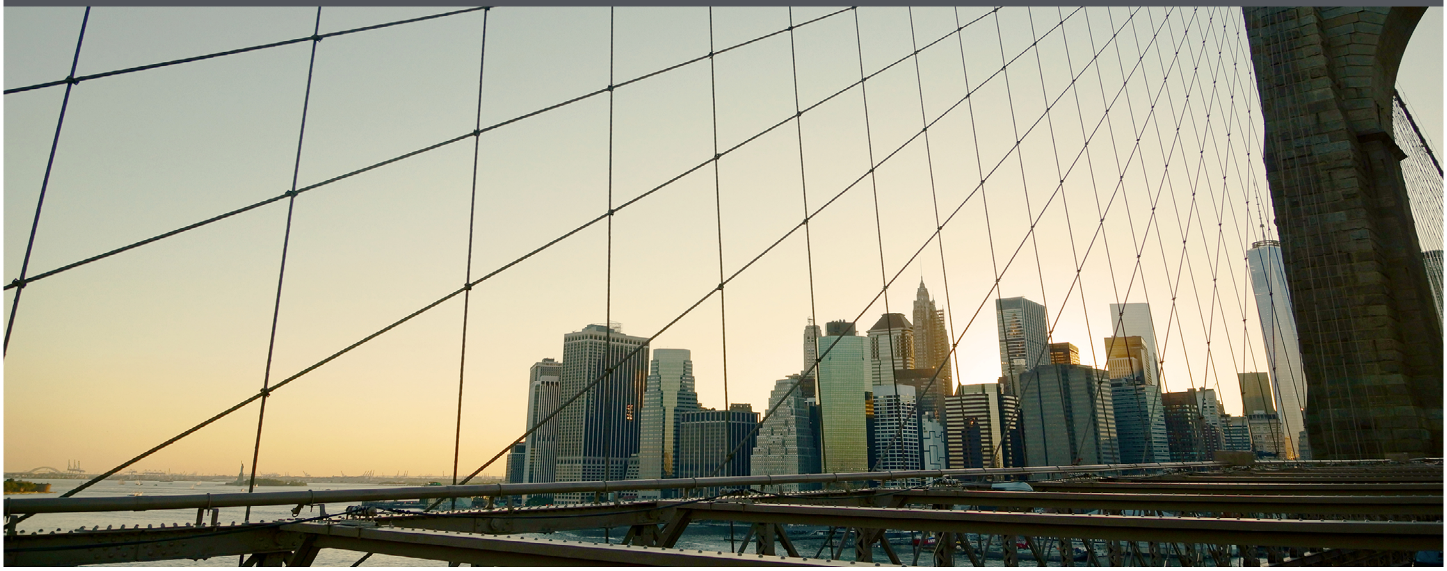
BLANKROME

Investment Management



APRIL 2023 • NO. 2

Regulatory Update and Recent SEC Actions

REGULATORY UPDATES

Recent SEC Leadership Changes

On January 10, 2023, the Securities and Exchange Commission (the "SEC") announced the appointment of Cristina Martin Firvida as director of the Office of the Investor Advocate, effective January 17, 2023. Ms. Martin Firvida was most recently the vice president of financial security and livable communities for government affairs at the American Association of Retired Persons ("AARP"). As the investor advocate, Ms. Martin Firvida will lead the office that assists retail investors in interactions with the SEC and with self-regulatory organizations ("SROs"), analyzing the impact on investors of proposed rules and regulations, identifying problems that investors have with financial service providers and investment products, and proposing legislative or regulatory changes to promote the interests of investors.

On January 11, 2023 the SEC announced that Paul Munter has been appointed as chief accountant. He has served as acting chief accountant since January 2021. In addition to continuing to lead the Office of the Chief Accountant ("OCA"), he will also assist the SEC in its oversight of the Financial Accounting Standards Board ("FASB") and the Public Company Accounting Oversight Board ("PCAOB"). Mr. Munter joined the SEC in 2019 as deputy chief accountant in charge of OCA's international work. Before joining the agency, Mr. Munter was a senior instructor of accounting at the University of Colorado Boulder. He had previously retired from KPMG, where he served as the lead technical partner for the U.S. firm's international accounting and International Financial Reporting Standards ("IFRS") activities and served on the firm's panel responsible for establishing firm positions on the application of IFRS.

On January 13, 2023, the SEC announced that Renee Jones, director of the Division of Corporation Finance, departed the agency and was replaced by Erik Gerding, effective February 2, 2023. Mr. Gerding previously served as the Division's deputy director. Mr. Gerding joined the SEC in October 2021 and led the Legal and Regulatory Policy in the Division of Corporation Finance. He has taught as professor of law and a Wolf-Nichol Fellow at the University of Colorado Law School, where he has focused in the areas of securities law, corporate law, and financial regulation. Mr. Gerding previously taught at the University of New Mexico School of Law. He also practiced in the New York and Washington, D.C., offices of Cleary Gottlieb Steen & Hamilton LLP, representing clients in the financial services and technology industries in an array of financial transactions and regulatory matters.

Boards File Comment Letters Asking SEC to Withdraw Swing Pricing Rule Proposal

Over thirty (30) fund boards have submitted comment letters to the SEC with respect to the controversial swing pricing rule proposal. Industry participants have noted that this level of direct board participation in the comment process for a rule proposal of this type is unprecedented in recent SEC history. Many of the letters call for a withdrawal of the rule proposal, with some arguing that millions of American investors will not get the best price for their trades. Many letters also stated that requiring swing pricing would burden fund complexes and harm mutual fund investors without solving the liquidity problems that the SEC aimed to resolve. A vast majority of the comment letters indicated that swing pricing is not needed and that current tools for managing liquidity worked well, even during the volatile 2020 markets.

The comment letters also noted that investors who hold fund shares through intermediaries may have to place their orders earlier as a result of the proposed hard close requirement, which would put them at a disadvantage over the investors who buy shares directly from a fund. Several commenters also expressed concern that the hard close could cause intermediaries to drop mutual funds from their offerings in favor of less-regulated investment vehicles, such as collective investment trusts ("CITs"). Some letters pointed out that one of the justifications the SEC raises for the new rule is the market volatility during the early part of the COVID-19 pandemic and its impact on fund liquidity risk management, yet the SEC then goes on to say that it did not have specific data about fund dilution during that period. Letters also alleged that the SEC did not provide an accurate cost benefit analysis, and noted that the SEC states in the rule proposal that it "cannot predict the number of investors that would choose to keep their investments in the mutual fund sector nor the number of investors that would exit mutual funds and instead invest in other fund structures such as ETFs, close-end funds, or CITs."

