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Investment Management

APRIL 2024

Regulatory Update and Recent SEC Actions

RECENT SEC LEADERSHIP CHANGES

William Birdthistle, the Director of the Division of Investment Management of the Securities and Exchange Commission ("SEC" or "Commission"), departed from the SEC on March 8, 2024. Natasha Vij Greiner was named the new Director of the Division of Investment Management. Prior to this role, Ms. Greiner served as the Deputy Director of the Division of Examinations.

In addition to serving as Deputy Director of the Division of Examinations, Ms. Greiner was the National Associate Director of the Investment Adviser/Investment Company ("IA/IC") examination program, which includes the Private Funds Unit, and was the Associate Director of the Home Office IA/IC examination program. She began her SEC career in the Division of Examinations (formerly Office of Compliance Inspections and Examinations) as a broker-dealer examiner and has served in a variety of roles across the agency for more than 22 years, including Acting Chief Counsel and Assistant Chief Counsel in the Division of Trading and Markets, where she provided legal and policy advice to the Commission on rules affecting market participants and the operation of the securities markets. Previously, Ms. Greiner worked in the Division of Enforcement, including in its Asset Management Unit, where she investigated possible violations of the federal securities laws and litigated matters in federal court and administrative proceedings.

Ms. Greiner received her J.D. from The Catholic University of America, Columbus School of Law, and graduated *cum laude* with a B.S. degree from Jame Madison University.

SEC RISK ALERTS

SEC Issues Risk Alert Related to Security-Based Swap Dealers

The SEC's Division of Examinations (the "Division") issued a risk alert ("the Risk Alert"), on January 10, 2024, in connection with its observations concerning compliance with rules applicable to security-based swap dealers. In 2022, the Division began conducting examinations of registered swap dealers with a focus on whether they have implemented reasonably designed policies and procedures for compliance with applicable Commission rules, including requirements related to accurate and timely reporting of security-based swap transactions to a registered security-based swap data repository.

The Division observed that certain swap dealers failed to (i) timely report certain security-based swap trade data to a registered security-based swap data repository; (ii) accurately report primary trade information, including notional amounts and underlying asset information; and (iii) accurately and completely report all secondary trade information, such as counterparty identifications.

In addition, with respect to business conduct standards, the Division observed that certain swap dealers failed to identify all associated persons, often resulting in a failure to satisfy supervisory obligations for all associated persons pursuant to Rule 15Fh-3(h) of the Securities Exchange Act of 1934 (the "Exchange Act"). The Division observed that certain swap dealers did not establish a system to address the minimum requirements set forth in the rule, including failing to establish procedures to prohibit a supervisor from supervising his or her own activities or from reporting to or having the supervisor's compensation or continued employment be determined by a person he or she supervises or that provide for supervision of associated persons' trading at another financial institution. The staff also noted that certain swap dealers had procedures that were not reasonably designed (i) to prevent supervisory systems from being compromised due to the conflicts of interest that may be present with respect to associated persons; (ii) to provide for the review of correspondence with counterparties or potential counterparties and internal written communications; or (iii) to provide for periodic reviews, at least annually, of the swap dealer's security-based swap business to assist in detecting and preventing violations of applicable federal securities laws and the rules and regulations thereunder.

The Division also observed that certain swap dealers maintained insufficient documentation and portfolio reconciliation with respect to periodic independent audits and record retention of security-based swap trading relationship documentation policies and procedures and written agreements with counterparties on the terms for portfolio reconciliation. In addition, certain swap dealers failed to consistently make and keep current, complete, and accurate records such as trade blotters, counterparty listings, and associated person listings.

SEC Issues Risk Alert Addressing T+1 Settlement Cycle

The Division issued a risk alert (the "Risk Alert") on March 27, 2024, regarding shortening the securities transaction settlement cycle. On May 28, 2024, the standard settlement cycle for most broker-dealer transactions in U.S. securities will shorten from two business days after the trade date ("T+2") to one business day after the trade date ("T+1"), pursuant to the recently adopted amendments to Rule 15c6-1 under the Exchange Act. This is also the compliance date for new rules related to the processing of institutional trades by broker-dealers and certain clearing agencies, as well as certain recordkeeping amendments applicable to registered investment advisers.

According to the Risk Alert, shortening the standard settlement cycle will impact market participants, such as broker-dealers, clearing agencies including those that are central matching services providers, and registered investment advisers (the "Registrants"), by requiring changes to their business practices, computer systems, and technology solutions and could impact how Registrants and other market participants comply with other existing regulatory obligations.

In addition, new Rule 15c6-2 under the Exchange Act requires a broker-dealer to either enter into written agreements with parties as specified in the rule or establish, maintain, and enforce written policies and procedures reasonably designed to address certain objectives related to completing allocations, confirmations, and affirmations ("ACA") as soon as technologically practicable and no later than the end of the trade date.

According to the Division, it will continue to conduct examinations and engage in outreach with Registrants to review and assess their preparedness associated with the shortening of the settlement cycle as well as changes they have made or plan to make in response to the final rules, such as relating to Registrants' ACA process and the requirements for straight-through processing, where applicable. Among other things, the Division may review whether and how Registrants have evaluated the potential impact of the final rules on their: (i) business activities; (ii) operations and risk assessments; (iii) services; and (iv) customers, clients, and/or other relevant parties. For example, the Division may review the plans that Registrants have developed and steps they have taken to prepare for the shortened settlement cycle, including Registrants' preparations relating to:

- Activities in clearance and settlement, including clearing services provided to institutional clients, retail customers, or other broker-dealers; custodial or prime brokerage services; securities lending recall activities and payment activities that support clearance and settlement; trade allocation and fail management processes; and custodian communication;
- Operational readiness, including any implementation of, or enhancements or modifications to, systems, controls, policies, or processes associated with the shortened settlement cycle, along with information related to any testing events, such as testing events with the Depository Trust & Clearing Corporation ("DTCC"), broker-dealers, vendors, or other parties; and
- Disclosures, representations, and/or communications to customers, clients, and/or vendors regarding changes that will occur.

