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Skadden

Investment Management Update

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SEC Adopts Amendments to Fund Names Rule

On September 20, 2023, the U.S. Securities and Exchange Commission (SEC) adopted amendments to Rule 35d-1 under the Investment Company Act of 1940 (the Fund Names Rule) as well as several forms and disclosure requirements (collectively, the Amendments). The Fund Names Rule provides that some types of fund names will be considered materially misleading for purposes of Section 35(d) of the Investment Company Act of 1940 unless certain conditions are satisfied, such as the adoption of an 80% investment policy — which may be fundamental (requiring shareholder approval to change) or nonfundamental (requiring only 60-days' notice to shareholders prior to change), depending on the circumstances. The Amendments significantly alter the regulatory landscape for registered funds and business development companies and require careful consideration of whether changes to (i) existing fund names, (ii) 80% investment policies and (iii) disclosures are necessary and, if so, (iv) how such changes should be disclosed, including whether a post-effective amendment to a registration statement pursuant to Rule 485(a) or Rule 485(b) under the Securities Act of 1933 or a prospectus sticker is required.

Among other things, the Amendments:

- Expand the existing 80% investment policy requirement to include funds with terms in their names suggesting (a) an investment focus in investments or (b) issuers that have "particular characteristics," including growth, value and terms indicating a focus on environmental, social and governance (ESG) factors. Many of these terms have historically been viewed as relating generally to a fund's strategy and not subject to the Fund Names Rule.
- Require that terms used in the names of funds that have an 80% investment policy that suggest either an investment focus or that the fund is tax-exempt be used consistently with the plain English meaning or established industry use of such terms and defined in a fund's prospectus.
- Require that, if a fund's name suggests multiple areas of investment focus, the fund's 80% investment policy addresses each such area of investment focus.
- Require funds to invest in accordance with their 80% investment policies "under normal circumstances." A fund may depart from its 80% investment policy in other-than-normal circumstances, as determined by the fund, subject to the prescribed time period for returning to compliance with the policy described below.
- Prescribe a time period for funds that deviate from their 80% investment policies to come back into compliance, which is generally 90 days from the date of noncompliance. Funds that deviate from their 80% investment policies in connection with the launch of the fund will be required to come into compliance with their 80% investment policies within 180 days. For purposes of determining compliance with an 80% investment policy, a fund must determine that a meaningful nexus exists between the investment and the investment focus suggested by the fund's name.
- Consistent with the current Fund Names Rule, require a fund to determine whether an investment should be included in the fund's 80% basket at the time of investment.
- Require that funds review the classifications of their portfolio assets with respect to their 80% investment policies on at least a quarterly basis. If a fund is not in compliance with its 80% investment policy upon such review, the fund must come back into compliance within 90 days.
- Require that funds calculate compliance with the Fund Names Rule and any 80% investment policy of a fund by valuing derivatives using their notional amount, and short sales using the value of the assets sold short, subject to certain adjustments.

- Clarify and expand the notice requirement for changes to a fund's name or 80% investment policy.
- Amend Form N-PORT to require that funds that are required to adopt an 80% investment policy report in the third month of each quarter: whether any portfolio investments are included in the 80% basket; the definitions of the terms used in the fund's name, including any specific criteria a fund uses to select the investments the term describes; and the value of a fund's investments pursuant to its 80% investment policy as a percentage of fund assets.
- Require that unlisted registered closed-end investment companies and business development companies (BDCs) obtain shareholder approval to change an 80% investment policy unless the fund provides investors an opportunity to exit the fund through a tender or repurchase offer in advance of the change, subject to certain conditions.