SEC Proposes Rule to Prohibit Conflicts of Interest in Certain Securitizations

The SEC issued a proposed rule (the "proposed rule") to prohibit material conflicts of interest in the sale of asset-backed securities ("ABS"). The proposed rule, Rule 192 under the Securities Act of 1933 (the "Securities Act"), was issued on January 25, 2023, to implement Section 27B of the Securities Act, a provision added by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Specifically, the proposed rule would prohibit securitization participants from engaging in certain transactions that could incentivize a securitization participant to structure an ABS in a way that would put the securitization participant's interests ahead of those of ABS investors. The SEC originally proposed a rule to implement Section 27B in September 2011. If adopted, the proposed rule would prohibit an underwriter, placement agent, initial purchaser, or sponsor of an ABS, including affiliates or subsidiaries of those entities, from engaging, directly or indirectly, in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in such ABS. Under the proposed rule, such transactions would be considered "conflicted transactions" and include, for example, a short sale of the ABS or the purchase of a credit default swap or other credit derivative that entitles the securitization participant to receive payments upon the occurrence of specified credit events in respect of the ABS.

The prohibition on conflicted transactions would commence on the date on which a person has reached, or has taken substantial steps to reach, an agreement that such person will become a securitization participant with respect to an ABS, and it would end one year after the date of the first closing of the sale of the relevant ABS. The proposed rule would provide certain exceptions for risk-mitigating hedging activities, bona fide market-making activities, and certain commitments by a securitization participant to provide liquidity for the relevant ABS. The public comment period will remain open for 60 days following publication of the proposing release on the SEC's website or 30 days following publication of the proposing release in the Federal Register, whichever period is longer.

Division of Examinations Publishes Risk Alert on Regulation Best Interest

On January 30, 2023, the Division of Examinations published a Risk Alert (the "Risk Alert") to highlight observations from examinations related to Regulation Best Interest, which had a June 30, 2020, compliance date and to assist broker-dealers in reviewing and enhancing their compliance programs related to Regulation Best Interest. The Risk Alert discusses deficiencies noted during examinations conducted, as well as examples of weak practices that could result in deficiencies. Regulation Best Interest established a new, enhanced standard of conduct under the Securities Exchange Act of 1934 (the "Exchange Act") for broker-dealers ("broker-dealers" or "firms") and associated persons that are natural persons ("financial professionals") of a broker-dealer when making recommendations of securities transactions or investment strategies involving securities (including account recommendations) to retail customers. Regulation Best Interest requires compliance with four component obligations: (1) providing certain prescribed disclosure, before or at the time of the recommendation, about the recommendation and the relationship between the retail customer and the broker-dealer ("Disclosure Obligation"); (2) exercising reasonable diligence, care, and skill in making the recommendation to, among other things, understand the potential risks, rewards, and costs associated with a recommendation, and having a reasonable basis to believe that the recommendation is in the best interest of a retail customer ("Care Obligation"); (3) establishing, maintaining, and enforcing written policies and procedures reasonably designed to identify and address conflicts of interest; and (4) establishing, maintaining, and enforcing written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest. The Risk Alert set out specific examples of practices, policies, and procedures that were deficient in complying with requirements under the Regulation, including:

- *Policies and Procedures Relating to the Disclosure Obligation*. Some broker-dealers did not have written policies and procedures reasonably designed to achieve compliance with the Disclosure Obligation. The SEC noted that examples of policies and procedures that may contain deficiencies or weaknesses include policies and procedures that did not specify when or how disclosures should be created or updated.

- *Policies and Procedures Relating to the Care Obligation*. Examples of policies and procedures that may contain deficiencies or weaknesses include policies and procedures that directed financial professionals to consider reasonably available alternatives without providing any guidance as to how to do so; directed financial professionals to consider costs without providing any guidance as to how to do so; or created systems that allowed financial professionals to evaluate costs or reasonably available alternatives but did not mandate their use or, in some instances, could not determine whether or not financial professionals used the systems.

- *Conflict of Interest*. The SEC observed a number of deficiencies related to the requirement that broker-dealers have written policies and procedures reasonably designed to address conflicts of interest associated with their recommendations to retail customers. For example: some broker-dealers did not have written policies and procedures reasonably designed to specify how conflicts are to be identified or addressed; some broker-dealers limited the identified conflicts to conflicts associated with prohibited activities (*e.g.*, churning) or used high-level, generic language that did not identify the actual conflict (*e.g.*, "we have conflicts related to compensation differences") and did not reflect all conflicts of interest associated with the recommendations made by the firm or its financial professionals; and some broker-dealers inappropriately relied on disclosure to "mitigate" conflicts that appeared to create an incentive for the financial professional to place its interest ahead of the interest of the retail customer, and did not establish any mitigation measures.

SEC Releases Staff Guidance on Differential Advisory Fee Waivers

The staff of the Division of Investment Management ("Staff") issued guidance ("Guidance") on February 2, 2023, to mutual funds, their boards of directors/trustees ("Boards"), and their legal counsel about the implications under the Investment Company Act of 1940, as amended (the "Investment Company Act"), regarding fee waiver and expense reimbursement arrangements that result in different advisory fees being charged to different share classes of the same fund. The Guidance noted that Rule 18f-3 permits fee waivers and expense reimbursements provided that such arrangements do not result in cross-subsidization of fees among classes. The Staff stated that whether a differential advisory fee waiver presents a prohibited means of cross-subsidization between classes is a facts-and-circumstances determination that a mutual fund's board, in consultation with the investment adviser and legal counsel, should consider making and documenting after considering all relevant factors.

For example, a fund's Board may be able to conclude that a long-term waiver of an advisory fee for one class of shares, but not other classes of shares, does not provide a means for cross subsidization in contravention of Rule 18f-3 if the Board finds that (1) shareholders in the waived class pay fees to the adviser at the investing fund level in a funds-of-funds structure for advisory services, and (2) that such fees, when added to the advisory fees that are paid by the waived class, after giving effect to the waiver, are at least equal to the amount of advisory fees paid by the other classes, such that the waiver for the waived class is demonstrably not being subsidized by other classes. For a fund that already has such differential advisory fee waivers in place, the Staff said the fund's board may wish to consider, specifically within the context of Rule 18f-3, whether: (i) such waivers present a means for cross-subsidization, (ii) the steps they are taking to monitor such waivers to guard against cross-subsidization are (and continue to be) effective, and/or (iii) alternative fee arrangements may be appropriate. Relatedly, the Staff suggested that a fund should consider the extent to which the Board's consideration of these issues under Rule 18f-3 should be disclosed to its shareholders.