In addition, the Division may review any additional preparation necessary for the final rules, including, as applicable, Registrants' readiness with respect to: (i) settlement, including the ACA process, and any changes to written agreements or processes; (ii) policies and procedures reasonably designed to facilitate straight-through processing; and (iii) new recordkeeping and reporting requirements.

SEC RULEMAKING

Status Update on SEC's Fall 2023 Rulemaking Agenda

The Office of Information and Regulatory Affairs released the Fall 2023 Unified Agenda of Regulatory and Deregulatory Actions (the "Agenda") on December 6, 2023. The Agenda included a total of 43 rules, 29 of which, at that time, were in the final rulemaking stage and 14 in the proposed stage. Notable rules that have been finalized since release of the Agenda include those relating to climate-related disclosures; special purpose acquisition companies ("SPACs"); share repurchase disclosure modernization; and registration exemption for certain investment advisers operating through the internet.

Climate-Related Disclosures

The rule initially proposed in March 2022 would establish three levels of reporting for greenhouse gas emissions: (1) a company's direct emissions; (2) emissions produced by a company's energy provider; and (3) emissions attributed to the company's supply chain and end users. SEC Chair Gary Gensler defended the rule despite significant pushback from public companies, interest groups, and lawmakers. On March 6, 2024, the SEC adopted rules to enhance climate-related disclosures by public companies and in public offerings. In light of recent litigation, the SEC decided to stay the final rule pending the outcome in the Eighth Circuit U.S. Court of Appeals. *(See* item below on *SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures.)*

Special Purpose Acquisition Companies

The final rules, which were initially proposed in March 2022, were adopted on January 24, 2024. The new SPAC rules would, among other things, impose additional disclosure requirements on initial public offerings by SPACs and in business combinations involving SPACs. In addition, the new rules would require disclosures regarding compensation paid to sponsors, conflicts of interest, and dilution. *(See* item below on *SEC Adopts Rules to Enhance Investor Protections Relating to SPACs.)*

Share Repurchase Disclosure Modernization

The SEC adopted amendments to modernize and improve disclosure about repurchases of an issuer's equity securities on May 3, 2023 ("Repurchase Rule"). However, a federal court's vacatur of the Repurchase Rule, that became effective on December 19, 2023, reverted the rules and forms back to those predating the rule adoption. On March 19, 2024, the SEC adopted technical amendments to revise the Code of Federal Regulations to reflect the court's vacatur of the Repurchase Rule. These technical amendments rescind the changes the Repurchase Rule made to rules and forms under the Exchange Act and Investment Company Act, including rescinding the addition of new Form F-SR. *(See* item below on *SEC Adopts Technical Amendments to Reflect a Federal Court's Vacatur of Share Repurchase Disclosure Modernization Amendments.)*

Exemption for Certain Investment Advisers Operating Through the Internet

Generally, investment advisers are prohibited from registering with the SEC unless they meet certain requirements (minimum assets under management, advise a registered investment company, or qualify for an exemption). On March 27, 2024, the SEC adopted amendments to the Investment Advisers Act of 1940 (the "Advisers Act") that provide an exemption to this general prohibition under the Advisers Act to certain advisers that provide services through the Internet. *(See* item below on *SEC Adopts Reforms Relating to Investment Advisers Operating Exclusively Through the Internet.)*

Below is status of certain other items as indicated in the Agenda. These could be impacted by the recent change in leadership in the Division of Investment Management.

Final Rule Stage: Anticipated Final Rule April 2024

- Safeguarding Advisory Client Assets
- Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies
- Enhanced Disclosures by Certain Investment Advisers and Investment Companies about ESG Investment Practices
- Outsourcing by Investment Advisers
- Regulation SP: Privacy of Consumer Financial Information and Safeguarding Customer Information
- Form PF; Reporting Requirements for All Filers and Large Hedge Fund Advisers
- Disclosure of Order Execution Information
- Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (recently SEC staff indicated not likely to move forward)
- Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers

- Amendments to Exchange Act Rule 3b-16 re Definition of "Exchange", Regulation ATS and Regulation SCI for ATSs That Trade U.S. Government Securities, NMS Stocks and Other Securities
- Order Competition Rule

Action Date for Issuance of Rule Proposal: October 2024

- Fund Fee Disclosure and Reform (proposing changes to regulatory requirements relating to registered investment companies' fees and fee disclosure)
- Corporate Board Diversity (disclosures to enhance registrant disclosures about the diversity of board members and nominees)
- Regulation of Alternative Trading Systems ("Regulation ATS") (modernize the conditions to the ATS exemption for all ATS)
- Rule 144 Holding Period (amending the conditions required to meet the non-exclusive safe harbor)

FINRA Proposes to Permit Use of Performance Projections and Target Returns in Institutional Communications

Recently, FINRA issued a proposed rule amendment to permit the use of performance projections and target returns. The proposed amendment to FINRA Rule 2210 (the "Proposal") would permit projections in "institutional communications" under certain circumstances. Rule 2210 defines "institutional communications" as "any written (including electronic) communication that is distributed or made available only to institutional investors, but does not include a member's internal communications."

"Institutional investors" include: (i) persons described in FINRA Rule 4512(c), including banks, insurance companies, registered investment companies, registered investment advisers, and persons with total assets of at least $50 million; (ii) government entities and subdivisions; (iii) certain pension plans and employee benefit plans with at least 100 participants; (iv) FINRA members and their registered persons; and (v) persons acting solely on behalf of institutional investors.

The Proposal notes that some institutional investors would prefer additional performance information from broker-dealers, which might include the broker's views on the projected performance of a particular security or investment strategy. FINRA is seeking to facilitate the provision of that additional information to institutional investors without increasing the risk of harm to retail investors. Thus, according to FINRA, the Proposal "would not alter the current prohibitions on including projections of performance or targeted returns in most types of retail communications." Moreover, members would still be subject to Regulation Best Interest when making any recommendations to natural persons.

