focus on whether their compliance programs have been appropriately adapted in light of any substantial growth or change in their business models. The Division will prioritize examination of advisers offering ESG products, with a focus on consistency and adequacy of disclosures, whether fund advertising contains false or misleading statements, and whether proxy voting policies and procedures and votes align with their disclosed strategies. EXAMS also noted the examination of registered investment advisers operating and utilizing turnkey asset management platforms ("TAMPs") as a particular area of focus.

- **Retail Investors, Including Seniors, Teachers, Military Personnel, and Those Saving for Retirement.** The Division will focus on compliance with: (i) Regulation Best Interest, which establishes a standard of conduct for broker-dealers; (ii) Form CRS, which requires broker-dealers and registered investment advisers to deliver relationship summaries to retail investors and file them with the SEC; and (iii) investment adviser fiduciary duties of loyalty and care.

- **Information Security.** The Division will continue to review business continuity and disaster recovery plans, but will shift its focus to whether such plans account for risks associated with climate change and other large scale events.

- **FinTech and Innovation, Including Digital Assets.** The Division will focus on whether registrants are handling customer orders in accordance with their instructions, and on compliance surrounding trade recommendations made in mobile applications. Examinations of participants in the digital asset markets will assess whether investments are in the best interests of investors, portfolio management and trading practices, safety of client funds and assets, and pricing and valuation.

- **AML Programs.** The Division will continue to review for compliance with AML requirements, including evaluating whether broker-dealers and registered investment companies have adequate policies and procedures in place that are reasonably designed to verify the identity of customers and beneficial owners of legal entities, perform customer due diligence, monitor for suspicious activity, and, where appropriate, file Suspicious Activity Reports with the Financial Crimes Enforcement Network.

- **LIBOR Transition.** The Division will assess registrants' preparations for the discontinuation of the London Interbank Offered Rate ("LIBOR") and the transition to an alternative reference rate.
- **Registered Investment Advisers to Private Funds.** The Division will focus on advisers to private funds that have a higher concentration of structured products, such as collateralized loan obligations and mortgage backed securities, to assess whether the funds are at a higher risk for holding non-performing loans and loans with higher default risk than what is disclosed to investors.
- **Broker-Dealers and Municipal Advisers.** The Division will continue to focus on broker-dealers safeguarding of customer assets. Examinations will also focus on compliance with requirements for borrowing securities from customers. With respect to municipal advisers, the Division will examine whether they have met their fiduciary duty obligations to municipal entity clients, including the disclosing and managing of conflicts of interest.
- **Market Infrastructure.** The Division will focus clearing agency examinations on compliance, legal, recovery and wind down, margin, back-testing, settlement and operations, liquidity risk management, effect of the LIBOR transition, and cybersecurity and resiliency. Examinations of national securities exchanges will focus on operations to monitor, investigate, and enforce member and listed company compliance with exchange rules and the federal securities laws. The Division will continue to examine the core functions of transfer agents, including the timely turnaround of transfers, recordkeeping, and safeguarding of funds and securities.
- **FINRA and MSRB.** The Division will focus examinations on FINRA's operations and regulatory programs and the quality of FINRA's examinations of broker-dealers and municipal advisers. It will also examine the municipal securities rulemaking board ("MSRB"), which regulates the activities of broker-dealers that buy, sell, and underwrite municipal securities as well as municipal advisers, to evaluate the effectiveness of its policies, procedures, and controls.

"This year, the Division is enhancing its focus on climate and ESG-related risks by examining proxy voting policies and practices to ensure voting aligns with investors' best interests and expectations, as well as firms' business continuity plans in light of intensifying physical risks associated with climate change," said Acting Chair Allison Herren Lee. "Through these and other efforts, we are integrating climate and ESG considerations into the agency's broader regulatory framework."

FCA Confirms LIBOR End Dates

On March 5, 2021, the United Kingdom Financial Conduct Authority (the "FCA") announced the dates that panel bank submissions for all LIBOR settings will cease, after which representative LIBOR rates will no longer be available. The FCA confirmed that all LIBOR settings will either cease to be provided by any administrator or no longer be representative:

- Immediately after December 31, 2021, in the case of all sterling, euro, Swiss franc, and Japanese yen settings, and the one-week and two-month U.S. dollar settings; and
- Immediately after June 30, 2023, in the case of the remaining U.S. dollar settings.

Also on March 5, 2021, the Intercontinental Exchange Benchmark Administration, which is the administrator of LIBOR, confirmed its intention to cease publication of the above LIBOR settings on the referenced dates.