SEC Division of Examinations Announces 2023 Priorities

On February 7, 2023, the SEC's Division of Examinations (the "Division") announced its 2023 examination priorities. The Division publishes its examination priorities annually to provide insights into its risk-based approach, including the areas it believes present potential risks to investors and the integrity of the U.S. capital markets. The following are a selection of the Division's 2023 priorities:

- New Investment Adviser and Investment Company Rules:

  The Division will focus on the new Marketing Rule (Rule 206(4)-1 under the Investment Advisers Act of 1940, as amended (the "Advisers Act)) and whether registered investment advisers ("RIAs") have adopted and implemented written policies and procedures that are reasonably designed to prevent violations by the advisers and their supervised persons of the new Marketing Rule and whether RIAs have complied with the substantive requirements.

  The Division will also focus on new rules applicable to investment companies ("funds"), including the Derivatives Rule (Rule 18f-4 under the Investment Company Act) and the Fair Valuation Rule (Investment Company Act Rule 2a-5). If a fund relies on the Derivatives Rule, the Division will, among other things: (1) assess whether registered investment companies, including mutual funds (other than money market funds), exchange-traded funds ("ETFs") and closed-end funds, as well as business development companies ("BDCs"), have adopted and implemented policies and procedures reasonably designed to manage the funds' derivatives risks and to prevent violations of the Derivatives Rule pursuant to Investment Company Act Rule 38a-1; and (2) review for compliance with Rule 18f-4, including the adoption and implementation of a derivatives risk management program, board oversight, and whether disclosures concerning the fund's use of derivatives are incomplete, inaccurate, or potentially misleading.

  Under the new Fair Valuation Rule, the Division will, among other things: (1) assess funds' and fund boards' compliance with the new requirements for determining fair value, implementing board oversight duties, setting recordkeeping and reporting requirements, and permitting the funds' board to designate valuation designees to perform fair value determinations; and (2) review whether adjustments have been made to valuation methodologies, compliance policies and procedures, governance practices, service provider oversight, and/or reporting and recordkeeping.

- RIAs to Private Funds – Examinations will include a review of issues under the Advisers Act, including an adviser's fiduciary duty, and will assess risks, focusing on compliance programs, fees and expenses, custody, the new Marketing Rule, conflicts of interest, and the use of alternative data. The Division will also review private fund advisers' portfolio strategies, risk management, and investment recommendations and allocations, focusing on conflicts and disclosures around these areas. In addition, the Division will focus on RIAs to private funds with specific risk characteristics, including highly leveraged private funds and private funds managed side-by-side with BDCs.

- Retail Investors and Working Families – Examinations will focus on how registrants are satisfying their obligations under Regulation Best Interest and the Advisers Act fiduciary standard to act in the best interests of retail investors and not to place their own interests ahead of the interests of retail investors.

- Registered Investment Companies – The Division will review compliance programs and governance practices, disclosures to investors, and accuracy of reporting to the SEC of the registered investment companies, including ETFs and mutual funds. The Division will also focus on funds with specific characteristics, such as: (1) turnkey funds, to review their operations and assess effectiveness of their compliance programs; (2) mutual funds that converted to ETFs, to assess governance and disclosures associated with the conversion to an ETF; (3) non-transparent ETFs, to assess compliance with the conditions and other material terms of their exemptive relief; (4) loan-focused funds, such as leveraged loan funds and funds focused on collateralized loan obligations, for liquidity concerns and to review whether the funds have been significantly impacted by, and have adapted to, elevated interest rates; and (5) medium and small fund complexes that have experienced excessive staff attrition, to focus on whether such attrition has affected the funds' controls and operations. The Division will also monitor the proliferation of volatility-linked and single-stock ETFs, and may review such funds' disclosures, marketing, conflicts, and compliance with portfolio management disclosures, among other things. In addition, the Division will focus on adviser compensation, practices and processes for assessing and approving advisory and other fund fees, the effectiveness of derivatives risk management and liquidity risk management programs.

- Environmental, Social, and Governance ("ESG") – The Division will focus on ESG-related advisory services and fund offerings, including whether funds are operating in the manner set forth in their disclosures, whether ESG products are appropriately labeled, and whether recommendations of such products for retail investors are made in the investors' best interests.

- Information Security and Operational Resiliency – The Division will review broker-dealers', RIAs', and other registrants' practices to prevent interruptions to mission-critical services and to protect investor information, records, and assets. Reviews of broker-dealers and RIAs will include a focus on the cybersecurity issues associated with the use of third-party vendors, including registrant visibility into the security and integrity of third-party products and services and whether there has been an unauthorized use of third-party providers.

- Emerging Technologies and Crypto-Assets – The Division will conduct examinations of broker-dealers and RIAs that are using emerging financial technologies or employing new practices, including technological and on-line solutions to meet the demands of compliance and marketing and to service investor accounts. Examinations of registrants will focus on the offer, sale or recommendation of, or advice regarding trading in, crypto or crypto-related assets and include whether the firm (1) met and followed its standard of care when making recommendations, referrals, or providing investment advice; and (2) routinely reviewed, updated, and enhanced its compliance, disclosure, and risk management practices.

As in recent past years, the Division noted that it prioritizes RIAs and investment companies that have never been examined, including recently registered firms or investment companies, and those that have not been examined for a number of years.

"Our priorities reflect the changing landscape and associated risks in the securities market and are the product of a risk-based approach to examination selection that balances our resources across a diverse registrant base. We will emphasize compliance with new SEC rules applicable to investment advisers and investment companies as well as continue our focus on emerging issues and rules aimed at protecting retail investors," said Division of Examinations' Director Richard R. Best. "Our examination program continues moving forward and remains committed to furthering investor protection through high-quality examinations and staying abreast of the latest industry trends and emerging risks to investors and the markets."