The Proposal would permit a communication that "projects the performance or provides a targeted return with respect to a security or asset allocation or other investment strategy," provided: (1) the communication is an institutional communication or a communication to a qualified purchaser; (2) the member adopts written policies and procedures reasonably designed to ensure compliance; (3) the member has a reasonable basis for the criteria used and assumption made in calculating the projected performance or targeted return; and (4) the communication discloses prominently that the projection is hypothetical in nature and there is no guarantee that the projected or targeted performance will be achieved.

SEC Adopts Rules to Enhance Investor Protections Relating to SPACs

The SEC, on January 24, 2024, adopted new rules and amendments to enhance disclosures and provide additional investor protection in initial public offerings ("IPOs") by SPACs and in subsequent business combination transactions between SPACs and target companies ("de-SPAC Transactions"). The adopting release sited the complexity of these transactions as a reason for the need for enhanced investor protection with respect to the adequacy of disclosure and the responsible use of projections.

The new rules and amendments require, among other things, enhanced disclosures about conflicts of interest, SPAC sponsor compensation, dilution, and other information important to investors in SPAC IPOs and de-SPAC Transactions. The new rules also require registrants to provide additional information about the target company to investors that will help investors make more informed voting and investment decisions in connection with a de-SPAC Transaction.

The new rules and amendments more closely align the required disclosures and legal liabilities that may be incurred in de-SPAC Transactions with those in traditional IPOs. For example, in certain situations, the rules require the target company to sign a registration statement filed by a SPAC (or another shell company) in connection with a de-SPAC transaction. This would make the target company a "co-registrant" and assume responsibility for disclosures in that registration statement. In addition, the rules make the Private Securities Litigation Reform Act of 1995 safe harbor from liability for forward-looking statements unavailable to certain blank check companies, including SPACs.

In connection with de-SPAC transactions, the rules include disclosure requirements related to projections, including disclosure of all material bases of the projections and all material assumptions underlying the projections. The rules also update and expand guidance on the use of projections in all SEC filings.

The rules were published in the Federal Register on February 26, 2024, and will become effective on July 1, 2024. Compliance with the structured data requirements becomes effective on June 30, 2025.

"Just because a company uses an alternative method to go public does not mean that its investors are any less deserving of time-tested investor protections," said SEC Chair Gary Gensler. "Today's adoption will help ensure that the rules for SPACs are substantially aligned with those of traditional IPOs, enhancing investor protection through three areas: disclosure, use of projections, and issuer obligations. Taken together, these steps will help protect investors by addressing information asymmetries, misleading information, and conflicts of interest in SPAC and de-SPAC transactions."

SEC Adopts Rules to Include Certain Significant Market Participants as "Dealers" or "Government Securities Dealers"

The SEC, on February 6, 2024, adopted two rules that require market participants who engage in certain dealer roles, in particular those who take on significant liquidity-providing roles in the markets, to: (i) register with the SEC; (ii) become members of a self-regulatory organization ("SRO"); and (iii) comply with federal securities laws and regulatory obligations.

The final rules, Rules 3a5-4 and 3a44-2 under the Exchange Act, set forth parallel *qualitative* standards designed to identify market participants who take on significant liquidity-providing roles. Any person (as defined in Section 3(a)(9) of the Exchange Act) that engages in any of the following activities as part of a regular business would be a "dealer" or "government securities dealer":

- Regularly expressing trading interest that is at or near the best available prices on both sides of the market for the same security and that is communicated and represented in a way that makes it accessible to other market participants; or
- Earning revenue primarily from capturing bid-ask spread, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interests.

According to the SEC, it will not presume that a person is not a "dealer" or "government securities dealer" solely because that person does not engage in the activities identified in the rule. Further, the rule does not seek to address all circumstances under which a person may be acting as a "dealer" or "government securities dealer" or to replace otherwise applicable interpretations and precedent. The rule excludes the following:

- Any person that has or controls total assets of less than $50 million;
- An investment company registered under the Investment Company Act; or
- A central bank, sovereign entity, or international financial institution.

The final rules were published in the Federal Register on February 29, 2024, and become effective on April 29, 2024.

Commission Denies Petition to Change No Admit/No Deny Enforcement Policy

New Civil Liberties Alliance (the "NCLA") filed a petition asking the SEC to amend Commission Rule of Procedure 202.5(e), 17 C.F.R. 202.5(e), known as the "no admit/no deny policy." The SEC denied the rulemaking request and reiterated its long-standing policy that it will not agree to a settlement of any enforcement action, including a consent judgment in federal court, if a defendant can later publicly deny the SEC's allegations.

Rule 202.5(e) was adopted by the Commission in 1972 and adopts "the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct did not, in fact, occur." Pursuant to the Rule, the SEC will "not…permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings"—although at the same time the SEC provides that the defendant or respondent may state "that he neither admits nor denies the allegations."

In a statement, SEC Chair Gensler said entering into a settlement "is a consequential choice for both the SEC and the defendant. The Commission, in agreeing to settle a case, is relinquishing the opportunity to present the case in court. The defendant, on the other hand, relinquishes the right to defend the case in court, in the press, and in the eyes of the public."

The NCLA's complaint referred to the rule as the "Gag Rule" and claims that it violates the First Amendment right to petition and that the rule was ill-conceived, unconstitutional, and without legal authority. The plaintiff claims that pursuant to SEC policy and the rule, the Commission has required persons or entities charged in judicial or administrative proceedings of an accusatory nature who enter into consents to agree in perpetuity not to take any action or to make or cause to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis, and that "the SEC in practice thus goes further than the rule and binds defendants to silence permanently under threat of a reopened prosecution." The NCLA asked the SEC to amend Rule 202.5(c) to indicate a defendant or respondent may consent to a judgment or order in which such defendant or respondent admits, denies, or states that it neither admits nor denies, the allegations in the complaint or order.

In the NCLA's view, this change would balance the interests at hand. "By providing for admissions, denials, or no-admit-no-deny for specific allegations of the charges against defendant, the proposed amended rules allow the SEC to bargain for admissions when it has a clear-cut case of specific wrongdoing, allows defendants to specifically deny erroneous or overreaching charges against them, and leaves intact the pragmatic no-admit-no-deny approach that the Second Circuit has recognized as a useful approach from all perspectives," the NCLA said in its complaint.