The final Amendments include notable departures from the May 25, 2022, proposal, in response to comments received by the SEC. In the most significant departure from the proposal, the SEC did not adopt proposed amendments that would have designated the use of ESG terms in the names of "integration funds" — defined as funds that incorporate one or more ESG factors alongside non-ESG factors, with the ESG factors being no more significant than the other factors in the fund's selection of investments — as materially deceptive and misleading for purposes of Section 35(d). Additionally, the Amendments generally will not apply to terms such as "global," "international" or "intermediate term" (*e.g.*, in describing bonds). Some proposed compliance requirements were also relaxed to be required quarterly, rather than monthly or daily, as proposed. The final Amendments also deviate from the proposal in preserving the current requirements that a fund's 80% investment policy apply under normal circumstances, with compliance measured at the time of investment. As initially proposed, the Amendments would have required that funds engage in continual and potentially daily compliance testing to confirm the characteristics of investments included in their 80% baskets and correct departures from their 80% investment policies as soon as reasonably practicable and within 30 days from a date of noncompliance. Instead of the proposed continual monitoring, the final Amendments require quarterly assessment of compliance with an 80% investment policy. If a quarterly assessment concludes that a fund is not in compliance with an 80% investment policy, the fund must come back into compliance within 90 days. This is a significant change from the current rule, which requires only that future investments of a fund that is noncompliant with its 80% investment policy be made in such a manner as to bring the fund back into compliance with its 80% investment policy. The initial proposal also would have replaced the requirement that a fund's 80% investment policy apply under normal circumstances with a list of specific exceptions addressing circumstances where departure would be permitted. The final Amendments also do not require a fund without an 80% investment policy to document why the fund determined it did not require an 80% investment policy, as had been proposed.

The amendments will become effective on December 10, 2023. Fund groups with net assets of $1 billion or more must comply with the amendments by December 10, 2025, and fund groups with net assets of less than $1 billion must comply with the amendments by June 10, 2026.

For a complete description of the final amendments, see the SEC's Release No. IC-35000.

SEC Adopts Amendments to Beneficial Ownership Reporting Rules

On October 10, 2023, the SEC adopted rule and form amendments regarding beneficial ownership reporting under Sections 13(d) and 13(g) of the Securities and Exchange Act of 1934 (the Beneficial Ownership Amendments). SEC Chair Gary Gensler stated the adoption of the Beneficial Ownership Amendments " … updates Schedules 13D and 13G reporting requirements for modern markets, ensures investors receive material information in a timely way, and reduces information asymmetries." Beneficial ownership reporting rules require investors who own more than 5% of a covered class of equity securities to file a Schedule 13D or 13G. At a high level, the Beneficial Ownership Amendments accelerate filing deadlines for Schedules 13D and 13G. Also, the SEC provided additional guidance on group formation for purposes of beneficial ownership and cash-settled derivatives securities.

The Beneficial Ownership Amendments:

- Decrease the filing deadline for initial Schedule 13D disclosures to five business days (from ten calendar days) from the time of a triggering event.
- Clarify the filing deadline for Schedule 13D amendments to within two business days of the triggering event (from "promptly after" a triggering event).
- Change the Schedule 13G filing deadline for qualified institutional investors[1] to 45 days after the end of the calendar quarter if beneficial ownership exceeds 5%. However, if beneficial ownership exceeds 10% at the end of any calendar month, the Schedule 13G filing is instead due within five business days of the end of that month. (The previous deadline was 45 days after the end of the calendar year.) For Schedule 13G amendments for qualified institutional investors, Schedule 13G filings are due within five business days of the end of the month in which beneficial ownership exceeds 10% and within five business days after any month-end decrease or increase of 5% in beneficial ownership since the last 13G filing.
- Change the Schedule 13G filing deadline for exempt investors[2] to 45 days after the end of the calendar quarter if beneficial ownership exceeds 5%. (The previous deadline was 45 days after the end of the calendar year.)
- Change the Schedule 13G filing deadline for passive investors[3] to five days after beneficial ownership exceeds 5%. (The previous deadline was ten days after an investor met this threshold.) For Schedule 13G amendments for passive investors, Schedule 13G filings are due within two business days after beneficial ownership exceeds 10% and within two business days afterany decrease or increase of 5% in beneficial ownership since the last 13G filing.

