BLANKROME

Investment Management

OCTOBER 2024

Regulatory Update and Recent SEC Actions

RECENT SEC ADMINISTRATION CHANGES

Keith E. Cassidy Named Interim Acting Director of the Division of Examinations

The Securities and Exchange Commission ("SEC") announced that Richard Best, the Director of the Division of Examinations, stepped down from his position on July 22, 2024, for medical leave. Keith E. Cassidy, the Division's Deputy Director, took over as its interim Acting Director. The SEC announced, on September 27, 2024, that Richard Best will serve as Senior Adviser to the Director of the Division of Examination once he returns from leave. Keith Cassidy will continue serving as the Division's Acting Director.

SEC Folds ESG Task Force, Saying Mission Accomplished

The SEC has disbanded the Climate and ESG Task Force ("Task Force"), which was a part of its Division of Enforcement, explaining that the task force had achieved its objective. The Task Force was formed three and a half years ago and was charged with coordinating SEC oversight of environmental, social and governance ("ESG") related disclosures and compliance. The most notable ESG development was the climate reporting rule which has been paused in the face of multiple lawsuits. The Task Force was also involved in the $25 million settlement with a registered investment adviser concerning misstatements regarding its ESG investment process in September 2023.

SEC Announces Six New Investor Advisory Committee Members

The SEC announced six new members to the Investor Advisory Committee on September 10, 2024. The six new members will serve four-year terms and join 17 current members. The Committee's stated purpose is to advise the SEC on regulatory priorities and initiatives to protect investors and promote the integrity of the U.S. securities markets. The newest members are:

- George Georgiev – Associate Professor of Law, Emory Law School
- R. Craig Knocke – Principal, Turtle Creek Management
- Amy C. McGarrity – Chief Investment Officer / Chief Operating Officer, Colorado Public Employees' Retirement Association
- Jennifer J. Schulp – Director of Financial Regulation Studies, Cato Institute's Center for Monetary and Financial Alternatives
- Andrea Seidt – Ohio Securities Commissioner
- Alvin Velazquez – Associate Professor of Law, Indiana University Maurer School of Law

SEC Announces Departure of Enforcement Director Gurbir S. Grewal

The SEC announced, on October 2, 2024, that Gurbir S. Grewal, Director of the Division of Enforcement (the "Enforcement Division"), will depart the agency, effective October 11, 2024. Upon his departure, Sanjay Wadhwa, the Enforcement Division's Deputy Director, will serve as Acting Director, and Sam Waldon, the Enforcement Division's Chief Counsel, will serve as Acting Deputy Director.

Mr. Wadhwa has served as Deputy Director of the Enforcement Division since August 2021. Before that, he was the Senior Associate Director of the Division of Enforcement in the New York Regional Office ("NYRO"), Deputy Chief of the Market Abuse Unit, and Assistant Director in NYRO. Prior to joining the SEC as a staff attorney in the Enforcement Division in 2003, Mr. Wadhwa served as a tax associate at Cahill Gordon & Reindel LLP and Skadden, Arps, Slate, Meagher & Flom LLP. Mr. Wadhwa earned a B.B.A from Florida Atlantic University, a J.D. from South Texas College of Law Houston and an LL.M. in taxation from New York University School of Law.

SEC RULEMAKING

SEC Adopts Tailored Registration Form for Offerings of Registered Index-Linked and Registered Market Value Adjustment Annuities

The SEC, on July 1, 2024, adopted tailored disclosure requirements and offering processes for registered index-linked annuities and registered market value adjustment annuities. The final rule will regulate such offerings and require issuers of non-variable annuities to register offerings on Form N-4 (which was amended in connection with this rule adoption).

The final rule and form amendments became effective on September 23, 2024, with a compliance date of May 1, 2026, for most of the rule and form amendments.

SEC Approves New and Updated Public Company Accounting Oversight Board ("PCAOB") Audit Standards

The SEC, on August 20, 2024, approved two PCAOB proposals updating the audit standards regarding general responsibilities of the auditor and the use of technology-assisted analysis in conducting an audit. These proposals touch on topics such as exercising due professional care and professional judgment when performing audits, and compliance with ethics and independent rules. The new rules amend the PCAOB ethics rules governing the liability of associated persons of a registered public accounting firm who directly and substantially contribute to audit firm violations.

SEC Adopts Rule Updating Definition of Qualifying Venture Capital Funds

The SEC, on August 21, 2024, adopted a rule that updates the dollar threshold for a fund to qualify as a "qualifying venture capital fund" (which is excluded from the definition of "investment company") for purposes of the Investment Company Act of 1940, as amended. The rule updates the dollar threshold from $10 million to $12 million and is effective September 30, 2024.