SEC Adopts Rule Amendments to Enhance Private Fund Reporting

The SEC, on February 8, 2024, adopted amendments to Form PF, the confidential reporting form for certain SEC-registered investment advisers to private funds, including those that also registered with the Commodity Futures Trading Commission (the "CFTC") as commodity pool operators or commodity trading advisers. The amendments, which the CFTC concurrently adopted, are designed to enhance the ability of the Financial Stability Oversight Council (the "FSOC") to monitor and assess systemic risk and to bolster the SEC's oversight of private fund advisers and the agency's investor protection efforts. The SEC and CFTC also agreed to a memorandum of understanding relating to the sharing of Form PF data.

Among other things, the amendments to Form PF will require additional disclosure regarding how large hedge fund adviser report investment exposures, borrowing and counterparty exposure, market factor effects, currency exposure, turnover, country and industry exposure, central clearing counterparty reporting, risk metrics, investment performance by strategy, portfolio liquidity, and financing and investor liquidity which, according to the SEC, will provide better insight into the operations and strategies of these funds and their advisers and improve data quality and comparability.

The rule was published in the Federal Register on March 12, 2024, and becomes effective on March 12, 2025.

SEC Proposes Rule to Update Definition of Qualifying Venture Capital Funds

The SEC proposed a rule on February 14, 2024, that would update the dollar threshold for a fund to qualify as a "qualifying venture capital fund" for the purposes of the Investment Company Act. Qualifying venture capital funds are exempt from the Investment Company Act's definition of an "investment company." The rule would update the dollar threshold to $12 million aggregate capital contributions and uncalled committed capital, up from the current standard of $10 million. The proposed rule would also establish a process for future inflation adjustments every five years. The rule was published in the Federal Register on February 21, 2024, and public comments were due on March 22, 2024.

SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures

The SEC, on March 6, 2024, adopted rules to enhance and standardize climate-related disclosures by public companies (including business development companies). According to the SEC, the final rules reflect the Commission's efforts to respond to investors' demand for more consistent, comparable, and reliable information about the financial effects of climate-related risks on an issuer's operations and how it manages those risks while balancing concerns about mitigating the associated costs of the rules.

Specifically, the final rules will require a registrant to disclose:

- Climate-related risks that have had or are reasonably likely to have a material impact on the registrant's business strategy, results of operations, or financial condition;
- The actual and potential material impacts of any identified climate-related risks on the registrant's strategy, business model, and outlook;
- If, as part of its strategy, a registrant has undertaken activities to mitigate or adapt to a material climate-related risk, a quantitative and qualitative description of material expenditures incurred and material impacts on financial estimates and assumptions that directly result from such mitigation or adaptation activities;
- Specified disclosures regarding a registrant's activities, if any, to mitigate or adapt to a material climate-related risk including the use, if any, of transition plans, scenario analysis, or internal carbon prices;
- Any oversight by the board of directors of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks;
- Any processes the registrant has for identifying, assessing, and managing material climate-related risks and, if the registrant is managing those risks, whether and how any such processes are integrated into the registrant's overall risk management system or processes;
- Information about a registrant's climate-related targets or goals, if any, that have materially affected or are reasonably likely to materially affect the registrant's business, results of operations, or financial condition. Disclosures would include material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or actions taken to make progress toward meeting such target or goal;
- For large accelerated filers ("LAFs") and accelerated filers ("AFs") that are not otherwise exempted, information about material Scope 1 emissions and/or Scope 2 emissions;
- For those required to disclose Scope 1 and/or Scope 2 emissions, an assurance report at the limited assurance level, which, for an LAF, following an additional transition period, will be at the reasonable assurance level;
- The capitalized costs, expenditures expensed, charges, and losses incurred as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise, subject to applicable one percent and de minimis disclosure thresholds, disclosed in a note to the financial statements;
- The capitalized costs, expenditures expensed, and losses related to carbon offsets and renewable energy credits or certificates ("RECs") if used as a material component of a registrant's plans to achieve its disclosed climate-related targets or goals, disclosed in a note to the financial statements; and
- If the estimates and assumptions a registrant uses to produce the financial statements were materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans, a qualitative description of how the development of such estimates and assumptions was impacted, disclosed in a note to the financial statements.

The final rules were published in the Federal Register on March 28, 2024, with an effective date of May 28, 2024. Compliance dates for the rules will be phased in for all registrants, with the compliance date dependent on the registrant's filer status.

Since the adoption of the final rules, the SEC issued a stay of its final rules, on April 5, 2024, pending the completion of judicial review. The final rule amendments adopted on March 6, 2024, became the subject of litigation soon after their adoption and consolidated petitions are now before the U.S. Court of Appeals for the Eighth Circuit. According to the SEC's statement, the Commission believes that the final rules are consistent with applicable law and will continue to vigorously defend the rules' validity, but a stay will facilitate the resolution of the challenges to the rules and avoid possible regulatory uncertainty if registrants become subject to the rules' requirements while the challenges to their validity are still pending (I*n the Matter of the Enhancement and Standardization of Climate-Related Disclosures for Investors,* Release No. 33-11280, April 4, 2024).

Chair Gensler stated that "[t]hese final rules build on past requirements by mandating material climate risk disclosures by public companies and in public offerings. The rules will provide investors with consistent, comparable, and decision-useful information, and issuers with clear reporting requirements. Further, they will provide specificity on what companies must disclose, which will produce more useful information than what investors see today. They will also require that climate risk disclosures be included in a company's SEC filings, such as annual reports and registration statements rather than on company websites, which will help make them more reliable."

SEC Adopts Rule Amendments to Enhance Disclosure of Order Execution Information

The SEC adopted rule amendments, on March 6, 2024, that update the disclosure required under Rule 605 of Regulation NMS for order executions in national market system stocks ("NMS stocks"), which are stocks listed on a national securities exchange.