SEC Reopens Comment Period for Proposed Cybersecurity Risk Management Rules and Amendments for Registered Investment Advisers and Funds

The SEC reopened the comment period on proposed rules and amendments related to cybersecurity risk management and cybersecurity-related disclosure for registered investment advisers, registered investment companies, and BDCs that were proposed by the SEC on February 9, 2022. The initial comment period ended on April 11, 2022. Per the SEC's March 15, 2023, announcement, the reopened comment period will allow interested persons additional time to analyze the issues and prepare comments in light of other regulatory developments, including whether there would be any effects of other SEC proposals related to cybersecurity risk management and disclosure that the SEC should consider. The comment period will remain open until 60 days after the date of publication of the reopening release in the Federal Register.

SEC Finalizes Rules to Reduce Broker-Dealer Settlement Cycle from (T+2) to (T+1)

The SEC adopted rule changes to shorten the standard settlement cycle for most broker-dealer transactions in securities from two business days after the trade date ("T+2") to one ("T+1"). The SEC indicates that the final rules, adopted on February 15, 2023, are designed to reduce the credit, market, and liquidity risks in securities transactions faced by market participants. The final rules will: (i) require a broker-dealer to either enter into written agreements or establish, maintain, and enforce written policies and procedures reasonably designed to ensure the completion of allocations, confirmations, and affirmations as soon as technologically practicable and no later than the end of the trade date; (ii) require registered investment advisers to make and keep records of the allocations, confirmations, and affirmations for certain securities transactions; (iii) add a new requirement to facilitate straight-through processing, which applies to certain types of clearing agencies that provide central matching services; and (iv) require central matching service providers to establish, implement, maintain, and enforce new policies and procedures reasonably designed to facilitate straight-through processing and require them to submit an annual report to the SEC that describes and quantifies progress with respect to straight-through processing. The final rules will become effective 60 days after publication in the Federal Register. The compliance date for the final rules is May 28, 2024.

SEC Proposes Enhanced Custody Rule for Registered Investment Advisers

The SEC proposed rule changes to enhance protections of customer assets managed by registered investment advisers. If adopted, the changes would amend and redesignate rule 206(4)-2, the SEC's current custody rule (the "custody rule"), as new rule 223-1 under the Advisers Act (the "proposed rule") and amend certain related recordkeeping and reporting obligations. According to the SEC's announcement on February 15, 2023, the SEC exercised its authority under the Dodd-Frank Act in broadening the application of the custody rule. The proposed rule would change the current rule's scope in two important ways. First, it would expand the types of investments covered by the rule. The proposed rule would extend the rule's coverage beyond client "funds and securities" to client "assets" so as to include additional investments held in a client's account, ***e.g.*** digital assets, including crypto assets. Second, an adviser would be deemed to have "custody" of client assets whenever the adviser has discretionary authority to trade client assets.

The proposed rule would also require qualified custodians to provide certain standard custodial protections when maintaining an advisory client's assets and additional protections for certain securities and physical assets that cannot be maintained by a qualified custodian. The proposed rule would also provide exceptions to the surprise examination requirement in instances in which the adviser's sole reason for having custody is because it has discretionary authority or because the adviser is acting according to a standing letter of authorization. In addition, the proposed rule would expand the scope of who can satisfy the custody rule's surprise examination requirement through financial statement audits. Finally, the proposed rule would update related recordkeeping requirements for advisers and amend Form ADV to align reporting obligations with the proposed rule and to improve the accuracy of custody-related data available to the SEC, its staff, and the public. The comment period on the proposal will remain open for 60 days following publication of the proposing release in the Federal Register.

"I support this proposal because, in using important authorities Congress granted us after the financial crisis, it would help ensure that advisers don't inappropriately use, lose, or abuse investors' assets," said SEC Chair Gary Gensler. "In particular, Congress gave us authority to expand the advisers' custody rule to apply to all assets, not just funds or securities. Further, investors would benefit from the proposal's changes to enhance the protections that qualified custodians provide. Thus, through this expanded custody rule, investors working with advisers would receive the time-tested protections that they deserve for all of their assets, including crypto assets, consistent with what Congress envisioned."

Republican Leaders Request Information from Gensler on Climate Disclosure Proposal

On February 22, 2023, the chairman of the House Financial Services Committee, Patrick McHenry (R-NC); the ranking member of the Senate Committee on Banking, Housing, and Urban Affairs, Tim Scott (R-SC); and the chairman of the Subcommittee on Oversight and Investigations, Bill Huizenga (R-MI), sent a letter to the SEC Chair Gary Gensler demanding records and other information related to the proposed climate disclosure rule, including responses to previous requests by numerous members of both the House and the Senate that Chair Gensler had failed to provide. The Republican leaders argued that the proposed rule exceeds the SEC's mission, expertise, and authority and—if finalized in any form—will unnecessarily harm consumers, workers, and the U.S. economy. In addition, the Republican members of the House Appropriations subcommittee pushed to cut the agency's budget and requested that the SEC expand its enforcement efforts, reduce the pace of its rulemaking, and refrain from regulation. According to the opening statement of Steve Womack (R-Ark.), chair of the Financial Services and General Government subcommittee, who opened the March 29, 2023, hearing, the SEC budget is too big, the agency costs too much to run, and it focuses too much on the implementation and enforcement of new regulations rather than on trying to encourage the flow of investment capital into markets.

"The blistering pace of the SEC rulemaking is a cause for concern," Womack wrote, "especially when the SEC is wading into areas that are not within their expertise and constitutionally questionable, such as requiring public companies to report on greenhouse gas emissions while claiming private enterprises won't be impacted."

SEC Fee Rate Advisories

The SEC announced that, starting on February 27, 2023, the fee rates applicable to most securities transactions would be set at $8.00 per million dollars. Per the January 23, 2023, announcement, the then-current rate of $22.90 per million dollars would remain in effect on charge dates through February 26, 2023. The assessment on security futures transactions remained unchanged at $0.0042 for each round-turn transaction. Subsequently, on March 1, 2023, the SEC announced that a mid-year adjustment to the fee rate for fiscal year 2023 was not required. As a result, the fiscal 2023 fee rate will remain at $8.00 per million dollars until September 30, 2023, or 60 days after the enactment of a regular FY 2024 appropriation, whichever occurs later. Similarly, the SEC confirmed that the Section 31 assessment on round-turn transactions in security futures also would remain at $0.0042 per transaction.