[1] Qualified institutional investors include the following: brokers or dealers registered under Section 15 of the Exchange Act, a bank as defined in Section 3(a)(6) of the Exchange Act; an insurance company as defined in Section 3(a)(19) of the Exchange Act of 1934; investment companies registered under Section 8 of the Investment Company Act of 1940; persons registered as investment advisers under Section 203 of the Investment Advisers Act of 1940; parent holding companies or control persons (if certain conditions are met); employee benefit plans or pension funds that are subject to the provisions of the Employee Retirement Income Security Act of 1974; a savings association as defined in Section 3(b) of the Federal Deposit Insurance Act; a church plan that is excluded from the definition of an investment company under Section 3(c)(14) of the Investment Company Act of 1940; non-U.S. institutions that are the functional equivalent of any of the institutions listed in Rules 13d-1(b)(1)(ii)(A) through (I), so long as the non-U.S. institution is subject to a regulatory scheme that is substantially comparable to the regulatory scheme applicable to the equivalent U.S. institution; and related holding companies and groups.

[2] "Exempt investors" refers to persons holding beneficial ownership of more than 5% of a covered class of securities who have not made an acquisition of beneficial ownership subject to Section 13(d). For example, persons who acquire all their securities prior to the issuer registering the subject securities under the Exchange Act of 1934 are not subject to Section 13(d). In addition, persons who acquire no more than 2% of a covered class within a 12-month period are exempted from Section 13(d) under Section 13(d)(6)(B). In both cases, however, those persons are subject to Section 13(g).

[3] "Passive investors" refers to beneficial owners of more than 5% but less than 20% of a covered class of securities who can certify under Item 10 of Schedule 13G that the subject securities were not acquired and are not held for the purpose or effect of changing or influencing the control of the issuer of such securities, and were not acquired in connection with or as a participant in any transaction having such purpose or effect. These investors are ineligible to report beneficial ownership pursuant to Rules 13d-1(b) or (d), but are eligible to report beneficial ownership on Schedule 13G (according to Rule 13d-1(c)).

- Require all Schedule 13G filers to report any material changes within 45 days of the end of the calendar quarter in which each material change occurred. (The previous deadline was within 45 days of the end of the year in which a material change occurred.)
- Apply structural data requirements to Schedule 13D and Schedule 13G filings.
- Adjust the timely filing deadline to 10:00 p.m. Eastern time on the applicable day (from 5:30 p.m. Eastern time).

The Beneficial Ownership Amendments will become effective 90 days after publication in the Federal Register. The compliance date for the new structural data requirements is December 18, 2024, although reporting persons may voluntarily begin complying with the structured data requirements on December 18, 2023. Compliance with the new Schedule 13G deadlines will be required on September 30, 2024.

For additional details about the Beneficial Ownership Amendments, see our October 13, 2023, client alert "SEC Amends Beneficial Ownership Reporting Rules, Shortening Deadlines and Offering Guidance on 'Groups' and Cash-Settled Derivatives." For a complete description of the final amendments, see the SEC's Release No. 33-11253.

SEC Charges Fintech Investment Adviser for Misrepresenting Hypothetical Performance of Investments and Other Violations

On August 21, 2023, in the SEC's first enforcement action addressing a violation of the amended marketing rule, Rule 206(4)-1 under the Investment Advisers Act of 1940 (the Marketing Rule), the SEC ordered Titan Global Capital Management USA LLC (Titan) to pay $192,454 in disgorgement, prejudgment interest and an $850,000 civil fine.

Titan, a New York based fintech investment adviser that offers retail investors alternative investment strategies through a mobile app, did not admit or deny the SEC's findings. Titan had opted into early compliance with the Marketing Rule in June 2021, and the SEC's cease-and-desist order (the Order) covers activity for a period ranging from August 2021 to October 2022. The Order covered the following areas of activity:

i. **Hypothetical performance.** The Order charged that Titan had used misleading hypothetical performance metrics in advertisements. Titan had advertised "annualized" performance results as high as 2,700% for its Titan Crypto strategy. The SEC alleged that the advertisement was misleading because, among other reasons, Titan failed to disclose that (i) the annualized return had been extrapolated from a period of only three weeks and (ii) the 2,700% annualized return was based on a hypothetical account in which no actual trading had occurred. In a statement, Osman Nawaz, the chief of the SEC Enforcement Division's Complex Financial Instruments Unit reported: "Titan's advertisements and disclosures painted a misleading picture of certain of its strategies for investors. This action serves as a warning for all advisers to ensure compliance."