The final amendments expand the scope of entities subject to Rule 605, modify the categorization and content of order information required to be reported under Rule 605, and require reporting entities to produce a summary report of execution quality. The amendments expand the scope of entities that must produce monthly execution quality reports to include broker-dealers with a larger number of customer accounts and single dealer platforms. In addition, the amendments expand the definition of "covered order" to include certain orders submitted outside of regular trading hours, certain orders submitted with stop prices, and certain short sale orders. The amendments will capture more relevant execution quality information for certain order types by requiring statistics to be reported from the time such orders become "executable."

Further, the amendments change how orders are categorized by both order size and order type. As part of the changes to the order size categories, the amendments modify Rule 605 to capture execution quality information for fractional share orders, odd-lot orders, and larger-sized orders. The amendments also modify the time-to-execution categories and require average time to execution to be measured in increments of a millisecond or finer and to be calculated for all orders. In addition, the amendments modify the information required to be reported under the rule, including adding realized spread time horizons and requiring new statistical measures of execution quality, such as average effective divided by quoted spread (a percentage-based metric that represents how much price improvement orders received) and size improvement statistics. Finally, the amendments require all entities subject to Rule 605 to make a summary report publicly available.

The rule will be effective 60 days after the date of publication in the adopting release in the Federal Register and has a compliance date of 18 months after the effective date.

SEC Adopts Technical Amendments to Reflect a Federal Court's Vacatur of Share Repurchase Disclosure Modernization Amendments

The SEC adopted the Share Repurchase Disclosure Modernization Rule ("Share Repurchase Rule") on May 3, 2023, which was designed to modernize and improve disclosure about repurchases of an issuer's equity securities that are registered under the Exchange Act. The Share Repurchase Rule became effective on July 31, 2023. However, the SEC issued an order postponing the effective date after the U.S. Court of Appeals for the Fifth Circuit granted a petition for review and remand of the rule to correct identified defects in the rule.

On March 19, 2024, the SEC adopted technical amendments to various rules and forms based on the federal court's vacatur. The SEC found that these technical amendments do not impose any new substantive regulatory requirements on any person and merely reflect the vacatur of the Share Repurchase Rule. As such, the SEC concluded that notice and public comment are unnecessary. (*See* Blank Rome's *July 2023 Regulatory Update*, "SEC Adopts Amendments to Modernize Share Repurchase Disclosure," for further discussion).

SEC Adopts Reforms Relating to Investment Advisers Operating Exclusively Through the Internet

The SEC adopted amendments to the rule permitting certain internet investment advisers to register with the Commission (the "internet adviser exemption"). The amendments, which were adopted on March 27, 2024, will require an investment adviser relying on the internet adviser exemption to have at all times an operational interactive website through which the adviser provides digital investment advisory services on an ongoing basis to more than one client. The amendments will also eliminate the current rule's de minimis exception by requiring an internet investment adviser to provide advice to all of its clients exclusively through an operational interactive website and to make certain corresponding changes to Form ADV.

The amendments will become effective 90 days after publication in the Federal Register. An adviser relying on the internet adviser exemption must comply with the rule, including the requirement to amend its Form ADV to include

a representation that the adviser is eligible to register with the Commission under the internet adviser exemption, by March 31, 2025. According to the SEC's release, most investment advisers will have filed their annual updating amendments to Form ADV by this date (*i.e.,* 90 days after the Dec. 31, 2024, fiscal year end). In addition, per the release, an adviser that is no longer eligible to rely on the internet adviser exemption and does not otherwise have a basis for registration with the Commission must register in one or more states and withdraw its registration with the Commission by filing a Form ADV-W by June 29, 2025.

"These amendments modernize a 22-year-old rule to better protect investors in a digital age," said SEC Chair Gensler. "These changes better reflect what it means in 2024 truly to provide an exclusively internet-based service. This will better align registration requirements with modern technology and help the Commission in the efficient and effective oversight of registered investment advisers."

SEC ENFORCEMENT ACTIONS AND OTHER CASES

SEC Uses Court's Decision in *SEC v. Terraform Labs* to Bolster its Action Against Other Crypto Exchanges

Over the last half-decade, the SEC has been confronted with the rise of cryptocurrency assets and whether these digital assets constitute securities under the *Howey* test. In February 2023, the SEC brought an enforcement action against Terraform Labs, claiming the firm and its founder sold unregistered securities through its ecosystem of digital assets. On December 28, 2023, U.S. District Judge Jed Rakoff agreed with the SEC and granted the Commission's Motion for Summary Judgment. Judge Rakoff found that the *Howey* test remains a binding statement of law and that the test also applies to digital assets. In applying the test, Judge Rakoff found that there was no genuine dispute that the crypto assets at issue in *Terraform* were offered as investment contracts, and thus were securities.

The court found that Terraform's "stablecoin," UST, was an investment contract. Terraform argued that UST did not constitute a security because it was designed to have a constant value of $1.00. However, Terraform allowed holders of UST to deposit their tokens in the "Anchor Protocol" to generate a yield based on the quantity they deposited. While Judge Rakoff agreed that the stablecoin was not a security on its own, it became an investment contract when combined with a protocol that allowed users to pool and lend "stablecoins" for a yield.

Shortly after the decision, the SEC submitted a Notice of Supplemental Authority in its case against two crypto exchanges on January 4, 2024, citing the *Terraform* case and the parallels to the allegations and facts in that action to the one at hand. Specifically, the SEC pointed to the similarities of UST and the other crypto exchange's stablecoin offerings and yield generating opportunities. These cases are ongoing and could have far reaching implications for cryptocurrency and crypto exchanges.

In addition, on April 5, 2024, in a separate case, a Manhattan federal jury found bankrupt cryptocurrency startup Terraform Labs and its creator liable for securities fraud, after the SEC claimed they lied to investors about the company's stability and business prospects. Civil penalties are yet to be determined.