SEC Increases Focus on Climate and ESG Matters

The SEC has taken various recent actions in an effort to develop a more comprehensive ESG framework. Actions taken include:

- **New Climate and ESG Position.** On February 1, 2021, the SEC named Satyam Khanna as Senior Policy Advisor for Climate and ESG, a new position that addresses climate and ESG issues (see *SEC Leadership Changes* above).

- **ESG Investor Bulletin.** On February 26, 2021, the SEC's Office of Investor Education and Advocacy issued a bulletin to educate investors about ESG funds. The bulletin includes a list of factors to consider and questions to ask before investing in ESG funds, including the following:
  - Is ESG a core component of the investment selection process, or is it one of many factors that are considered to select investments?
  - To what extent does the fund focus on ESG factors versus more traditional factors?
  - How does the fund weight each of the three ESG factors within its ESG portfolio holdings?
  - How do the fund's fees and expenses compare to other investment options?
  - How does the fund explain and discuss its ESG practices, and how do those practices affect the performance and risk of the fund?

- **2021 Examination Priorities Focus on ESG Issues.** On March 3, 2021, the Division identified ESG issues as a 2021 examination priority (see *Newly Named SEC Division of Examinations Announces FY 2021 Examination Priorities* above).

- **Climate and ESG Task Force.** On March 4, 2021, the SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement. The SEC stated that the initial focus of the task force will be to identify any material gaps or misstatements in issuers' disclosure of climate risks, and to analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies. This new task force will also evaluate and pursue tips, referrals, and whistleblower complaints on ESG-related issues, and provide expertise and insight to teams working on ESG-related matters across the SEC.

- **New ESG Page on SEC Website.** On March 22, 2021, the SEC launched a new page on its website that will consolidate agency actions and the latest information about climate and ESG investing. See SEC Response to Climate and ESG Risks and Opportunities. In its press release, the SEC noted that the link will appear on the front page of sec.gov and is in response to increased investor demand for this information.

- **Risk Alert Regarding ESG Investing.** On April 9, 2021, the Division issued a risk alert regarding ESG investing, which highlighted observations from its recent exams of investment advisers, registered investment companies, and private funds offering ESG products and services (collectively, "firms"). The risk alert sets forth the staff's observations of deficiencies and internal control weaknesses, including:
  - Portfolio management practices inconsistent with disclosures about ESG approaches.
  - Controls inadequate to maintain, monitor, and update clients' ESG-related investing guidelines, mandates, and restrictions.
  - Proxy voting inconsistent with advisers' stated approaches.
  - Unsubstantiated or otherwise potentially misleading claims regarding ESG approaches.
  - Controls inadequate to ensure that ESG-related disclosures and marketing are consistent with the firm's practices.
  - Compliance programs that do not adequately address relevant ESG issues.

The staff also noted that some firms had effective practices in place, such as (i) disclosures that accurately conveyed material aspects of the firms' approaches to ESG investing; and (ii) policies, procedures, and practices that appeared to be reasonably designed in view of the firms' particular approaches to ESG investing. The staff elaborated on these effective practices, noting that firms may find them helpful in addressing the compliance issues identified in the risk alert.

The risk alert also provided insight into the Division's focus areas during examinations of firms claiming to engage in ESG investing, noting that, among other matters, such examinations will focus on: (i) portfolio management; (ii) performance advertising and marketing; and (iii) compliance programs.

- **Statement and Request for Comment from Acting Chair.** In a statement on March 15, 2021, Allison Herren Lee, the Acting Chair of the SEC, asked staff to evaluate current disclosure rules with an eye towards developing an ESG framework for consistent, comparable, and reliable information on climate change. Noting that investor demand for, and company disclosure about, climate change risks, impacts, and opportunities has grown dramatically, and the mounting evidence that ESG disclosure correlates with performance, Lee also requested input from the public. Lee's statement outlined 15 categories of questions for consideration, including: (i) what information related to climate risks can be quantified and measured; (ii) whether disclosures should be tiered or scaled based on the size of a registrant; (iii) the advantages and disadvantages of developing climate change standards for different industries; (iv) whether disclosure should be incorporated into specific rules, such as Regulations S-X and S-K, as opposed to implementing an entirely new rule; (v) the possibility of using a "comply or explain" framework; and (vi) how the SEC's climate-related priorities should consider information from private companies. In her statement, Lee also addressed ESG issues beyond climate change, expressing concern that SEC guidance issued in 2019 subjecting proxy firms to closer scrutiny discourages fiduciaries from voting to forward ESG agendas. Lee asked the staff to consider recommendations for enhancing or replacing that guidance. The statement also requested that the staff examine whether to update Form N-PX, which discloses fund voting decisions. With respect to shareholder proposals, Lee recommended revisiting SEC rules adopted last year that changed the criteria for the submission of proposals by shareholders and made it more difficult for smaller shareholders to access the proposal process. Lee suggested that the process is a key mechanism for engagement by shareholders with company management, including on ESG-related issues, such as climate change, workforce diversity, independent board leadership, and corporate political spending. Comments were requested within 90 days of the date of the statement.

