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Regulatory Update and Recent SEC Actions

REGULATORY UPDATES

SEC Leadership Changes

On April 17, 2021, Gary Gensler was sworn into office as the Chair of the Securities and Exchange Commission (the "SEC"). Gensler served as chair of the U.S. Commodity Futures Trading Commission from 2009 to 2014, and helped to draft the Sarbanes-Oxley Act as senior advisor to Senator Paul Sarbanes.

On April 28, 2021, the SEC announced Alex Oh's resignation as Director of the Division of Enforcement, five days after her appointment to the post. Following Oh's resignation, Melissa Hodgman returned to the role of Acting Director. On June 29, 2021, the SEC announced the appointment of Gurbir S. Grewal as Director of the Division of Enforcement, effective July 26, 2021. Grewal currently serves as Attorney General for the State of New Jersey.

On June 15, 2021, the SEC announced the appointments of Renee Jones as Director of the Division of Corporate Finance and John Coates as General Counsel. Jones most recently served as Professor of Law and Associate Dean for Academic Affairs at Boston College Law School. Coates has served as the SEC's Acting Director of the Division of Corporation Finance since February 2021. Before joining the SEC, he served as the John F. Cogan Professor of Law and Economics at Harvard University.

Other SEC appointments include Jessica Wachter as Chief Economist and Director of the Division of Economic and Risk Analysis and David Saltiel as Acting Director of the Division of Trading and Markets.

"I feel incredibly privileged to join the SEC's team of remarkable public servants," Gensler said. "As chair, every day I will be animated by our mission: protecting investors, facilitating capital formation, and promoting fair, orderly, and efficient markets. It is that mission that has helped make American capital markets the most robust in the world."

SEC Staff Updates Guidance for Shareholder Proposals in Light of COVID-19

On April 9, 2021, the staff of the SEC's Division of Corporate Finance and Division of Investment Management updated existing guidance for conducting shareholder meetings in light of COVID-19 concerns.

The guidance addressed procedures for changing the date, time, or location of shareholder meetings, conducting virtual shareholder meetings, delays in printing and mailing proxy materials, and the presentation of shareholder proposals. The guidance was updated to extend the presentation of shareholder proposals procedures, which encourages issuers to provide shareholder proponents or their representatives with the ability to present their proposals through alternative means, such as by phone, through the 2021 proxy season. Furthermore, to the extent a shareholder proponent or representative is unable to attend the annual meeting due to the inability to travel or other hardships related to COVID- 19, the staff will consider this to be "good cause" under Rule 14a-8(h) under the Securities Exchange Act of 1934 (the "Exchange Act").

SEC Continues to Focus on ESG Agenda

In a statement released on April 12, 2021, SEC Commissioner Hester Peirce provided her interpretation of a recent SEC risk alert on Environmental, Social, and Governance ("ESG") investing that highlighted compliance shortcomings, including misleading claims and inadequate policies, procedures, and documentation, that the SEC observed during recent exams of investment advisers, registered investment companies, and private funds offering ESG products and services. Peirce indicated that the SEC will not make a determination as to the quality of the ESG strategy but rather will focus on whether investment advisers are following the ESG strategies that they are promoting.

"The staff's role is not to second-guess investment decisions through an SEC-created ESG scoring system; rather, it is to understand whether firms are adhering to their own ESG claims," Peirce said.