SEC Adopts Reporting Enhancements for Registered Investment Companies and Provides Guidance on Open-End Fund Liquidity Risk Management Programs

The SEC adopted amendments to reporting requirements on Form N-PORT on August 28, 2024. The amendments will require funds that are required to report on Form N-PORT to file on a monthly basis within 30 days after the end of the month to which the filing relates. Currently, funds are only required to file these monthly reports on a quarterly basis within 60 days after quarter-end. Further, the SEC adopted amendments to Form N-CEN requiring open-end funds to report certain information about service providers used to fulfill liquidity risk management program requirements. It is noteworthy that the "swing-pricing" provision, which was included in the SEC's original proposal in 2022, was not adopted.

The amendments to Forms N-PORT and N-CEN will become effective on November 17, 2025. Funds that have net assets of less than $1 billion will have until May 18, 2026, to comply with the Form N-PORT amendments.

"Reliable, accessible data benefits everyone. These amendments will benefit investors through greater transparency of funds' investment portfolios and improve the Commission's oversight of the asset management industry," said SEC Chair Gary Gensler.

SEC Adopts Rules to Amend Minimum Pricing Increments, Access Fee Caps, and Enhance the Transparency of Better Priced Orders

The SEC adopted amendments to certain rules under Regulation NMS to adopt an additional minimum pricing increment, or "tick size," for certain NMS stocks (Rule 612), reduce access fee caps for protected quotations of trading centers, increase the transparency of exchange fees and rebates (Rule 610), and accelerate the implementation of rules that will make odd-lot information about the market's best priced, smaller-sized orders publicly available. The amendments will become effective 60 days after the publication of the adopting release in the Federal Register. The compliance date for Rules 610 and 612 will be the first business day of November 2025. The compliance date for odd-lot information will be the first business day of May 2026.

SEC ENFORCEMENT ACTIONS AND OTHER CASES

SEC Charges Former CEO for Misleading Investors about Compliance Program

The SEC, on July 1, 2024, charged a former CEO and former Chief Risk Officer ("CRO") with misleading investors about the strength of the company's Bank Secrecy Act / Anti-Money Laundering compliance program and the monitoring of crypto customers. The SEC's complaint alleges that the CEO and CRO misled investors by stating that the company's wholly-owned bank subsidiary had an effective compliance program and conducted ongoing monitoring of its high-risk crypto customers, when, in reality, the automated transaction monitoring system failed to monitor more than $1 trillion of transactions by its customers on the subsidiary-bank's payment platform.

SEC Charges Founder of a Social Media Platform and its Native Crypto Token with Fraud and Unregistered Offering of Crypto Asset Securities

The SEC, on July 30, 2024, charged the founder of a social media platform and its native crypto token (the "Founder") with perpetrating a $257 million fraudulent crypto asset scheme. The SEC alleges that the Founder conducted unregistered offers and sales of the crypto asset, while telling investors that proceeds would not be used to compensate him or other employees. The complaint alleges that the Founder spent more than $7 million of investor funds on personal expenditures and cash gifts to family members.

Investment Adviser Receives Wells Notice in Connection with ESG ETFs

A multi-national investment adviser with over $100 billion in assets under management (the "Adviser") recently disclosed in a regulatory filing that it received a Wells Notice from the SEC stating that the SEC staff had come to a "preliminary determination" to proceed with a case against the Adviser with respect to alleged violations relating to the liquidation of three ESG ETFs, which represented $119 million in average assets. The filing does not specify which laws the SEC staff has alleged were breached, but the Adviser maintains that it was compliant with all applicable laws and regulations.

SEC Charges Investment Adviser for Use of Hypothetical Performance in Ads

The SEC, on August 9, 2024, settled charges with a registered investment adviser (the "Adviser") for advertising hypothetical performance information about its model portfolios that, allegedly, violated Rule 206(4)-1 of the Investment Advisers Act of 1940, as amended (the "Advisers Act"), the marketing rule that applies to investment advisers. According to the order, the Adviser used hypothetical performance data on its website without tailoring it for an intended audience. The Adviser agreed to pay $430,000 in civil penalties.

"As we alleged, [the Adviser] and its executives defrauded investors, including by misstating its financial statements and failing to disclose material information to investors. The investing public must be able to trust the accuracy of a company's disclosures, and we will hold accountable executives who abuse that trust by engaging in fraud," said Stacy Bogert, Associate Director of the Division of Enforcement.