ii. **Custody.** The Order charged that Titan made conflicting disclosures to clients about how it custodied cryptoassets. Titan had disclosed untrue and contradictory custody practices in various places in its materials. The SEC argued that Titan clients therefore received misleading information about who held their assets, how their assets were secured and whether their assets were subject to financial risk, such as custodian bankruptcy.

iii. **Hedge clauses.** Further, the SEC alleged use of improper "hedge clauses"[4] in client agreements and noted that the Titan hedge clause was inconsistent with the company's fiduciary duty as an adviser.

iv. **Client signatures.** Titan self-reported to the SEC staff in August 2022 that the company failed to ensure that client signatures were obtained for certain types of transactions in client accounts, and agreed to settle related charges.

v. **Compliance policies.** The SEC also charged Titan with failing to adopt policies and procedures concerning employees' personal trading in cryptoassets, contrary to representations by the company that it had done so.

For more information on the requirements of the Marketing Rule, see "SEC Adopts Modernized Marketing Rule for Investment Advisers" in our June 2021 *Investment Management Update*.

[4] A "hedge clause" is a provision in an advisory contract that is intended to limit an adviser's liability to clients.

Fund Administrator Charged for Missing Red Flags

On August 7, 2023, the SEC announced settled charges against Florida-based fund administrator Theorem Fund Services LLC (TFS) for the company's failure to respond to red flags concerning fraud against a private fund and its investors. TFS provided administration services to a fund managed by EIA All Weather Alpha Fund Partners (EIA) and Andrew M. Middlebrooks, both of which the SEC charged with fraud in May 2022 for allegedly engaging in a scheme that included the misuse and misappropriation of investors' funds over a five-year period. In the course of TFS's engagement, the fund experienced significant losses stemming from trading by Mr. Middlebrooks and EIA. TFS, at the direction and bequest of Mr. Middlebrooks and EIA, calculated the fund's net asset value without recognizing the losses, and sent account statements to investors that materially overstated the value of their investments.

The SEC's order found that TFS was a cause of certain of EIA's and Mr. Middlebrooks' violations of the Securities Act of 1933 and of the Investment Advisers Act of 1940 and Rule 206(4)-8(a)(1) thereunder. Without admitting or denying the SEC's findings, TFS agreed to a cease-and-desist order and to pay a civil penalty of $100,000, disgorgement of $18,000 and prejudgment interest of $4,271.

SEC Charges Eleven Wall Street Firms With Recordkeeping Failures

On August 8, 2023, the SEC announced charges against ten broker-dealer firms and one dually registered broker-dealer and investment adviser for failures by the firms and their employees to maintain and preserve electronic communications. The SEC's investigation found use of "off-channel" communications at the firms, meaning that the firms' employees at times communicated through messaging platforms such as iMessage, WhatsApp and Signal on their personal devices and did not preserve the substantial majority of these off-channel communications. The SEC charged each of the broker-dealers with violating certain record-keeping provisions of the Securities Exchange Act of 1934 and with failing to reasonably supervise and detect the violations, and charged the dually registered broker-dealer and investment adviser with violating certain recordkeeping provisions of the Investment Advisers Act of 1940.

Combined penalties for the charges amounted to $289 million, and additionally each of the firms was ordered to cease and desist from future violations of the relevant recordkeeping provisions. Furthermore, the firms agreed to retain independent compliance consultants to conduct reviews of their policies relating to the retention of electronic communications found on personal devices and their respective procedures for addressing noncompliance by their employees with those policies.

This action reflects the SEC's continued focus on compliance and recordkeeping by registered broker-dealers and investment advisers.