On May 13, 2021, in opening remarks delivered at the Conference on Financial Market Regulation, SEC Chair Gary Gensler emphasized the SEC's focus on initiatives related to climate and other ESG matters. Gensler identified a regulatory framework centered on disclosure of climate investing risks and human capital disclosures as an "early focus" of his tenure. Gensler pointed to investor interest in such information, stating that a clearer set of disclosure rules would also serve to benefit issuers and help them deliver the exact information their investors want. Gensler addressed ESG investing again in a speech delivered on June 23, 2021, stating that the SEC received more than 400 letters in response to its March 2021 request for comment on climate change disclosure; and that the SEC staff (the "Staff") is looking at a range of specific metrics, such as greenhouse gas emissions, to determine what is most relevant to investors. Gensler also stated that he has asked the Staff to consider potential requirements for companies that have made forward-looking climate commitments, or that have significant operations in jurisdictions with national requirements to achieve specific, climate-related targets. Finally, in his remarks to the SEC's Asset Management Advisory Committee (the "AMAC") on July 7, 2021, Gensler stated that the SEC would consider rules to require sustainable fund managers to disclose the criteria and underlying data used to support the label, noting that there is no standard meaning for terms like "green," "sustainable," or "net-zero." In addition, Gensler indicated he instructed the SEC Staff to consider whether the names rule should include strategies as well as types of investments in its 80% policy, noting that he believes investors would benefit from seeing the criteria and data underlying investment decisions. Such an amendment to the names rule could subject funds that indicate ESG strategies in their name to the 80% policy.

In his remarks on June 3, 2021 and June 22, 2021, SEC Commissioner Elad Roisman expressed his concerns over the attempt to standardize ESG disclosure requirements, including: the potential costs (such as costs associated with litigation); the difficulty of crafting and overseeing ESG regulation effectively; and whether the SEC has the legislative mandate to construct ESG (especially climate) disclosure rules. Roisman also advocated for the SEC to consider a safe harbor for companies that are trying in earnest to provide this new information, similar to that which is available for companies' forward-looking statements, expressing his concern that without it, ESG investing could be chilled.

The SEC's Rulemaking Agenda, issued on June 11, 2021, also addresses ESG matters. The agenda includes potential new rules with respect to disclosure relating to ESG claims, climate risk, and human capital, including workforce diversity and corporate board diversity, and cybersecurity risk *(See, SEC Announces Annual Regulatory Agenda).*

On July 7, 2021, the AMAC approved recommendations regarding ESG investments. Among them was a recommendation that the SEC "foster meaningful, consistent, and comparable disclosure of material ESG matters" by issuers. The AMAC also called on the SEC to suggest best practices for ESG investment product disclosure, including a clear description of the product's strategy and investment priorities. The AMAC also approved recommendations to implement diversity disclosures for mutual funds and investment advisers, which is discussed further below *(See, New Initiatives on Diversity Disclosure).* While it is up to the SEC to determine whether they will act on these recommendations, SEC Chair Gensler indicated in his remarks before the AMAC that the SEC may already be taking some of the steps recommended by the AMAC.

SEC Staff Announces Termination of March 2020 Liquidity-Related Relief for Funds

On April 15, 2021, the Staff provided notice that certain COVID-19-related temporary regulatory relief issued on March 23, 2020 (the "Relief") relating to the liquidity of registered open-end management investment companies other than money market funds ("open-end funds") and insurance company separate accounts registered as unit investment trusts ("separate accounts") will terminate, and that two related no-action letters issued by the Division of Investment Management (the "Division") in March 2020 will be withdrawn, effective April 30, 2021. The Relief provided open-end funds and separate accounts flexibility to obtain short-term funding. Subject to certain conditions, the Relief:

- Permitted open-end funds and separate accounts to borrow money from certain affiliates and permitted an affiliated person to make collateralized loans to open-end funds and separate accounts;
- Permitted additional flexibility under existing interfund lending arrangements and extending the ability to use interfund lending arrangements to funds that did not have exemptive relief; and
- Permitted open-end funds to enter into lending arrangements or borrowings that deviated from fundamental policies, subject to prior board approval.

The two related letters also provided no-action relief, under certain facts and circumstances, with respect to the purchase of securities by an affiliated person.