"ESG factors often represent a core risk management strategy for portfolio construction. That's because investors, asset managers responsible for trillions in investments, issuers, lenders, credit rating agencies, analysts, index providers, and other financial market participants have observed their significance in terms of enterprise value. They have embraced sustainability factors and metrics as significant drivers in decision-making, capital allocation, and pricing," said Acting Chair Allison Herren Lee.

DOL Issues Enforcement Policy Statement on ESG and Proxy Voting Final Rules

On March 10, 2021, the DOL announced that it will suspend enforcement of two rules finalized under the previous administration limiting socially conscious investments by retirement plans, a signal that the Biden administration is attempting to advance ESG governance goals. The rules discouraged ESG investments by (i) holding plan fiduciaries to a "pecuniary" standard; and (ii) restricting plan fiduciaries from considering ESG factors in voting proxies. The DOL said that it will suspend enforcement of the Trump-era policy while crafting new regulations that better recognize the important role of socially conscious investments in retirement plans. According to Morningstar Inc., $51 billion or 25 percent of all new investments last year were in ESG funds.

"These rules have created a perception that fiduciaries are at risk if they include any environmental, social, and governance factors in the financial evaluation of plan investments, and that they may need to have special justifications for even ordinary exercises of shareholder rights…We intend to conduct significantly more stakeholder outreach to determine how to craft rules that better recognize the important role that environmental, social, and governance integration can play in the evaluation and management of plan investments, while continuing to uphold fundamental fiduciary obligations," said Ali Khawa, Principal Deputy Assistant Secretary for the Employee Benefits Security Administration.

SEC Staff Statement on Cross Trading

On March 11, 2021, the SEC's Division of Investment Management issued a statement asking for feedback regarding investment company cross trading in light of the recently adopted valuation rule, which permits a fund's board to delegate fair value determinations to a fund's investment adviser. Under the new Rule 2a-5 of the 1940 Act (the "Valuation Rule"), if a market quotation is "readily available" for a security, the security must be valued at its market value. The Valuation Rule provides that a market quotation is "readily available," a term that was not previously defined in the 1940 Act, "only when that quotation is a quoted price (unadjusted) in active markets for identical investments that the fund can access at the measurement date." In the accompanying release, the SEC noted that the Valuation Rule's definition of readily available market quotations would apply in all contexts under the 1940 Act and the rules thereunder, including Rule 17a-7.

Under Rule 17a-7, securities transactions between a fund and certain affiliates may be effected provided certain conditions are met, including that cross trades (i) involve a security for which market quotations are readily available; and (ii) are effected at the independent current market price of the security. The SEC indicated in its statement that a number of industry participants commented that certain cross trades between funds and their affiliates involving securities with prices derived from indirect sources, such as pricing services, would no longer be permissible under Rule 17a-7 because they would not qualify as having "readily available" market quotations under the new definition of the term. The statement also noted that cross trading practices have evolved over the last several decades, presenting valuation challenges and prompting conflict of interest considerations. As such, the statement notes, it is appropriate to assess what, if any, changes to Rule 17a-7 may be warranted. The statement asks for feedback on the following four topics: (i) which securities are eligible to cross trade; (ii) liquidity concerns; (iii) conflicts of interest; and (iv) controls advisers use to govern such trades and market transparency issues.

SEC Issues Amendments to Holding Foreign Companies Accountable Act

In December 2020, the Holding Foreign Companies Accountable Act (the "HFCA Act") was enacted, requiring the SEC to ban trading on all U.S. exchanges of any foreign company for which the Public Company Accounting Oversight Board ("PCAOB") is unable to inspect audit workpapers for three consecutive years. The HFCA Act, which aims to address restrictions China has placed on the PCAOB's ability to inspect audit workpapers of Chinese companies and reflects congressional concern about the securities of such companies trading in the U.S. markets, requires that the SEC adopt certain disclosure and submission requirements within 90 days of its enactment. On March 18, 2021, the SEC adopted interim final amendments to implement these congressionally-mandated disclosure and submission requirements. The amendments will apply to issuers that the SEC identifies as having filed an annual report with an audit report that is (i) issued by a registered public accounting firm located in a foreign jurisdiction; and (ii) unable to be inspected by the PCAOB because of a position taken by an authority in that jurisdiction (a "Commission-Identified Issuer"). Commission-Identified Issuers will be required to submit documentation to the SEC establishing that the issuer is not owned or controlled by a governmental entity in that foreign jurisdiction, and will be required to disclose in its annual report the audit arrangements of, and governmental influence on, such issuer. Pursuant to Section 2 of the HFCA Act, if an issuer is identified as a Commission-Identified Issuer for three consecutive years, the SEC must prohibit the securities of the issuer from being traded on a national securities exchange or through any other method that is within the jurisdiction of the SEC to regulate, including over-the-counter trading.