SEC Proposes Changes to Reg S-P to Enhance Protection of Customer Information

The SEC proposed amendments to Regulation S-P ("Reg S-P") that would, among other things, require broker-dealers, investment companies, registered investment advisers, and transfer agents (collectively, "covered institutions") to provide notice to individuals affected by certain types of data breaches that may put them at risk of identity theft or other harm. Reg S-P currently requires broker-dealers, investment companies, and registered investment advisers to adopt written policies and procedures for the protection of customer records and information (the "safeguards rule"). Reg S-P also requires the proper disposal of consumer report information (the "disposal rule"). If adopted, the SEC's proposal, which was announced on March 15, 2023, would (i) update current requirements to address the expanded use of technology and corresponding risks since the SEC originally adopted Reg S-P in 2000; (ii) require covered institutions to adopt written policies and procedures for an incident response program to address unauthorized access to or use of customer information; (iii) require, with certain limited exceptions, covered institutions to provide notice to individuals whose sensitive customer information was or is reasonably likely to have been accessed or used without authorization; (iv) require a covered institution to provide such notice as soon as practicable, but not later than 30 days after the covered institution becomes aware that an incident involving unauthorized access to or use of customer information has occurred or is reasonably likely to have occurred; and (v) make a number of additional changes to Reg S-P, including:

> a) broadening and aligning the scope of the safeguards rule and disposal rule to cover "customer information," a new defined term which would extend the protections of the safeguards and disposal rules to both nonpublic personal information that a covered institution collects about its own customers and nonpublic personal information that a covered institution receives about customers of other financial institutions;
>
> (b) extending the safeguards rule to transfer agents registered with the SEC or another appropriate regulatory agency, and expanding the existing scope of the disposal rule to include transfer agents registered with another appropriate regulatory agency rather than only those registered with the SEC; and
>
> (c) conforming Reg S-P's existing provisions regarding the delivery of an annual privacy notice with a statutory exception created by the U.S. Congress in 2015.

The public comment period for the proposed amendments will remain open until 60 days after the date of publication of the proposing release in the Federal Register.

SEC Proposes New Requirements to Address Cybersecurity Risks to the U.S. Securities Markets

The SEC proposed requirements (the "proposal") for broker-dealers, clearing agencies, major security-based swap participants, the Municipal Securities Rulemaking Board, national securities associations, national securities exchanges, security-based swap data repositories, security-based swap dealers, and transfer agents (collectively, "Market Entities") to address their cybersecurity risks. In its March 15, 2023, announcement of the proposal, the SEC noted that Market Entities increasingly rely on information systems to perform their functions and provide their services and that the interconnectedness of Market Entities increases the risk that a significant cybersecurity incident can simultaneously impact multiple Market Entities causing systemic harm to the U.S. securities markets.

Proposed new Rule 10 under the Exchange Act would require all Market Entities to (i) establish, maintain, and enforce written policies and procedures that are reasonably designed to address their cybersecurity risks, (ii) review and assess, at least annually, the design and effectiveness of their cybersecurity policies and procedures, including whether they reflect changes in cybersecurity risk over the time period covered by the review, and (iii) provide the SEC with immediate written electronic notice of a significant cybersecurity incident upon having a reasonable basis to conclude that the significant cybersecurity incident has occurred or is occurring. The proposal includes additional requirements for Market Entities other than certain types of small broker-dealers (collectively, "Covered Entities"), including the requirement that Covered Entities utilize a proposed new Form SCIR to (a) report and update information about any significant cybersecurity incident and (b) publicly disclose summary descriptions of their cybersecurity risks and the significant cybersecurity incidents they experienced during the current or previous calendar year. The public comment period for the proposal will remain open until 60 days after the date of publication of the proposing release in the Federal Register.

SEC Proposes to Expand and Update Regulation SCI

The SEC proposed amendments to expand and update Regulation Systems Compliance and Integrity ("Regulation SCI"). Regulation SCI requires certain U.S. securities markets entities ("SCI entities") to take corrective action with respect to systems disruptions, systems compliance issues, and systems intrusions and to notify the SEC of such events. In the SEC's March 15, 2023, announcement of the proposed amendments, the SEC explained that trading and technology have evolved since Regulation SCI's adoption in 2014 and that the growth in electronic trading allows ever-increasing volumes of securities transactions in a broader range of asset classes at increasing speed by competing trading platforms, including those offered by broker-dealers that play multiple roles in the markets. The proposed amendments would expand the scope of SCI entities covered by Regulation SCI to include registered security-based swap data repositories, all clearing agencies that are exempt from registration, and certain large broker-dealers (in particular, those that exceed a total assets threshold or a transaction activity threshold in national market system stocks, exchange-listed options contracts, U.S. Treasury Securities, or Agency Securities).

The proposed amendments would require that an SCI entity's policies and procedures include the maintenance of a written inventory and classification of all SCI systems and a program for life cycle management; a program to prevent unauthorized access to such systems and information therein; and a program to manage and oversee certain third-party providers, including cloud service providers, of covered systems. The proposed amendments would also expand the types of SCI events experienced by an SCI entity that would trigger immediate notification to the SEC, update the rule's annual SCI review and business continuity and disaster recovery testing requirements, and update certain of the Regulation's recordkeeping provisions. The public comment period for the proposed amendments will remain open until 60 days after the date of publication of the proposing release in the Federal Register.

The SEC Issues Frequently Asked Questions for Registration of Municipal Advisors

On March 20, 2023, the SEC updated its Registration of Municipal Advisors Frequently Asked Questions ("FAQs") page which provides general interpretive staff guidance on various aspects of the SEC's municipal advisor registration rules. The updated page provides answers to questions across several categories, including the following topics: (i) independent registered municipal advisor exemption; (ii) registered investment adviser exclusion; (iii) issuance of municipal securities/post-issuance advice; (iv) completion of Form MA, Form MA-I, and Form MA-NR; (v) withdrawal from municipal advisor registration; and (vi) investment strategies and proceeds of municipal securities.

SEC Issues Statement Regarding Risk Legend Used by Non-Transparent ETFs

Under the terms of the SEC's exemptive relief granted to actively managed ETFs that do not provide daily portfolio transparency ("non-transparent ETFs"), each non-transparent ETF is required to include in its prospectus, fund website, and any marketing materials a risk legend highlighting the differences between the non-transparent ETF and fully transparent actively managed ETFs, as well as certain costs and risks unique to non-transparent ETFs. Recognizing that the standardized risk legend required by the exemptive orders may be difficult to place in certain digital advertisements (*e.g.*, banner advertisements) due to space limitations, the SEC issued new disclosure language on March 29, 2023, which may be used in digital advertisements by non-transparent ETFs in place of the standardized risk legend currently provided in the exemptive orders. Requirements relating to placement of the risk legend or new disclosure language in a prominent location remain as prescribed in the exemptive orders.