SEC Reopens Comment Period for Universal Proxy

On April 16, 2021, the SEC issued a release reopening the comment period on new rules and amendments proposed by the SEC in October 2016 that would mandate the use of universal proxy cards in all non-exempt contested director elections (the "Proposed Rules"). Currently, shareholders voting by proxy in contested elections are limited to choosing among candidates nominated by the person soliciting the proxy. Under the Proposed Rules, each universal proxy card would list all management and dissident nominees for director, enabling shareholders voting by proxy to pick among the different candidates similar to the manner in which they would be able to vote for directors in person at a shareholder meeting. The Proposed Rules would also, among other things: (i) revise the consent requirement for a bona fide nominee and eliminate the short slate rule; (ii) require management and dissidents to provide each other with notice of the names of their nominees; and (iii) require dissidents in a contested election to solicit the holders of shares representing at least a majority of the voting power of shares entitled to vote on the election of directors. In addition, the Proposed Rules would amend proxy card and proxy statement disclosure requirements to more clearly specify voting options and standards in director elections (*i.e.,* by mandating that proxy cards include an "against" voting option when permitted under state laws and requiring disclosure about the effects of a "withhold" vote in an election). The reopened comment period permits interested parties to submit further comments on the Proposed Rules, as well as additional

comments on the questions raised in the reopening release, including whether the Proposed Rules should be extended to registered investment companies and business development companies. It further allows interested parties to comment on developments since the Proposed Rules were issued, including developments in corporate governance matters. The public comment period will remain open for 30 days following publication of the release in the Federal Register.

"Reopening the comment period will allow the public to share additional views on the use of universal proxy cards in director elections, particularly in light of the corporate governance developments that have occurred since the Commission issued its proposal," said Acting Director of the SEC's Division of Corporation Finance John Coates.

New Initiatives on Diversity Disclosure

On April 21, 2021, the House Financial Services Committee passed the Improving Corporate Governance Through Diversity Act. If approved by Congress, the legislation would require companies to disclose the race, ethnicity, gender, and veteran status (based on voluntary self-identification) of their board members, nominees, and executives. Companies would disclose the data when they solicit shareholder votes for director elections or file annual reports with the SEC. The law would also create an advisory group that would study corporate diversity and submit annual reports to Congress.

On July 7, 2021, the AMAC approved recommendations to implement diversity disclosures that would require mutual funds to disclose the gender and racial diversity of their boards, workforces and executive leadership and ownership, and investment advisers to disclose the gender and racial diversity of their workforces, officer ranks, and ownership ranks, noting that of the $70 trillion in global financial assets under management, less than one percent are managed by minority-owned or women-owned firms. As noted above, SEC Chair Gensler indicated in his remarks before the AMAC that the SEC may already be taking some of the steps recommended by the AMAC.

Updated FAQs on Modernized Registered Investment Company Reporting

On April 21, 2021, the staff of the Division (the "Division Staff") issued an update to the Frequently Asked Questions ("FAQs") related to the investment company reporting modernization reforms adopted in October 2016 and revised in 2017 and 2019. In its updated FAQs, the Division Staff noted that, with respect to calculating the "monthly average of the value of portfolio securities on loan" and the "monthly average net assets during the reporting period" (Items C.6.f and C.19.a, respectively, on Form N-CEN), responses should reasonably represent the monthly averages and that the Division Staff had observed a wide range of calculation methodologies, all of which properly reflected these averages.

The Division Staff also flagged the importance of reporting a funds monthly average of the value of portfolio securities on loan and monthly average net assets, noting that this information could help "inform investors and other interested parties about the use of and potential risks associated with a management company's securities lending activities."

SEC Chairman Gensler Testifies Before the House Committee on Financial Services

On May 6, 2021, SEC Chair Gary Gensler testified before the House of Representatives Financial Services Committee to discuss the market volatility of January 2021, including GameStop and AMC, and Robinhood's temporary trading restrictions, and the ways in which the intersection between finance and technology contributed to these events. Gensler highlighted several factors that contributed to the market volatility, including (i) gamification and user experience; (ii) payment for order flow; (iii) equity market structure; (iv) short selling and market transparency; (v) social media; (vi) market plumbing: clearance and settlement; and (vii) system-wide

risks. Gensler also noted that the SEC is continuing to vigorously review the recent market events for any regulatory violations, and expects to publish a Staff report further assessing the events in summer 2021.