In addition, the SEC requested public comment regarding implementation of the disclosure and submission requirements and the appropriate mechanics for determining Commission-Identified Issuers. The interim final amendments become effective 30 days after publication in the Federal Register and comments on the amendments are due by the same date, however, no action will be required by an issuer until it has been identified by the SEC as having a non-inspection year pursuant to a process that has yet to be established by the SEC. The SEC will also assess how best to implement other requirements of the HFCA Act not subject to the 90-day deadline, including the trading prohibition in Section 2 of the HFCA Act.

Withdrawal and Modification of Staff Statements Related to Derivatives

On March 30, 2021, the staff of the SEC's Division of Investment Management issued an information update regarding the withdrawal and modification of certain staff statements. The withdrawal relates to recently-adopted Rule 18f-4 under the 1940 Act, which permits funds to enter into certain derivatives and other transactions subject to the conditions of the new rule. The staff noted that, consistent with the new rule and the discussion in the rule's release, staff statements relating to Section 18 and Section 12(a) of the 1940 Act are withdrawn or modified effective as of August 19, 2022. A list of the affected staff statements was included in an appendix to the information update.

ENFORCEMENT ACTIONS

SEC Suspends Trading in Multiple Issuers Based on Social Media and Trading Activity

On February 26, 2021, the SEC issued an order that suspended trading in the securities of 15 issuers for 10 days. These suspensions arose from questions surrounding the increased activity and volatility in the trading of the issuers, as well as the influence of certain social media accounts on that trading activity. According to the SEC's order, none of the issuers had filed any information with the SEC or OTC Markets, where the issuer' securities are traded, for over a year. The SEC's action followed other recent trading suspensions of numerous issuers, many of which may also have been targets of social media attempts to artificially inflate their stock price.

Under federal securities laws, the SEC can suspend trading in a stock for 10 days and generally prohibit a broker-dealer from soliciting investors to buy or sell the stock again until certain reporting requirements are met. The SEC noted that it continues to review market and trading data to identify other securities where the public interest and the protection of investors require trading suspensions. In a related risk alert, the SEC warned investors to understand the significant risks of trading based on social media.

SEC Charges Three Individuals in Digital Asset Fraud

On February 1, 2021, the SEC charged three individuals with defrauding hundreds of retail investors out of more than $11 million through two fraudulent and unregistered digital asset securities offerings. According to the complaint, Kristijan Krstic, founder of Start Options and Bitcoiin2Gen, and John DeMarr, the primary U.S.-based promoter for the companies, fraudulently induced investors to buy digital asset securities by touting Start Options' purported digital asset mining and trading platform, falsely claiming that Start Options was "the largest bitcoin exchange in euro volume and liquidity." The complaint alleges that Kristic and DeMarr also promoted Bitcoiin2Gen's unregistered initial coin offering of digital asset securities known as B2G tokens. According to the complaint, the promotional materials contained numerous false statements, including that the B2G tokens would be deliverable on the Ethereum blockchain, that the invested funds would be used to develop a coin that was mineable, and that the tokens would be tradeable on a proprietary digital asset trading platform. In reality, the complaint alleges, Bitcoiin2Gen was a sham, and Krstic and DeMarr allegedly misappropriated millions of dollars of investor funds for their own personal benefit. The SEC's complaint charges the individuals with violating the antifraud and registration provisions of the federal securities laws. The complaint seeks injunctive relief, disgorgement plus interest, penalties, and an officer-and-director bar against Krstic and DeMarr.