SEC Charges Broker-Dealer for Failing to File Suspicious Activity Reports ("SARs")

The SEC, on August 12, 2024, charged a New York based broker-dealer (the "Broker-Dealer") with failing to file numerous SARs. The order finds that the Broker-Dealer failed to adopt or implement reasonably designed anti-money laundering policies and procedures to surveil transactions conducted through alternative trading system

platforms. The Broker-Dealer, without admitting or denying the SEC's findings, agreed to a cease-and-desist order and a $1.19 million penalty.

SEC Announces New Wave of Enforcement Action Settlements Relating to Off-Channel Communications

During August and September 2024, the SEC staff announced the settlement of multiple enforcement actions against registrants for failing to apply the record retention requirements of Rule 17a-4(b)(4) of the Securities Exchange Act of 1934, as amended ("Exchange Act") and Rule 204-2(a)(7) of the Advisers Act to employee personal devices or other modern communications applications, such as text messaging, iMessage, and WhatsApp, (so called "off-channel communications"). These latest settlements reflect the Division of Enforcement's continued focus on off-channel communications over the past few years, as discussed previously in past *Blank Rome Regulatory Update and Recent SEC Actions* quarterly updates.

- *August 14, 2024 –* The SEC announced that it settled charges with 26 broker-dealers, investment advisers, and dually registered entities, for widespread and longstanding failures to maintain and preserve electronic communications. Specifically, the SEC's investigations uncovered longstanding and pervasive use of off-channel communications. Three of the firms self-reported their violations and, as a result, will pay significantly lower civil penalties. In total, the firms will pay a combined $392.75 million in civil penalties.

- *September 3, 2024 –*The SEC announced charges against six nationally recognized statistical rating organizations (each a "NRSRO" and collectively, the "NRSROs") for significant failures by the NRSROs and their personnel to maintain and preserve electronic communications. The NRSROs admitted the facts set forth in their respective SEC orders and agreed to pay civil penalties that combine to more than $49 million. A majority of the NRSROs were required to retain a compliance consultant who will perform a comprehensive review of their policies and procedures relating to the retention of electronic communications.

- *September 17, 2024 –* The SEC announced charges against 12 municipal advisors for failures by the municipal advisors and their personnel to maintain and preserve electronic communications sent and / or received by their personnel relating to municipal advisory activity. The municipal advisors agreed to pay a combined civil penalty of more than $1.3 million to settle the charges.

- *September 23, 2024 –* The SEC announced charges against a registered investment adviser for its failure to maintain and preserve off-channel communications in violation of the recordkeeping provisions of the federal securities laws. The SEC, however, did not impose a penalty because the adviser self-reported the conduct, promptly remediated the violations, and provided substantial cooperation to SEC staff in an investigation of another entity.

- *September 24, 2024 –* The SEC announced charges against 12 firms, including broker-dealers, investment advisers, and one dually registered broker-dealer and investment adviser (each a "Firm" and collectively the "Firms") for widespread and longstanding failure to maintain and preserve electronic communications. The Firms agreed to pay a combined $88 million in civil penalties. Of note, is that one Firm did not have to pay a penalty because it self-reported its violations and demonstrated substantial efforts at compliance with recordkeeping requirements.

Discussing the twenty-six Firms charged on August 14, the former Director of the SEC's Division of Enforcement, Gurbir Grewal, said: "As today's enforcement actions against more than two dozen firms reflect, we remain committed to ensuring compliance with the books and records requirements of the federal securities laws, which are essential to investor protection and well-functioning markets. Among this group of firms, there are several that differentiated themselves by self-reporting prior to the staff's investigation, demonstrating once again the real benefits of proactive cooperation."

SEC Charges Transfer Agent with Failing to Protect Client Funds Against Cyber Intrusions

The SEC, on August 20, 2024, announced the settlement of charges against a registered transfer agent (the "Transfer Agent"). The SEC charged the Transfer Agent with failing to assure that client securities and funds were protected against theft or misuse, alleging that such failures led to a loss of more than $6.6 million of client funds as the result of two separate cyber intrusions in 2022 and 2023. The SEC's order found that the Transfer Agent violated Section 17A(d) of the Exchange Act and Rule 17Ad-12 thereunder.