Transfer Agent Enforcement Action Seemingly Compels New Mutual Fund Disclosure

On August 17, 2023, the SEC ended an administrative proceeding against DST Asset Manager Solutions, Inc. (DST), a registered transfer agent that had "failed to exercise reasonable care to ascertain the correct addresses of lost securityholders." DST's inability to locate 78 lost securityholders resulted in $651,433 of unclaimed assets being escheated to various states. In addition to paying a $500,000 civil penalty as part of its settlement with the SEC, DST agreed to "[r]equest that its mutual fund clients periodically send out notifications to their client shareholder base informing them of the risk of escheatment and educating them on steps to take to avoid dormancy, including updating their addresses and otherwise establishing contact with the funds or DST." The SEC's order includes further details.

The latter undertaking has "effectively impose[d] a substantive new disclosure requirement on mutual funds," according to SEC Commissioners Hester M. Peirce and Mark T. Uyeda. The commissioners remarked that mutual funds receiving such a request under SEC compulsion would interpret it as a new mandate on escheatment disclosure and maintaining shareholder information. In a dissenting commentary on the proceeding, Commissioners Peirce and Uyeda criticized the use of an enforcement action to effect this requirement as a "substitute for notice and comment rulemaking," and highlighted the lack of guidance on sufficient disclosure and notice procedures.

SEC Proposes New Requirements To Address Risks to Investors From Conflicts of Interest Associated With the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers

On July 26, 2023, the SEC proposed rules intended to ensure that broker-dealers and investment advisers prioritize investors' interests over their own when using predictive data analytics and similar technologies. SEC Chair Gary Gensler highlighted the growing significance of predictive data analytics and artificial intelligence, which can lead to conflicts of interest if a firm optimizes for its own benefit instead of the benefit of its investors.

The proposed rules would generally require a firm to evaluate and determine whether its use of certain technologies in investor interactions involves a conflict of interest that results in the firm's interests being placed ahead of investors' interests. Firms would be required to eliminate or neutralize the effect of any such conflicts. Additionally, the proposed rules would also require a firm to have written policies and procedures reasonably designed to achieve compliance with the proposed rules, and to make and keep books and records related to these requirements.

The proposal's highly detailed and prescriptive set of rules is a major departure from the traditional approach of the securities laws. The new rules would dictate disclosure of potential conflicts of interest and informed consent of the investor.

Before a broker-dealer or an investment adviser can use technology to serve a client, the SEC's proposed rules would require the broker-dealer or investment adviser to prove that the technology does not in any way potentially put the firm's interest ahead of the client's — a notoriously difficult if not impossible task to prove the absence of a situation in advance, particularly when dealing with "black box" technologies where even the world's foremost experts in these technologies may be unable to articulate exactly how they arrive at a given result.

The proposed rules are intended to address predictive data analytics technologies, and the SEC clarifies that this specifically includes AI, machine learning, neural networks and similar technologies. However, the scope of "covered technologies" is broader than that because it is intended to be technology-agnostic. As a result, it would seem to include technologies that have been used by broker-dealers and investment advisers for years, such as spreadsheets, statistical tools, mathematical formulas, valuation tools and similar tools.

Given the breadth and ambiguity of the meaning of this term, it may even be interpreted to include search engines and other general-purpose technologies that are not designed with functionality that is likely to give rise to a conflict of interest, but could, at least in theory, be used in a way that would put the interests of the firm ahead of those of investors.

For more information on the proposal, see our August 10, 2023, alert "SEC Proposes New Conflicts of Interest Rule for Use of AI by Broker-Dealers and Investment Advisers."

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

On July 26, 2023, the SEC proposed amendments to Rule 203A-2(e) under the Advisers Act, which permits certain investment advisers that provide investment advisory services through the internet to register with the SEC. As proposed, the amendments would generally require an investment adviser relying on the internet adviser registration rule to maintain a continuously operational interactive website through which the adviser provides digital investment advisory services on an ongoing basis to more than one client. In addition, the proposed amendment would remove the de minimis exception from the current rule by requiring that an internet investment adviser furnish advice to all its clients solely through an interactive website. The amendment would also make certain corresponding changes to Form ADV. The public comment period has closed.