SEC Charges Investment Adviser and Others with Defrauding Over 17,000 Retail Investors

On February 4, 2021, the SEC charged three individuals and their affiliated entities with running a Ponzi-like scheme that raised more than $1.7 billion from securities issued by an asset management firm and registered investment adviser, GPB Capital. The SEC's complaint alleges that David Gentile, the owner and CEO of GPB Capital, and Jeffry Schneider, the owner of GPB Capital's placement agent Ascendant Capital, lied to investors about the source of money used to make an eight percent annualized distribution payment to investors. According to the complaint, the defendants told investors that the payments were paid exclusively with monies generated by GPB Capital's portfolio companies, when in reality GPB Capital used investor money for portions of the payments. GPB Capital and Gentile also allegedly manipulated the financial statements of certain limited partnership funds managed by GPB Capital to give the appearance that the funds' income was closer to generating sufficient income to cover the distribution payments than it actually was. As alleged, the scheme continued for more than four years in part because GPB Capital kept investors in the dark about the limited partnership funds' true financial condition, failing to deliver audited financial statements and register two of its funds with the SEC. GPB Capital allegedly violated the whistleblower provisions of the securities laws by including language in termination and separation agreements that impeded individuals from coming forward to the SEC, and by retaliating against a known whistleblower. The SEC's complaint charges Gentile, Schneider, GPB Capital, and Ascendant Capital with violating the antifraud provisions of the federal securities laws and charges GPB Capital with violating the registration and whistleblower provisions of the federal securities laws. The complaint seeks disgorgement of ill-gotten gains plus prejudgment interest and penalties.

SEC Charges Ratings Agency with Disclosure and Internal Controls Failures

On February 16, 2021, the SEC filed a civil action alleging that a former credit ratings agency (the "Credit Ratings Agency") violated disclosure and internal controls provisions of the federal securities laws. According to the complaint, in 30 commercial mortgage-backed securities ("CMBS") transactions totaling $30 billion, the Credit Rating Agency permitted analysts to make undisclosed adjustments to reduce the stress applied in the model used in determining many of the ratings that the Credit Rating Agency awarded to classes of the CMBS transactions. The complaint alleges that in certain instances the adjustments benefited the issuers that paid for the ratings because the adjustments resulted in ratings that enabled issuers to pay investors less interest than they would have if the ratings were determined without the adjustments. The complaint also alleges that the Credit Rating Agency failed to establish an effective internal control structure governing the adjustments. The SEC's complaint charges the Credit Rating Agency with violating disclosure and internal control provisions of the federal securities laws, and seeks injunctive relief, disgorgement with prejudgment interest, and civil penalties.

Whistleblower Awards Hit Record Level

On March 29, 2021, the SEC announced that it had set a new record for individual awards in any one year period. The awards were paid to 40 individuals, which is on track to nearly double last year's 39 individuals by year end. The office has paid roughly $200 million to tipsters in the last six months, surpassing last year's record of $175 million.

SEC Charges Unregistered Investment Adviser with Defrauding Investors

On March 9, 2021, the SEC charged an unregistered investment adviser (the "Defendant") for operating a decade-long investment adviser fraud through two private hedge funds (the "Hedge Funds") that he formed to conceal massive losses incurred by another fund that he controlled (the "Fund"). According to the complaint, the Defendant formed the Hedge Funds and transferred the Funds' poorly performing assets to them. The complaint alleges that the Defendant falsely told investors that their funds were being used to engage in very short-term equity trading and that the investments were consistently generating positive returns. In truth, according to the complaint, a substantial number of investors' funds had not been invested at all, and of the $90 million in new investor capital that the Defendant raised through the Hedge Funds and three other entities he controlled, more than $32 million was used to repay or redeem prior investors. In addition, the SEC alleges that the Defendant took more than one million dollars for his personal use. The complaint charges the Defendant with violations of the antifraud provisions of the federal securities laws. The Defendant has agreed to settle the SEC's charges by consenting to a bifurcated judgment that permanently enjoins him from future violations of the charged provisions and bars him from the securities industry, with disgorgement and penalties to be resolved at a future date.

SEC Charges Fraudster with Selling "Insider Tips" on the Dark Web

On March 18, 2021, the SEC charged an Internet fraudster (the "Defendant") with perpetrating a fraudulent scheme to sell insider tips on the dark web. The dark web allows users to access the Internet anonymously and, as such, has often been used to host websites and marketplaces that support or promote illegal activity. The SEC's complaint alleges that the Defendant accessed various dark web marketplaces, including a website claiming to be an insider trading forum, in search of material, nonpublic information to use for his own securities trading. The SEC alleges that the Defendant offered and sold on one of the dark web marketplaces various purported insider tips that he falsely described as material, nonpublic information. According to the complaint, several users paying in bitcoin purchased these tips and ultimately traded based on the information that the Defendant provided. The SEC's complaint charges the Defendant with violating the antifraud provisions of the federal securities laws. This is the SEC's first enforcement action involving alleged securities violations on the dark web.

Thomas R. Westle *and* ***Stacy H. Louizos*** *would like to thank* ***Margaret M. Murphy*** *and* ***Jennifer Patt*** *for their contributions to this update.*

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