SEC ENFORCEMENT ACTIONS

SEC Charges Former Investment Adviser Managing Director and Co-Portfolio Manager with Undisclosed Conflict of Interest

The SEC charged a former managing director (the "defendant") of a New York-based investment adviser (the "Adviser"), with failing to disclose a conflict of interest arising from his relationship with a film distribution company in which the fund he managed for the Adviser invested millions of dollars. The SEC's order, issued on January 5, 2023, found that, from 2015 to 2019, a closed-end publicly traded fund (the "fund"), invested in Aviron Group, LLC subsidiaries by loaning the subsidiaries, which were in the business of funding advertising budgets of motion pictures, as much as $75 million. The defendant, a co-portfolio manager of the fund, had a significant role in recommending and overseeing the fund's loans to the Aviron subsidiaries. At the same time, the defendant asked Aviron to help advance his daughter's acting career. Aviron helped defendant's daughter obtain a small role in a film produced in 2018. The defendant did not disclose to the fund's board of trustees or the Adviser's compliance and legal teams that he asked Aviron to help advance his daughter's acting career or that Aviron helped his daughter obtain a film role. The defendant consented to the entry of the SEC's order finding that he violated Section 206(2) of the Advisers Act. Without admitting or denying the SEC's findings, the defendant agreed to a cease-and-desist order, a censure, and a $250,000 penalty.

SEC Charges Former SPAC CFO for Orchestrating Fraud Scheme

The SEC announced fraud charges against Cooper J. Morgenthau, the former CFO of African Gold Acquisition Corp. ("African Gold"), a special purpose acquisition company ("SPAC"), alleging that he stole more than $5 million from African Gold and from investors in two other SPACs that he incorporated. The SEC's January 3, 2023, complaint alleged that from June 2021 through July 2022, Morgenthau embezzled money from African Gold and stole funds from another SPAC series to pay for his personal expenses and to trade in crypto assets and other securities; concealed unauthorized withdrawals by falsifying African Gold's bank account statements; and raised money from the other SPAC's investors based on misrepresentations. The SEC's complaint alleged that Morgenthau violated antifraud provisions of the federal securities laws, lied to African Gold's auditor and accountants in violation of the Exchange Act, knowingly falsified African Gold's books and records, and filed false certifications with the SEC. Morgenthau consented to a judgment enjoining him from further federal securities laws violations and barring him from serving as an officer or director of a publicly traded company, with monetary remedies to be determined at a later date. In a parallel action, the U.S. Attorney's Office for the Southern District of New York, on the same day the SEC issued its complaint, announced criminal charges against Morgenthau.

In a related matter, on February 22, 2023, the SEC announced that it settled charges against African Gold for internal controls, reporting, and recordkeeping violations. Per the SEC, it was due to these failures that Morgenthau was able to embezzle money from the company's operating bank account as discussed in the above complaint. The SEC noted that African Gold made materially false filings with the SEC and maintained inaccurate books and records. According to the SEC's order, African Gold's only liquid asset was the money held in its operating bank account, and thus potential fraud by management posed one of the company's most significant risks of material misstatements in its financial statements. The SEC's order alleged that, despite this risk, African Gold gave Morgenthau control over nearly all aspects of its operating bank account and financial reporting process with little to no oversight. The SEC's order found that African Gold violated Exchange Act provisions relating to internal controls, reporting, and recordkeeping. Without admitting or denying the SEC's findings, African Gold agreed to a cease-and-desist order and to pay a $103,591 civil monetary penalty.

SEC Settles Charges Against Investment Adviser for Alleged Conflicts of Interest Arising Out of Revenue Sharing and Incentive Arrangements

The SEC issued an order instituting and settling administrative and cease-and-desist proceedings against Moors & Cabot, Inc. ("Moors & Cabot"), a registered investment adviser and broker-dealer. Per the January 19, 2023, order, between at least February 2017 and September 2021, Moors & Cabot failed to fully and fairly disclose material facts and conflicts of interest associated with certain revenue-sharing payments and financial incentives that Moors & Cabot received from two unaffiliated clearing brokers. According to the order, Moors & Cabot also failed to implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with the disclosure of revenue sharing, fee markups, financial incentives, and associated conflicts of interest, as well as disciplinary histories. Moors & Cabot is charged with willfully violating Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

Company to Pay $5 Million for Misleading Disclosures About Its Valuation Methodologies for Fixed Income Securities

The SEC announced settled charges against a privately held financial, software, data and media company headquartered in New York (the "Company") for misleading disclosures relating to its paid subscription service, which provides daily price valuations for fixed income securities to financial services entities. The SEC's January 23, 2023, order found that from at least 2016 through October 2022, the Company failed to disclose to its subscription service customers that the valuations for certain fixed income securities could be based on a single data input, such as a broker quote, which did not adhere to methodologies it had previously disclosed. The order found that the Company was aware that its customers, including mutual funds, may utilize subscription service prices to determine fund asset valuations, including for valuing fund investments in government, supranational, agency, and corporate bonds, municipal bonds, and securitized products, and that subscription service prices, therefore, can have an impact on the price at which securities are offered or traded. The SEC's order found that the Company violated section 17(a)(2) of the Securities Act. Without admitting or denying the findings, the Company agreed to cease and desist from future violations and to pay a $5 million penalty. The SEC's order noted that the Company voluntarily engaged in remedial efforts to improve its subscription service line of business.

Twenty-five States File Lawsuit to Block DOL's ESG Rule

Twenty-five states are suing the Biden Administration in an attempt to block the Department of Labor ("DOL") rule that allows fiduciaries to consider ESG factors when choosing retirement investments ("DOL ESG Rule"). According to the lawsuit filed in Texas federal court on January 26, 2023, the attorneys general claim that the DOL ESG Rule violates Employment Retirement Income Security Act ("ERISA"), which requires that retirement plans invest solely for financial gain, and runs afoul of the Administrative Procedure Act ("APA") as arbitrary and capricious because the DOL failed to assess either the harm it poses for plan participants and beneficiaries or the advantage of superseding the 2020 DOL rule effectively banning ESG considerations in plan investment selections. Among the twenty-five states are Alabama, Alaska, Arkansas, Florida, Georgia, Indiana, Idaho, and Iowa. In addition to the states, listed plaintiffs include two energy companies, an energy industry trade group, and an individual participant in an unnamed workplace plan.