SEC Charges Registered Investment Adviser for Compliance Failures in Handling of Nonpublic Information

The SEC, on August 26, 2024, announced settled charges against a registered investment adviser (the "Adviser") for failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information ("MNPI") concerning its trading of collateralized loan obligations ("CLOs"). The Adviser managed and traded its own CLOs, and the CLOs managed by third parties. From time to time, the Adviser came into possession of MNPI about companies whose loans were held in the CLOs that the Adviser traded. The SEC order finds that the Adviser violated Sections 204A and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

SEC Charges China-based Investment Adviser and its CEO in Pre-IPO Fraud Scheme

The SEC, on August 27, 2024, announced fraud charges against a China-based investment adviser (the "Adviser") for lying to clients and prospective clients regarding the safety of their investments, the Adviser's relationship with certain well-known banks and law firms, and the initial public stock offering of the Adviser's holding company. The SEC alleges, amongst other things, that the Adviser touted it would use proprietary artificial intelligence ("AI") to help generate extraordinary weekly returns with "100% protection" for client funds and that well-known banks and law firms were providing services to the Adviser. The Adviser falsely represented that it had positive communications with the SEC regarding the listing of its holding company's stock on the Nasdaq Global Select Market and touted the holding company's SEC filings, which the SEC alleges were materially deficient.

Ex-SPAC Agrees to Face 'Springing Penalty' in SEC Case

The SEC settled charges with a former blank check company (the "Company") in the amount of $400,000 with a potential 'springing penalty' of $1.2 million if the Company does not undertake required remedial action to address "material weaknesses" in its internal controls over financial reporting. SEC Enforcement Director, Gurbir Grewal said that the SEC has been using these springing penalties for firms that are unable to pay large penalties and also fully remediate violations, which essentially permits the firms to acknowledge violations and agree to a remediation plan in the short-term.

SEC Charges Crypto-Focused Advisory Firm for Custody Failures

The SEC, on September 3, 2024, announced settled charges against a former registered investment adviser (the "Adviser"). The SEC's order found that the Adviser failed to ensure that certain crypto assets held by a private fund advised by the Adviser were maintained with a qualified custodian, a violation of the Adviser Act's Custody Rule. Without admitting or denying the SEC's findings, the Adviser agreed to pay a civil penalty of $225,000 which will be distributed to harmed investors.

SEC Charges Advisory Firm with Custody Rule and Liability Disclaimer Violations

The SEC announced that it settled charges with an advisory firm (the "Adviser") on September 3, 2024. The SEC's order stated that the Adviser failed to timely distribute annual audited financial statements to investors in certain private funds that it advised. In its advisory agreements and certain private fund partnership and operating agreements, the Adviser included liability disclaimers, known as hedge clauses, which could lead a client to (incorrectly) believe that the client had waived non-waivable causes of action against the adviser. Without admitting or denying the SEC's findings, the Adviser agreed to a cease and desist from further violations and a $65,000 civil penalty to settle the violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

SEC Charges Nine Investment Advisers in Ongoing Sweep into Marketing Rule Violations

The SEC announced that it settled charges against nine registered investment advisers (the "Advisers") for violating the Rule 206(4)-1 under the Advisers Act (the "Marketing Rule") by disseminating advertisements that included untrue or unsubstantiated statements of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures. The September 9, 2024, announcement stated that the Advisers agreed to settle the charges for a total of $1.24 million in combined civil penalties.

SEC Reaches Settlement with Financial Services Company in Connection with the Firm's Crypto Asset Trading Platform

The SEC, on September 12, 2024, announced that it settled charges with a financial services company (the "Firm") in connection with its trading platform that facilitated buying and selling certain crypto assets as securities. The SEC's order finds that, since at least 2020, the Firm operated as an unregistered broker and clearing agency by providing U.S. customers the ability to trade crypto assets being offered and sold as securities. Without admitting or denying the findings, the Firm agreed to pay a penalty of $1.5 million.

SEC Settles Charges with Audit Firm for Negligence in the Audit of a Crypto Asset Trading Platform and for Violating Auditor Independence Requirements

The SEC announced that it settled charges with an audit firm (the "Firm") on September 17, 2024. The SEC's order alleges that the Firm misrepresented its compliance with the Generally Accepted Auditing Standards ("GAAS") regarding its audit of a crypto asset trading platform (the "Platform"). Specifically, the SEC alleges that the Firm failed to follow GAAS and its own policies and procedures by not adequately assessing whether it had the competency and resources to undertake the audit of the Platform. Without admitting or denying the findings, the Firm agreed to a permanent injunction and to pay a civil penalty of $745,000.

SEC Charges 11 Institutional Investment Managers with Failing to Report Certain Securities Holdings

The SEC, on September 17, 2024, announced charges against 11 institutional investment managers (each a "Firm" and collectively, the "Firms") for failing to file reports on Form 13F and Form 13H. The majority of these Firms had assets under management between $1.5 billion and $10 billion, with one firm having $95 billion. The Firms were required to make these filings based on their discretion over more than $100 million in certain securities. However, each Firm failed to file these forms for sustained periods of time after crossing the $100 million threshold. Nine of the firms will pay more than $3.4 million in combined civil penalties while three of the firms were not ordered to pay any civil penalties because the firms self-reported the violations and otherwise cooperated with the SEC's investigations.