SDNY Declares Control Share Provisions Violate the Investment Company Act

A control share statute is a state law that generally permits a company to restrict a shareholder from voting shares in excess of a set threshold, unless it is approved by non-interested shareholders. In May 2020, the SEC Division of Investment Management withdrew its longstanding guidance prohibiting closed-end funds from using these control share provisions. On December 5, 2023, Judge Rakoff of the United States District Court for the Southern District of New York ("SDNY") issued an order granting summary judgment for the plaintiff, declaring that defendant closed-end funds' control share provisions from the Maryland Control Share Acquisition Act ("MCSAA") violated the Investment Company Act.

The court granted summary judgment based on the decision in another similar case last year. In that case, the court found that Section 18(i) of the Investment Company Act requires that the stock "presently entitle" the owner to vote the stock and that the stock have equal voting rights with all other fund voting stock. The court stated that, because control share provisions strip voting rights for shares owned above a prescribed threshold, their use does not guarantee equal voting rights as required by Section 18(i). Further, the court reasoned that, while Maryland allows for funds to adopt control share provisions, it does not require the adoption of such provisions and therefore such provisions would not fall under Section 18(i)'s "otherwise required by law" exception. The defendant closed-end funds have appealed the summary judgement order.

Investment Management Company to Pay $18 Million for Violating Whistleblower Protection Rules

The SEC announced, on January 16, 2024, that it settled charges against an investment adviser and broker-dealer (the "Company") for impeding hundreds of advisory clients and brokerage customers from reporting potential securities law violations to the SEC. The Company agreed to pay an $18 million civil penalty to settle the charges.

According to the SEC's order, from March 2020 through July 2023, the Company regularly asked retail clients to sign confidential release agreements if they had been issued a credit or settlement from the firm of more than $1,000. The agreements required clients to keep confidential the settlement, all underlying facts relating to the settlement, and all information relating to the account at issue. Even though the agreements permitted the clients to respond to an SEC inquiry, they did not permit clients to voluntarily contact the SEC.

The SEC's order found that the Company violated Rule 21F-17(a) under the Exchange Act, a whistleblower protection rule that prohibits taking any action to impede an individual from communicating directly with the SEC staff about possible securities law violations. Without admitting or denying the SEC's findings, the Company agreed to be censured, to cease and desist from violating the whistleblower protection rule, and to pay the $18 million civil penalty.

"Whether it's in your employment contracts, settlement agreements or elsewhere, you simply cannot include provisions that prevent individuals from contacting the SEC with evidence of wrongdoing," said Gurbir S. Grewal, Director of the SEC's Division of Enforcement.

"Investors, whether retail or otherwise, must be free to report complaints to the SEC without any interference," said Corey Schuster, Co-Chief of the Enforcement Division's Asset Management Unit. "Those drafting or using confidentiality agreements need to ensure that they do not include provisions that impede potential whistleblowers."

SEC Charges Chicago-based Investment Adviser and Former Partner with Misleading Pennsylvania Public Employees' Pension Fund

The SEC announced, on January 25, 2024, that it settled charges against a Chicago-based registered investment adviser (the "Adviser") and the firm's former partner for misleading their client, a Public School Employees' Retirement System (the "Client"), about the reason for a discrepancy between two different calculations by the Adviser of the Client's investment returns for the same period.

The SEC's orders found that the Adviser was responsible for calculating the Client's investment returns for "risk share," a provision under Pennsylvania law that requires public school employees to contribute more to their pensions if the retirement fund does not meet certain investment return rates.

According to the SEC's orders, after the Adviser provided the Client its quarterly returns for the purpose of estimating the Client's investment return rate in June 2020, the Client repeatedly questioned the Adviser's calculations of the investment returns and asked the Adviser to investigate a discrepancy between the returns. The SEC found that, in response to these inquiries, the Adviser and its former partner, who led the Client engagement, failed to adequately investigate that discrepancy, instead providing the Client with two reasons for the discrepancy that the Adviser had previously ruled out. Ultimately, the discrepancy turned out to be due to errors in the underlying data, and when the rate was recalculated, the corrected return rate triggered risk share, requiring additional employee contributions.

Without admitting or denying the SEC's findings, the Adviser consented to a settled order finding that it violated Section 206(2) of the Advisers Act and ordering it to pay a civil penalty of $1 million and disgorgement and prejudgment interest of $542,187. Without admitting or denying the SEC's findings, the former partner also consented to a settlement order and was required to pay a civil penalty of $30,000.

Public Company Brings Suit Against Investors Over ESG Proposal

A public oil company (the "Company") filed a lawsuit in Texas federal court on January 21, 2024, to prevent a shareholder vote concerning a proposal to accelerate and increase the scope of the Company's reduction targets with respect to greenhouse gas emissions.

The proposal was submitted by two sustainable investment firms that are investors in the Company and who are the named defendants in the lawsuit. Under Rule 14a-8 under the Exchange Act, companies are allowed to exclude certain shareholder proposals from proxy statements, including those that touch on the issue of "ordinary business operations." In its lawsuit, the Company claims that its process in reducing greenhouse gas emissions falls within the ordinary business operations exemption. The SEC had previously allowed similar proposals to move forward for a vote at the Company's annual shareholder meetings in 2022 and 2023.

Rather than seeking an exemption from the SEC to exclude the proposal, the Company instead took the highly unusual approach of filing suit in the United State District Court for the Northern District of Texas.

In February, the shareholders subsequently withdrew their proposal, citing the litigation, and filed a motion to dismiss the case, which the Company has asked the court to deny. The U.S. Chamber of Commerce and the non-profit Business Roundtable group has filed amicus briefs in support of the Company, arguing that the Commission is too permissive of shareholder speech.

SEC Charges TradeStation Crypto for Unregistered Offer and Sale of Crypto Asset Lending Product

The SEC, on February 7, 2024, announced charges against TradeStation Crypto, Inc. for failing to register the offer and sale of a crypto lending product that allowed U.S. investors to deposit or purchase crypto assets in a TradeStation account in exchange for the company's promise to pay interest. To settle the charges, TradeStation agreed to pay a $1.5 million penalty.