Congressional Leaders Ask Government Accountability Office to Examine Target-Date Funds

On May 6, 2021, Sen. Patty Murray, D-Wash., Chair of the Senate Committee on Health, Education, Labor, and Pensions, and Rep. Robert Scott, D-Va., Chair of the House Committee on Education and Labor, asked the Government Accountability Office (the "GAO") to review the use of target-date funds ("TDFs") in 401(k) and similar defined contribution retirement plans. The letter cites research showing wide variances in fund risk exposures for such funds and asks the GAO to consider topics such as: (i) the variation in the performance of TDFs of the same target retirement year, particularly for TDFs at or near the target retirement date; (ii) how asset allocation and fee structure vary across TDFs and how TDF fee structures compare with other investment products; (iii) to what extent TDFs include alternative assets, such as hedge funds or private equity; (iv) how TDFs are marketed and advertised and whether participants are sufficiently aware of the cost and asset allocation variation among TDFs; and (v) possible legislative or regulatory options that would not only bolster the protection of plan participants who are nearing retirement or are retired, but also achieve the intended goals of TDFs.

SEC Approves Registration of First Security-Based Swap Data Repository and Sets Compliance Date for Regulation SBSR

On May 7, 2021, the SEC announced that it approved the registration of its first security-based swap data repository ("SDR") capable of accepting transaction reports. DTCC Data Repository (U.S.), LLC ("DDR") will operate as a registered SDR for security-based swap transactions in the equity, credit, and interest rate derivatives asset classes. The SEC's approval of DDR came under Regulation SBSR, a mandate from the Dodd-Frank Wall Street Reform and Consumer Protection Act that provides for regulatory reporting of security-based swap information to registered repositories and public dissemination of transaction, volume, and pricing information. The compliance date for Regulation SBSR was set for November 8, 2021.

"Implementing Regulation SBSR fulfills an important mandate under the Dodd-Frank Act," said SEC Chair Gary Gensler. "A centralized database of security-based swap transactions is an essential reform to better understanding these markets, for surveillance and for enforcement. The data repository also will facilitate public reporting of security-based swap transactions, bringing much-needed transparency to these markets."

SEC Division of Investment Management Issues Statement on Bitcoin Futures and Registered Funds

On May 11, 2021, the Division Staff issued a statement encouraging investors in mutual funds with exposure to the Bitcoin futures market to carefully consider the risk disclosure of the fund, the investor's own risk tolerance, and the possibility of investor loss.

Referring to the Division's January 2018 letter that identified several areas of concern for registered funds investing in cryptocurrency-related investments, including valuation, liquidity, custody, arbitrage mechanisms for ETFs, and potential market manipulation, the Division acknowledged the various developments in the Bitcoin futures market since the letter, including increased trading volumes, readily available prices and the lack of custody challenges as a result of being cash-settled, and the recent adoption of Rule 18f-4 under the Investment Company Act of 1940 (the "1940 Act"), which imposes certain limitations on the level of leverage created by derivatives use. Notwithstanding these developments, the statement warns of the highly speculative nature of the Bitcoin futures market, its volatility, and the lack of regulation and potential for fraud and manipulation in the underlying Bitcoin market.

The Division stated that it would closely monitor mutual funds' and investment advisers' ongoing compliance with the 1940 Act as well as investor protection, including the ability of funds to liquidate Bitcoin futures positions, as necessary to meet daily redemption demands and funds' liquidity classifications of positions in the Bitcoin futures market. The Division noted that investment in the Bitcoin futures market by open-end funds should be pursued only by funds with appropriate strategies and full disclosure of material risks. Because closed-end funds do not provide for daily redemption of their shares, the Division noted that they do not present the same types of liquidity challenges as open-end funds. Nonetheless, the Division encourages any closed-end fund that seeks to invest in the Bitcoin futures market to consult with the Division, prior to filing a registration statement, about the fund's proposed investment, anticipated compliance with the 1940 Act, and how the fund would provide for appropriate investor protection.