SEC Charges Broker-Dealer with Regulation Best Interest Violations

The SEC charged a registered broker-dealer (the "Broker-Dealer") for failing to maintain and enforce policies and procedures reasonably designed to achieve compliance with Regulation Best Interest ("Reg BI"). The charges, announced on September 18, 2024, related to the Broker-Dealer's recommendation of a type of derivative security called a structured note. The SEC's order finds that the Broker-Dealer did not have accurate customer information necessary to make recommendations or the proper documentation approving the structured note recommendations in compliance with the Broker-Dealer's policies and procedures. The Broker-Dealer has agreed to pay a civil penalty of $325,000 to resolve the charge.

"To help reduce the chance of retail customer harm, Reg BI requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Reg BI as a whole. This action underscores that broker-dealers must ensure appropriate compliance around complex financial products and that it is not enough to simply have written policies; firms must also enforce them." said Osman Nawaz, Chief of the SEC Enforcement Division's Complex Financial Instruments Unit.

SEC Charges Advisory Firm with Fraud Related to the Pricing of Illiquid Securities

The SEC, on September 19, 2024, announced that a registered investment adviser (the "Adviser") will pay nearly $80 million to settle charges for overvaluing approximately

4,900 largely illiquid collateralized mortgage obligations ("CMOs") held in 20 advisory accounts, including 11 retail mutual funds, and for executing hundreds of cross trades between advisory clients that favored certain clients over others. The Adviser valued thousands of smaller-sized, "odd-lot," CMO positions using pricing obtained from a third-party pricing service that was intended for institutional lots only. The Adviser, according to the order, had no reasonable basis to believe it could sell the odd-lot CMOs at the pricing vendor's valuation and thus the odd-lot CMO positions were marked at inflated prices resulting in overstating the performance of client accounts holding the odd-lot CMOs.

SEC Charges Advisory Firm with Misleading Investors Regarding its Investment Strategy

The SEC charged an investment adviser (the "Adviser") with making misleading statements and for compliance failures related to the execution of its "biblically responsible investing" strategy. According to the SEC's order, the Adviser represented that it used a data-driven approach to evaluate companies and that it would not invest in companies that the Adviser determined did not align with biblical values. However, according to the SEC's order, the Adviser relied on a manual research process and did not typically perform research on individual companies to evaluate them for eligibility under its investing criteria. Without admitting or denying the SEC's findings, the Adviser agreed to a cease-and-desist order, to pay a $300,000 penalty, and to retain an independent compliance consultant.

SEC Charges Two Investment Advisers for Ignoring Client Instructions

The SEC, on September 25, 2024, announced charges against two investment advisers (the "Advisers") for exceeding clients' designated investment limits over a two-year period, which resulted in clients paying higher fees, being subjected to increased market exposure, and incurring investment losses. According to the SEC's order, the Advisers failed to adopt and implement policies and procedures reasonably designed to ensure that they disclosed all material facts to their clients and alerted them to the excessive exposure. As part of separate settlements, the Advisers have agreed to pay a combined $9.3 million in penalties and disgorgement to resolve the SEC's claims.

SEC Levies More than $3.8 Million in Penalties in Sweep of Late Beneficial Ownership and Insider Transaction Reports

The SEC, on September 25, 2024, announced that it settled charges against 23 entities and individuals for failures to timely report information about their holdings and transactions in public company stocks. Two public companies were also charged for contributing to filing failures by their officers and directors and failing to report their insiders' filing delinquencies as required. The charges related to reports that were required to be filed on Schedules 13D and 13G, as well as on Forms 3, 4 and 5 under Section 16(a). The entities include two *Fortune* 500 companies that repeatedly failed to file on a timely basis.

SEC Charges Independent Director and Ex-CEO of American Consumer Goods Company with Concealing Close Friendship with Company Executive

The SEC, on September 30, 2024, announced settled charges against a former CEO, Chairman, and board member (the "Director") of a publicly traded Consumer Goods Company (the "Company") for violating proxy disclosure rules. The SEC alleges that the Director stood election as an independent director without informing the board of his close personal friendship with a high-ranking executive of the Company (the "Executive") thereby causing the Company's proxy statements to contain materially misleading statements. The Director maintained a close personal relationship with the Executive—even paying more than $100,000 for the Executive and the Executive's Spouse to join him and his spouse on international vacations.

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

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