According to the SEC's order, TradeStation began to offer and sell the crypto leading product with the interest feature around August 2020. TradeStation marketed the interest feature as a way for investors to earn interest, and TradeStation had complete discretion over how to deploy the assets to generate revenue for such interest payments. The order found that TradeStation's crypto lending product was a security and since it did not qualify for a registration exemption, TradeStation was required to register its offer and sale but failed to do so.

This enforcement action is important in light of the court's finding in *SEC v. Terraform Labs,* discussed above, that a crypto asset may not be a security on its own, but when combined with a lending feature, such asset satisfied the *Howey* test and thus was considered a security. In this case, the SEC's order emphasized that the specific interest feature combined with the crypto asset was an offering and sale of securities in the form of investment contracts.

Sixteen Firms to Pay More than $81 Million Combined to Settle Charges for Widespread Recordkeeping Failures Relating to Off-Channel Communications

The SEC announced, on February 9, 2024, charges against five broker-dealers, seven dually registered broker-dealers and investment advisers, and four affiliated investment advisers for widespread and longstanding failures by the firms and their employees to maintain and preserve electronic communications. The firms admitted the facts set forth in their respective SEC orders, acknowledged that their conduct violated recordkeeping provisions of the federal securities laws, agreed to pay combined civil penalties of more than $81 million, and have begun implementing improvements to their compliance policies and procedures.

The SEC's investigations uncovered pervasive and long-standing uses of unapproved communication methods, known as off-channel communications, at all sixteen firms. As described in the SEC's orders, the broker-dealer firms admitted that, from at least 2019 or 2020, their employees communicated through personal text messages about the business of their employers. The investment adviser firms admitted that their employees sent and received off-channel communications related to recommendations made or proposed to be made and advice given or proposed to be given. The firms did not maintain or preserve the majority of these off-channel communications, in violation of the federal securities laws. By failing to maintain and preserve required records, some of the firms likely deprived the SEC of these off-channel communications in various SEC investigations. The failures involved employees at multiple levels of authority, including supervisors and senior managers.

The firms were charged with violating certain recordkeeping provisions of the Exchange Act, violating certain recordkeeping provisions of the Advisers Act, and with failing to reasonably supervise with a view to preventing and detecting those violations.

In addition to the significant financial penalties, each of the firms was ordered to cease and desist from future violations of the relevant recordkeeping provisions and was censured. The firms also agreed to retain independent compliance consultants to, among other things, conduct comprehensive reviews of their policies and procedures relating to the retention of electronic communications found on personal devices and their respective frameworks for addressing non-compliance by their employees with those policies and procedures.

"Today's actions against these 16 firms result from our continuing efforts to ensure that all regulated entities comply with the recordkeeping requirements, which are essential to our ability to monitor and enforce compliance with the federal securities laws," said Gurbir S. Grewal, Director of the SEC's Division of Enforcement.

SEC Charges Van Eck Associates for Failing to Disclose Influencer's Role in Connection with ETF Launch to Board During 15(c) Process

The SEC, on February 15, 2024, announced that Van Eck Associates Corporation, a registered investment adviser, agreed to pay a $1.75 million civil penalty to settle charges that it failed to disclose a social media influencer's role in the launch of its new exchange-traded fund ("ETF"). Without admitting or denying the SEC's findings, Van Eck Associates agreed to a cease-and-desist order and a censure in addition to the monetary penalty.

According to the SEC's order, in March 2021, Van Eck Associates launched the VanEck Social Sentiment ETF (NYSE: BUZZ) to track an index based on "positive insights" from social media and other data. The provider of that index informed Van Eck Associates that it planned to retain a well-known and controversial social media influencer to promote the index in connection with the launch of the ETF. To incentivize the influencer's marketing and promotion efforts, the proposed licensing fee structure included a sliding scale linked to the size of the fund; so, as the fund grew, the index provider would receive a greater percentage of the management fee the fund paid to Van Eck Associates. However, according to the SEC's order, Van Eck Associates failed to disclose the influencer's planned involvement and the sliding scale fee structure to the ETF's board in connection with its approval of the fund launch and of the management fee.

Some industry participants voiced concern that the SEC's decision to tie marketing efforts into a Section 15(c) enforcement action would complicate the contract renewal process and that the marketing arrangement in question was "too attenuated" to support a Section 15(c) violation. In addition, industry participants noted that while the adviser should have disclosed the fee arrangements to the board as a matter of prudence, such marketing arrangements do not belong in the contract review process and the decision to include it in this case sets a problematic precedent.

"Fund boards rely on advisers to provide accurate disclosures, especially when involving issues that can impact the advisory contract, known as the 15(c) process," said Andrew Dean, Co-Chief of the Enforcement Division's Asset Management Unit. "Van Eck Associates' disclosure failures concerning this high-profile fund launch limited the board's ability to consider the economic impact of the licensing arrangement and the involvement of a prominent social media influencer as it evaluated Van Eck Associates' advisory contract for the fund."

SEC Charges a Registered Broker-Dealer for Failing to Act in the Best Interest of Retail Customers

The SEC announced on February 16, 2024, that a registered broker-dealer (the "Broker-Dealer"), which is a wholly owned subsidiary of an insurance company, will pay more than $2.2 million to settle charges that it failed to comply with Regulation Best Interest ("Reg BI") in connection with recommendations to retail customers to open an individual retirement account ("IRA") with the insurance company.

According to the SEC's order, the IRA allowed retail customers to invest in both a pre-selected "core menu" of affiliated investments, including affiliated mutual funds, and, through the IRA's optional "brokerage window," a broader array of securities, including a variety of mutual funds, ETFs, stocks, and bonds. During the relevant period, the brokerage window included the lowest-cost share classes of certain affiliated mutual funds offered in the core menu, but with the investment minimums waived. Due to the waivers, customers could have purchased substantially equivalent, lower-cost share classes of these mutual funds in the brokerage window. The SEC's order found that the Broker-Dealer violated Reg BI by, among other things, failing to disclose both that substantially equivalent, lower-cost share classes of affiliated funds were available in the brokerage window and the related conflict of interest.