Extension of Trading Ban on Chinese-Military Linked Securities

On May 18, 2021, the Biden administration extended the deadline for the ban on transactions involving securities of entities whose names closely match, but do not exactly match, the name of a Communist Chinese military company (a "CCMC"), from May 27, 2021 to June 11, 2021, citing the need to craft a stronger policy to prohibit such trades.

Executive Order 13959 (the "Executive Order"), which prohibits investors from engaging in transactions involving securities of any 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 the name of a CCMC, but the Biden administration extended that date for the first time, to May 27, 2021. Under 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 one year to divest their existing holdings in the company.

At least eight Chinese companies have been delisted from U.S. exchanges as a result of the Executive Order. In February 2021, mobile phone maker Xiaomi filed a lawsuit to remove itself from the CCMC List, and in March 2021 a federal judge temporarily blocked enforcement, citing the U.S. government's "deeply flawed" process for including it in the ban. The Defense Department subsequently agreed to remove Xiaomi from the CCMC List.

Executive Order and Democratic Bill Address ESG Regulation and Retirement Investing

On May 20, 2021, President Biden signed into effect an Executive Order entitled "Climate-Related Financial Risk" (the "Order"). The Order emphasizes the administration's focus on issues related to climate change and requires federal agencies, including financial regulators, to begin to incorporate climate-risk and other ESG issues into financial regulation. Specifically, the Order establishes that it is the administration's policy to: "advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk…, including both physical and transition risks;" "act to mitigate that risk and its drivers, while accounting for and addressing disparate impacts on disadvantaged communities and communities of color;" and "achieve our target of a net-zero emissions economy by no later than 2050."

The Order also directs the Labor Secretary to reconsider two rules issued under the Trump administration that were broadly seen as an attempt to restrain the consideration of ESG factors in investment decisions (the "Rules"). The Rules discourage ESG investments by (i) holding plan fiduciaries to a "pecuniary" standard (the "Financial Factors in Selecting Plan Investments" rule); and (ii) restricting plan fiduciaries from considering ESG factors in voting proxies (the "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" rule). President Biden had already indicated in March 2021 that the Rules would not be enforced.

Also on May 20, 2021, Senators Patty Murray (D-WA) and Tina Smith (D-MN) and Representative Suzan DelBene (D-WA) introduced the Financial Factors in Selecting Retirement Plan Investment Act. The bill would expressly permit ESG investing in retirement plans, thereby reversing the Rules. The legislation, which faces an uncertain future in a closely divided Senate, would:

- Amend the Employee Retirement Income Security Act of 1974 ("ERISA") to make clear that plans may consider ESG factors in their investment decisions when they are expected to have an impact on investment outcomes, provided plans consider them in a prudent manner consistent with their fiduciary obligations;
- Amend ERISA to codify a longstanding principle that plans may consider ESG factors as tiebreakers when deciding between otherwise comparable options; and
- Formally repeal the Financial Factors in Selecting Plan Investments rule and seek to limit future regulatory actions that impose unfair regulatory burdens in an effort to discourage ESG investing by ERISA plans.

> ***"We're putting forth this legislation because we know there's a growing demand for sustainable investing, and because we believe Congress should act now to provide the legal certainty necessary to make sure workplace retirement plans are able to offer these options to workers across the country," Smith stated in introducing the legislation.***

SEC Statements on Proxy Voting

On June 1, 2021, SEC Chair Gary Gensler issued a statement directing the Staff to consider whether to recommend further regulatory action regarding proxy voting advice, in particular, whether the SEC should revisit (i) the SEC's 2019 guidance and interpretation that voting advice produced by proxy advisors generally constitutes a solicitation under the proxy rules and that the failure to disclose material information regarding proxy voting advice could cause such advice to be misleading in violation of the proxy rules (the "Guidance"); and (ii) the amendments adopted in 2020 that codified the Guidance and added new conditions (the "Conditions") to certain exemptions from the proxy rules' information and filing requirements (the "Amendments"). The Amendments became effective on November 2, 2020, and the compliance date for the Conditions in the Amendments is December 1, 2021.