The claimants argue that the DOL is deviating from prior policy because its 2020 DOL rule still required that financial factors take precedence. It is argued in the complaint that the DOL justified the 2022 rule by noting that it would cure a "chill" or "confusion" allegedly caused by the 2020 rule. Per the claimants, the DOL never identified who was confused, what the source of confusion was, or whether the alleged confusion caused a reduction in the financial returns for plan participants. Claimants further allege that the DOL did not consider alternatives and failed to consider that the solution to the purported concerns caused by the 2020 rules would be to issue clarifying sub-regulatory guidance. The claimants request the court to postpone the DOL ESG Rule's effective date and to impose a preliminary injunction and declare the DOL ESG Rule in violation of the APA and ERISA.

SEC Charges Options Clearing Corporation with Rule Failures

The SEC announced that The Options Clearing Corporation ("OCC") will undertake remedial efforts and pay $17 million in penalties to settle charges that it failed to comply with its own SEC-approved stress testing and clearing fund methodology rule during certain times between October 2019 and May 2021. According to the SEC's February 16, 2023, order, Chicago-based OCC's failure to implement and comply with its own rule was the result of its failure to properly establish, implement, and enforce written policies and procedures reasonably designed to manage certain operational risks. The SEC's order further found that OCC failed to modify its comprehensive stress testing system and did not provide timely notification to the SEC of this failure as required by Regulation SCI. The SEC also found that OCC failed to comply with its margin methodology, margin policy, and stress testing and clearing fund methodology relating to specific wrong way risk and holiday margin.

According to the SEC, in addition to the $17 million penalty, OCC has undertaken several remedial measures, including revising its model validation policies and procedures; enhancing its approach to risk data governance; implementing changes to elements of its control environment, including processes, procedures, and controls; and conducting appropriate training on the changes. This is the SEC's second enforcement action against OCC. In a September 2019 settled action, the SEC charged OCC with failure to establish and enforce policies and procedures involving financial risk management, operational requirements, and information-systems security, and imposed remedial measures and a $15 million penalty.

Republican Attorney-Generals Ask Court to Set Aside SEC Proxy Voting Disclosure Rules
Texas Attorney General Ken Paxton and three other Republican attorneys general filed a petition on February 21, 2023, against the SEC in the federal appeals court opposing the new proxy voting disclosure rules. Among other changes, the new rules amend Form N-PX by expanding the number of voting categories to include information about votes in certain standardized categories, including various ESG-related topics such as environment or climate, and diversity, equity and inclusion. Though the petition does not detail the states' legal arguments against the proxy voting disclosure rules, Attorney General Paxton claimed in a statement that the rules are politically motivated. According to the office of Utah's attorney general, the rules "will put shareholders at increased risk of loss, encouraging political activism and raising administrative costs." The SEC's two Republican commissioners, Hester Peirce and Mark Uyeda, both voted against adopting the rules, which the SEC's three Democrats supported.

SEC Charges a Church and Its Investment Management Company for Disclosure Failures and Misstated Filings
The SEC announced charges against an exempt investment adviser (the "Adviser"), a non-profit entity operated by a religious organization (the "Church") to manage the Church's investments, for failing to file forms that would have disclosed the Church's equity investments, and for instead filing forms for shell companies that obscured the Church's portfolio and misstated the Adviser's control over the Church's investment decisions. The SEC also announced charges against the Church for causing these violations. To settle the charges, the Adviser agreed to pay a $4 million penalty and the Church agreed to pay a $1 million penalty. The SEC's order, issued on February 21, 2023, found that from 1997 through 2019, the Adviser failed to file Forms 13F. According to the SEC's order, the Church was concerned that disclosure of its portfolio, which by 2018 had grown to approximately $32 billion, would lead to negative consequences and in order to obscure the amount of the Church's portfolio, and with the Church's knowledge and approval, the Adviser filed Forms 13F in the names of shell LLCs which it had created rather than in the Adviser's name.

The order found that the Adviser maintained investment discretion over all relevant securities, that it controlled the shell LLCs, and that it directed nominee "business managers," most of whom were employed by the Church, to sign the SEC filings. The SEC found that the shell LLCs' Forms 13F misstated, among other things, that the LLCs had sole investment and voting discretion over the securities, when in reality the Adviser retained control over all investment and voting decisions. The Adviser agreed to settle the SEC's allegation that it violated Section 13(f) of the Exchange Act and Rule 13f-1 thereunder by failing to file Forms 13F and by misstating information in these forms. The Church also agreed to settle the SEC's allegation that it caused the Adviser's violations through its knowledge and approval of the Adviser's use of the shell LLCs.

SEC Charges Private Fund Auditor and Audit Engagement Partner with Improper Professional Conduct
The SEC announced settled charges against Spicer Jeffries LLP, an audit firm based in Denver, and an audit engagement partner Sean P. Tafaro, for their improper professional conduct in connection with audits of two private funds. According to the SEC's March 29, 2023, order, during the audit planning stages, Spicer Jeffries and Tafaro assessed that valuation of investments was a significant fraud risk but did not implement the planned audit approach to respond to the risk. The order further finds that Spicer Jeffries and Tafaro failed to obtain sufficient audit evidence about the method of measuring fair value, the valuation models, and whether alternative valuation assumptions were considered. According to the order, due to these failures and others, Spicer Jeffries and Tafaro did not exercise due care, including professional skepticism. The order also found that Spicer

Jeffries' deficient system of quality control led to failures to adhere to professional auditing standards. Without admitting or denying the findings, Spicer Jeffries and Tafaro consented to the SEC's order finding that they engaged in improper professional conduct. Spicer Jeffries agreed to be censured and to implement undertakings to retain an independent consultant to review and evaluate certain of its audit, review, and quality control policies and procedures. Tafaro agreed to be suspended from appearing and practicing before the SEC as an accountant. The SEC's order permits Tafaro to apply for reinstatement after one year.