According to the SEC's order, more than 94 percent of IRA customers invested only through the core menu. As a result, nearly 6,000 Broker-Dealer retail customers paid more than $900,000 combined in expenses that they could have avoided by purchasing substantially equivalent funds through the brokerage window.

The SEC's order found that the Broker-Dealer violated Reg BI's General Obligation as well as Disclosure, Care, and Compliance Obligations. Without admitting or denying the findings, the Broker-Dealer consented to the entry of an order that requires it to cease and desist from violating Reg BI, censures the firm, and orders it to pay disgorgement of $936,714 together with prejudgment interest of $103,425, as well as a civil monetary penalty of $1,250,000.

"Reg BI protects retail investors by requiring broker-dealers to act in the best interest of their customers when making recommendations, and today's action demonstrates our commitment to ensuring compliance," said Thomas P. Smith, Jr., Associate Regional Director in the SEC New York Regional Office.

SEC Charges Advisory Firm for Disclosure Failures Ahead of an Acquisition Bid

The SEC settled charges against a New York-based investment adviser (the "Adviser") for its failure to make timely ownership disclosures in the lead-up to its May 2022 acquisition bid for a trucking fleet company (the "Company").

Under the federal securities laws, a company that owns more than five percent of a public company's stock must report its position and whether it has a control purpose, which is an intention to influence or control the company. According to the SEC's order, on February 14, 2022, the Adviser disclosed that it owned 5.6 percent of the Company's common stock as of December 31, 2021, and certified that it did not have a control purpose. The order states that the Adviser then built up its position to 9.9 percent of the Company's stock and formed a control purpose no later than April 26, 2022. The federal securities laws therefore required it to report its control purpose and its then-current ownership position by May 6, 2022, but it did not report this information until May 13, 2022. On that same day, the Adviser sent a letter to the Company proposing to buy all of the Company's shares for $86 a share, a sizeable premium over the trading price. Before the letter to the Company and its filing, and after forming a control purpose, the Adviser purchased swap agreements that gave it economic exposure to the equivalent of 450,000 more shares of Company common stock. After the Adviser's public announcement of its bid on May 13, 2022, the Company's stock price increased significantly.

The SEC's order found that the Adviser violated the beneficial ownership reporting/disclosure requirements of the Exchange Act. Without admitting or denying the findings, the Adviser agreed to cease and desist from future violations and to pay a $950,000 civil penalty to settle the SEC's charges. On October 10, 2023, the SEC adopted rules shortening the deadline for filing an initial Schedule 13D from 10 to five business days. The Adviser was found to have violated the rules in effect at the time of the conduct at issue in the SEC's order by filing its Schedule 13D more than 10 days after forming a control purpose.

SEC Charges Two Investment Advisers with Making False and Misleading Statements About Their Use of Artificial Intelligence

The SEC announced on March 18, 2024, that it settled charges against two investment advisers, Delphia (USA) Inc. ("Delphia") and Global Predictions Inc. ("Global Predictions"), for making false and misleading statements about their purported use of artificial intelligence ("AI").

According to the SEC's order against Delphia, from 2019 to 2023, the Toronto-based firm made false and misleading statements in its SEC filings, in a press release, and on its website regarding its purported use of AI and machine learning that incorporated client data in its investment process. For example, according to the order, Delphia claimed that it "put[s] collective data to work to make our artificial intelligence smarter so it can predict which companies and trends are about to make it big and invest in them before everyone else." The order found that these statements were false and misleading because Delphia did not in fact have the AI and machine learning capabilities that it claimed. The firm was also charged with violating the Marketing Rule, which, among other things, prohibits a registered investment adviser from disseminating any advertisement that includes any untrue statement of material fact.

In the SEC's order against Global Predictions, the SEC found that the San Francisco-based firm made false and misleading claims in 2023 on its website and on social media about its purported use of AI. For example, the firm falsely claimed to be the "first regulated AI financial advisor" and misrepresented that its platform provided "expert AI-driven forecasts." Global Predictions also violated the Marketing Rule, falsely claiming that it offered tax-loss harvesting services and included an impermissible liability hedge clause in its advisory contract, among other securities law violations.

Without admitting or denying the SEC's findings, each of Delphia and Global Predictions consented to the entry of order against it finding that it violated the Advisers Act and ordering it to be censured and to cease and desist from violating the charged provisions. In addition, each firm agreed to pay $400,000 in total civil penalties.

"We find that Delphia and Global Predictions marketed to their clients and prospective clients that they were using AI in certain ways when, in fact, they were not," said SEC Chair Gensler. "We've seen time and again that when new technologies come along, they can create buzz from investors as well as false claims by those purporting to use those new technologies. Investment advisers should not mislead the public by saying they are using an AI model when they are not. Such AI washing hurts investors."

OTHER INDUSTRY HIGHLIGHTS

SEC Approves Eleven ETPs Holding Bitcoin

The SEC, on January 10, 2024, approved eleven exchange-traded products ("ETPs") holding bitcoin. The SEC first approved Form 19b-4 requests to list the products on the Nasdaq Stock Market, CboeBZX Exchange, and NYSE Arca, and later approved the registration statements from the issuers themselves, clearing them to begin trading the next day.

Chair Gensler joined Commissioners Hester Peirce and Mark Uyeda in the voting decision but stated that their approval of these ETPs does not reflect an approval or endorsement of bitcoin. In his statement on the approval of the ETPs, Chair Gensler referenced a recent case involving a Crypto Asset Manager ("Crypto Manager") who successfully challenged the SEC's rejection of its spot bitcoin ETP. Commissioner Caroline Crenshaw warned in a dissent that the approval of these products could put the Commission on a "wayward path" for investor protection.

The decision to approve the ETPs comes months after the August finding by the D.C. Circuit that the SEC's concerns surrounding market manipulation were no longer convincing after the Crypto Manager challenged its own rejection. The Crypto Manager argued that the SEC acted arbitrarily when it rejected spot bitcoin ETPs but permitted products holding bitcoin futures to list, which the Crypto Manager argued are priced on the same underlying market. The three-judge panel agreed and called for a new review of the product.

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

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