In response to Gensler's statement, the SEC's Division of Corporation Finance issued a statement indicating that it would not recommend enforcement action based on the Guidance or the Amendments during the period in which the SEC is considering further regulatory action. In addition, the Division of Corporate Finance stated that, in the event that new regulatory action leaves the Conditions in place with the current December 1, 2021 compliance date, it will not recommend enforcement action based on the Conditions for a reasonable period of time after any resumption by Institutional Shareholder Services Inc. of its litigation challenging the Guidance and Amendments.

In response to the statements from Gensler and the Division of Corporate Finance, SEC Commissioners Hester Peirce and Elad Roisman, each of whom voted in favor of the Amendments, issued a joint statement that, while they are open to seeing what the Staff recommends and to working with colleagues to consider such recommendations, they find it difficult to imagine what has changed since the recently adopted Amendments that would justify changes to the rule. They also noted the difficulty in judging how the Conditions will work in practice given that the compliance date has not yet occurred. Finally, the Commissioners expressed skepticism as to how the SEC would justify a departure from its longstanding legal interpretation regarding proxy solicitation.

> ***"We hope that today's actions and whatever future actions the Commission takes with respect to these rules will not deprive users of proxy voting advice of information they need to properly consider such advice or lead them to make decisions based on misinformation," said SEC Commissioners Peirce and Roisman in a joint statement.***

SEC Announces Removal of PCAOB Chairperson and Replacement of Board

On June 4, 2021, the SEC announced the removal of William D. Duhnke III from the Public Accounting Oversight Board (the "PCAOB"). Duane M. DesParte has been designated to serve as acting chairperson. DesParte, a CPA, has been a member of the PCAOB since April 2018. The decision by the SEC to remove Duhnke III came after the PCAOB and its leadership faced criticism from various groups and individuals, including a letter from former members of the PCAOB's Investor Advisory Group to SEC Chair Gary Gensler and several Democratic politicians in mid-April calling for Duhnke III's removal. The SEC also announced that it intends to seek candidates to fill all five board positions on the PCAOB, including those currently held by members whose terms have not yet expired. One seat has been vacant since late January 2021 after Jay Brown stepped down when his spouse, SEC Commissioner Allison Herren, became acting chair and served in that capacity until Gary Gensler was sworn in as permanent chair. In a joint statement, SEC Commissioners Hester Peirce and Elad Roisman, who voted against removing Duhnke and replacing all board members, strongly criticized the decision.

SEC Announces Annual Regulatory Agenda

On June 11, 2021, the Office of Information and Regulatory Affairs released the Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions. The report lists short-term and long-term regulatory actions that administrative agencies plan to take. The SEC's agenda includes potential new rules and rule amendments specific to investment companies and investment advisers, including:

- Proposed new rule to streamline shareholder reports under the 1940 Act;
- Amendments to Rule 17a-7 under the 1940 Act concerning the exemption of certain purchase or sale transactions between an investment company and certain affiliated persons;
- Amendments to existing rules and/or proposed new rules under the 1940 Act to improve and modernize the regulations around the custody of funds or investments of clients by investment advisers;
- Proposed changes to regulatory requirements relating to open-end fund's liquidity and dilution management;
- Regulation of money market funds; and
- Requirements for investment companies and investment advisers related to ESG factors, including ESG claims and related disclosures.

Other proposed and final SEC rulemaking areas include: disclosure relating to climate risk, human capital, including workforce diversity and corporate board diversity, and cybersecurity risk; market structure modernization within equity markets, treasury markets, and other fixed income markets; transparency around stock buybacks, short sale disclosure, securities-based swaps ownership, and the stock loan market; 10b5-1 affirmative defense provisions; unfinished work directed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, including, among other things, securities-based swaps and related rules, incentive-based compensation arrangements, and conflicts of interest in securitizations; enhancing shareholder democracy; special purpose acquisition companies; and mandated electronic filings and transfer agents. In addition, the SEC may seek public comment on the role of certain third-party service providers, such as index providers and model providers, and their implications for the asset-management industry.