Cyber Fraud and Crypto Asset Enforcement Actions

The SEC brought charges against various individuals and entities relating to cyber fraud and crypto assets, including blockchain and lending programs. For example, these include:

I. The SEC charged five individuals and three entities for their involvement in a fraudulent investment scheme named CoinDeal that raised more than $45 million from sales of unregistered securities to tens of thousands of investors worldwide. According to the SEC's complaint filed on January 4, 2023, the five individuals allegedly disseminated false and misleading statements to investors about extravagant returns from investing in a blockchain technology called CoinDeal; the purported value of CoinDeal; the parties involved in the supposed sale of CoinDeal; and the use of investment proceeds. The complaint further alleged that no sale of CoinDeal ever occurred and no distributions were made to CoinDeal investors, and that the defendants collectively misappropriated millions of dollars of investor funds for personal use. In June 2022, the U.S. Department of Justice indicted one of the individuals on three counts of wire fraud and two counts of monetary transaction in unlawful proceeds for his involvement in CoinDeal. The SEC's complaint charged each party with different violations of the antifraud and registration provisions of the Securities Act and Exchange Act; and aiding and abetting under the antifraud provisions of the Exchange Act; and under the antifraud and registration provisions of the Securities Act and Exchange Act.

II. The SEC charged a crypto asset-related financial products and services corporation (the "Corporation"), with failing to register the offer and sale of its retail crypto asset lending product. To settle the SEC's charges, the Corporation agreed to pay a $22.5 million penalty and cease its unregistered offer and sale of its product to U.S. investors. In parallel actions announced the same day, the Corporation agreed to pay an additional $22.5 million in fines to settle similar charges by state regulatory authorities. The SEC's January 19, 2023, order found that the Corporation marketed its product as a means for investors to earn interest on their crypto assets, and that the Corporation exercised its discretion to use investors' crypto assets in various ways to generate income for its own business and to fund interest payments to investors. The order also found that the Corporation's product is a security and that the offer and sale of the Corporation's product did not qualify for an exemption from SEC registration. Without admitting or denying the SEC's findings, the Corporation agreed to a cease-and-desist order prohibiting it from violating the registration provisions of the Securities Act.

III. The SEC charged Avraham Eisenberg with orchestrating an attack on a crypto asset trading platform, Mango Markets, by manipulating the MNGO token, a so-called governance token that was offered and sold as a security. Eisenberg is facing parallel criminal and civil charges in the Southern District of New York brought by the U.S. Department of Justice and the Commodities Futures Trading Commission ("CFTC"). The SEC's complaint alleged that beginning on October 11, 2022, Eisenberg engaged in a scheme to steal approximately $116 million worth of crypto assets from the Mango Markets platform. The SEC's complaint, filed in federal district court in Manhattan, charged Eisenberg with violating antifraud and market manipulation provisions of the securities laws and sought permanent injunctive relief, a conduct-based injunction, disgorgement with prejudgment interest, and civil penalties.

IV. The SEC charged Singapore-based Terraform Labs PTE Ltd and Do Hyeong Kwon with orchestrating a multibillion-dollar crypto asset securities fraud involving an algorithmic stablecoin and other crypto asset securities. According to the SEC's complaint filed on February 16, 2023, from April 2018 until the scheme's collapse in May 2022, Terraform and Kwon raised billions of dollars from investors by offering and selling an inter-connected suite of crypto asset securities, many in unregistered transactions. The complaint charged the defendants with violating the registration and antifraud provisions of the Securities Act and the Exchange Act.

V. The SEC announced charges against former NBA player Paul Pierce for touting EMAX tokens, crypto asset securities offered and sold by EthereumMax, on social media without disclosing the payment he received for the promotion and for making false and misleading promotional statements about the same crypto asset. The SEC's February 17, 2023, order found that Pierce violated the anti-touting and antifraud provisions of the federal securities laws. Without admitting or denying the SEC's findings, Pierce agreed to settle the charges and pay over $1.4 million in penalties, disgorgement, and interest. Pierce also agreed not to promote any crypto asset securities for three years.

VI. The SEC charged the former co-lead engineer (the "defendant") of an Antigua- and Barbuda-based company that operated a global crypto asset trading platform (the "Company"), for his role in a multiyear scheme to defraud equity investors. According to the SEC's complaint, issued on February 28, 2023, the defendant created software code that allowed Company customer funds to be diverted to a quantitative trading firm specializing in crypto assets (a "crypto hedge fund") owned by co-founders and officers of the Company despite false assurances to investors that the Company was a safe crypto asset trading platform with sophisticated risk mitigation measures to protect customer assets and that the crypto hedge fund was just another customer with no special privileges. The complaint alleged that the defendant knew or should have known that such statements were false and misleading, and that the defendant actively participated in the scheme to deceive the Company's investors.

The SEC's complaint charged the defendant with violating the antifraud provisions of the Securities Act and the Exchange Act. The defendant consented to a bifurcated settlement, subject to court approval, which would permanently enjoin him from violating the federal securities laws, a conduct-based injunction, and an officer and director bar. In a parallel action, the U.S. Attorney's Office for the Southern District of New York and the Commodity Futures Trading Commission ("CFTC") announced charges against the defendant on the same day the SEC's complaint was filed.

VII. The SEC charged the crypto asset trading platform beaxy.com (the "Beaxy Platform") and its executives for failing to register as a national securities exchange, broker, and clearing agency. The SEC also charged the founder of the platform, Artak Hamazaspyan, and a company he controlled, Beaxy Digital, Ltd., with raising $8 million in an unregistered offering of the Beaxy token ("BXY") and alleged that Hamazaspyan misappropriated at least $900,000 for personal use, including gambling. Finally, the SEC charged market makers operating on the Beaxy Platform as unregistered dealers. Pursuant to the Consents filed on March 29, 2023, the charged market makers have agreed to perform certain undertakings, including ceasing all activities as an unregistered exchange, clearing agency, broker, and dealer; shutting down the Beaxy Platform; providing an accounting of assets and funds for the benefit of customers; transferring all customer assets and funds to each respective customer; and destroying any and all BXY in possession.

For additional information and assistance, contact Thomas R. Westle, Stacy H. Louizos, or another member of Blank Rome's Investment Management Group.

Thomas R. Westle
Partner and Co-Chair, Investment Management
212.885.5239 | thomas.westle@blankrome.com

Stacy H. Louizos
Partner and Co-Chair, Investment Management
212.885.5147 | stacy.louizos@blankrome.com

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