"To meet our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, the SEC has a lot of regulatory work ahead of us," said SEC Chair Gary Gensler. "I look forward collaborating with my fellow commissioners and the dedicated staff to propose and finalize rules that will strengthen our markets, increase transparency, and safeguard investors."

SEC Increases Dollar Amount Thresholds under the Investment Advisers Act of 1940

On June 17, 2021, the SEC issued an order (the "Order") increasing the "assets under management" test from $1,000,000 to $1,100,000 and the "net worth" test from $2,000,000 to $2,200,000, for purposes of the "qualified client" definition under Rule 205-3 of the Investment

Advisers Act of 1940. Rule 205-3 exempts an investment adviser from the prohibition against charging a client performance fees when the client is a "qualified client." To qualify, a client must have at least a certain dollar amount in assets under management with the adviser immediately after entering into the advisory contract (the "assets-under-management" test) or a net worth of more than a certain dollar amount immediately prior to entering into the advisory contract (the "net worth" test). Rule 205-3 requires the SEC to adjust the dollar amounts in these tests for inflation every five years, rounded to the nearest $100,000. The Order is effective beginning August 16, 2021.

ENFORCEMENT ACTIONS

SEC Settles Charges with Registered Investment Adviser Over Share Class Selection Practices

On April 15, 2021, an investment advisory services corporation (the "Adviser") agreed to settle charges for breaches of fiduciary duty in connection with its mutual fund share class selection practices and the receipt of fees by its affiliated broker-dealer ("Broker-Dealer") pursuant to Rule 12b-1 under the 1940 Act. According to the order, Adviser purchased, recommended, or held for certain advisory clients mutual fund share classes that charged 12b-1 fees instead of lower cost share classes of the same funds that were available to the clients. Adviser's affiliate, Broker-Dealer, received 12b-1 fees in connection with these investments, a small portion of which was then paid to certain of Adviser's investment adviser representatives, in their capacities as registered representatives of Broker-Dealer. According to the order, Adviser did not adequately disclose this conflict of interest in its Form ADV or otherwise. The order further indicates that Adviser breached its duty to seek best execution by causing certain advisory clients to purchase mutual fund share classes that charged 12b-1 fees when other share classes of the same funds that presented a more favorable value were available to the clients. Adviser agreed to cease and desist from further violations and pay disgorgement and prejudgment interest totaling $825,057.

SEC Charges Fund Manager with Fraud

On April 23, 2021, the SEC charged a fund manager ("Fund Manager") and investment adviser FF Fund Management, LLC ("FFM") with fraudulently raising and misappropriating tens of millions of dollars from the sale of limited partnership interests in a private fund. The SEC's complaint alleges that Fund Manager, the sole owner and principal of FFM, defrauded investors by making misrepresentations regarding the fund's strategy and investments, failing to eliminate or disclose conflicts of interest, misappropriating fund assets, and falsely representing that the fund would be audited annually. According to the complaint, Fund Manager told potential and existing investors that his investment strategy for the fund was to maintain a highly liquid portfolio primarily focused on options and preferred stock trading. In reality, as alleged in the complaint, Fund Manager diverted substantial fund assets to an entity he owned and invested the fund's remaining assets mainly in highly illiquid private companies and real estate ventures. The SEC's complaint charges Fund Manager and FFM with violating the antifraud provisions of the federal securities laws and seeks disgorgement of ill-gotten gains, civil penalties, and permanent and conduct-based injunctive relief.

SEC Charges Broker-Dealer for Failures Related to Filing Suspicious Activity Reports

On May 12, 2021, the SEC announced it had settled charges against a Colorado-based registered broker-dealer (the "Broker") for violations related to the filing of Suspicious Activity Reports ("SARs"). The SEC's order found that the Broker failed to file approximately 130 SARs, including in cases when it had detected external bad actors gaining, or attempting to gain, access to the retirement accounts of participants in the employer-sponsored retirement plans it serviced. Further, for nearly 300 SARs that the Broker did file, the order found that the Broker did not include the "five essential elements" of information it knew and was required to report about the suspicious activity and suspicious actors, including cyber-related data, such as URL addresses and IP addresses. The SEC's order noted that significant cooperation by the Broker with the SEC's investigation and took into consideration the Broker's subsequent remedial efforts, which included adding dedicated anti-money laundering staff and systems, replacing key personnel, clarifying delegation of responsibility for filing SARs, and implementing new SAR-related policies, procedures, standards, and training. The SEC's order found that the Broker violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder. Without admitting or denying the SEC's findings, the Broker agreed to a settlement that imposes a $1.5 million penalty, a censure, and an order to cease and desist from future violations.

SEC Charges Index Provider for Failures Relating to Volatility-Related Index

On May 17, 2021, the SEC announced it had settled charges against an index provider ("Index Provider") for failures relating to a previously undisclosed quality control feature of one of its volatility-related indices, which led the Index Provider to publish and disseminate stale index values during a period of unprecedented volatility. The SEC's order found that an index ("Index") published by the Index Provider was intended to calculate values based on real-time prices of certain CBOE Volatility Index ("VIX") futures contracts. The Index is licensed by issuers, including the issuer of an inverse exchange-traded note (the "XIV ETN"). According to the SEC's order, on February 5, 2018, an undisclosed "Auto Hold" feature of the Index was triggered, at which point the immediately prior Index value continued to be reported. The SEC found that the XIV ETN's issuer derived information about the Index from the Index Provider's public disclosures about the Index, but the Auto Hold feature had never been publicly disclosed and that the Index Provider's failure to release the Auto Hold resulted in the publication and dissemination of stale and static Index values, rather than values based on the real-time prices of certain VIX futures contracts. In addition, the SEC's order found that, because the Index was the primary input for the calculation of the XIV ETN's indicative value, the XIV ETN's indicative values published to the market during the same intervals were similarly static and, as a result, the indicative values being reported in real-time were higher than they would have been if the Auto Hold had not been triggered. The SEC's order charged the Index Provider with violating Section 17(a)(3) of the Securities Act. Without admitting or denying the SEC's findings, the Index Provider agreed to a cease-and-desist order and to pay a nine-million-dollar penalty.

FINRA Orders Record Financial Penalties Against Brokerage Firm

On June 30, 2021, the Financial Industry Regulatory Authority ("FINRA") announced it had fined a discount brokerage firm offering commission-free trading through its website and mobile app ("Brokerage Firm") $57 million and ordered the firm to pay approximately $12.6 million in restitution, plus interest, to thousands of harmed customers. FINRA reported that the sanctions represent the largest financial penalty ever ordered by FINRA. In determining the appropriate sanctions, FINRA noted it had considered the "widespread and significant harm" suffered by the Brokerage Firm's customers. FINRA found that (i) the Brokerage Firm had negligently communicated false and misleading information to its customers concerning a variety of critical issues, including whether customers could place trades on margin, how much cash was in customers' accounts, how much buying power or "negative buying power" customers had, the risk of loss customers faced in certain options transactions, and whether customers faced margin calls; (ii) the Brokerage Firm failed to exercise due diligence before approving customers to place options trades, resulting in thousands of customers being approved for options trading who either did not satisfy the firm's eligibility criteria or whose accounts contained red flags indicating that options trading may not have been appropriate for them; and (iii) the Brokerage Firm failed to reasonably supervise the technology that it relied upon to provide core broker-dealer services and as a result the firm experienced a series of outages and critical systems failures, the most serious of which occurred on March 2 and 3, 2020, when the Brokerage Firm's website and mobile applications shut down, preventing its customers from accessing their accounts during a time of historic market volatility. Additionally, FINRA found that the Brokerage Firm failed to report to FINRA tens of thousands of written customer complaints that it was required to report. The settlement resolved numerous other charges against the Brokerage Firm, including its failure to have a reasonably designed customer identification program and its failure to display complete market data information.

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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