SEC Adopts Final Private Fund Adviser Rules

On August 23, 2023, the SEC voted to adopt a final set of rules and amendments under the U.S. Investment Advisers Act of 1940 (collectively, the Final Rules) that significantly expand the regulatory compliance requirements for certain investment advisers. The Final Rules impact registered investment advisers, exempt reporting advisers, private advisers and investment advisers that would not otherwise be required to register with the SEC.

See our September 14, 2023, client alert "A Practical Guide to Interpreting the New SEC Private Fund Adviser Rules" for a detailed summary of the Final Rules, including a table summarizing the applicability of each part of the Final Rules to private fund advisers, state-regulated advisers, advisers relying on the foreign private adviser exemption and other registered advisers.

SEC Division of Examinations Issues Risk Alert on Adviser Examinations

On September 6, 2023, the SEC Division of Examinations (the Division) issued a risk alert detailing its process for selecting investment advisers for examinations and offering insight on the information it generally requests from advisers.

The alert outlines how the Division selects firms to examine, how it determines the focus areas of an examination and what documents officials typically request from firms. According to the alert, in selecting advisers to examine and determining the scope of examinations, the Division employs a dynamic, risk-based approach responding to market conditions, industry practices and investor preferences. The alert notes that the Division selects firms in order to evaluate risks at a particular firm, assess how registrants are adapting to new regulatory requirements, respond to events that present risks to investors and the markets, or in response to tips, complaint referrals or compliance risk concerns. The Division staff also considers firm-specific risk factors, including particular business activities, conflicts of interest and regulatory history.

The alert details disclosures and records the Division generally requests from firms under examination, including general information about an adviser's business, compliance risks and written policies and procedures, as well as information needed to conduct testing on advisory trading activities and other compliance areas.

SEC Division of Examinations Announces 2024 Examination Priorities

On October 16, 2023, the SEC's Division of Examinations announced its 2024 examination priorities. The 2024 Examination Priorities Report highlights seven areas of focus that will involve clearing agencies, investment advisers and the risk areas impacting various market participants. The priorities most applicable to funds and investment advisers are summarized below.

Investment Advisers

The Division will continue to prioritize examinations of investment advisers. Some of its areas of focus are unique to private funds.

Examination of Investment Advisers

The Division's areas of focus for all funds include investment advisers' adherence to their duties of care and duties of loyalty and the effectiveness of advisers' compliance programs.

- **Adherence to Fiduciary Duties:** Authorities will prioritize monitoring investment advice regarding complex derivative and leveraged exchange-traded funds (ETF) products, expensive and illiquid products and alternative strategies aimed at addressing rising interest rates. The Division will examine the processes advisers use to determine that their advice is in the clients' best interest, including processes for making suitability determinations, seeking best execution, evaluating costs and addressing conflicts of interest (COI). Specifically, officials will examine how advisers mitigate COI and allocate investments when investors have multiple accounts. The Division will also examine COI and economic incentives associated with advice to purchase or hold onto investments, invest through relatively expensive accounts and use products and affiliated providers with higher fees.
- **Compliance Programs:** The Division will continue to examine advisers' compliance programs, focusing on: (i) portfolio management processes; (ii) disclosures made to investors and regulators; (iii) proprietary trading by advisers and the personal trading activities of supervised advisory personnel; (iv) protection of client assets from conversion or abuse; (v) accurate recordkeeping; (vi) privacy safeguards; (vii) trading practices; (viii) marketing advisory services; (ix) processes to value client holdings and assess fees; and (x) business continuity plans. The Division will prioritize conducting marketing practice assessments to investigate whether advisers have implemented compliance programs to comply with the Advisers Act and the Marketing Rule, disclosed their marketing information on Form ADV, recorded processes and disseminated accurate advertisements. Other priorities include assessing compensation arrangements to ensure that advisers' receipts of compensation satisfy fiduciary obligations, as well as investigating how advisers maximize revenue and calculate fee breakpoints. In addition, the Division will assess how advisers value illiquid assets, protect clients' material nonpublic information, ensure the accuracy of regulatory filings, use third-party and affiliated service providers, oversee branches and obtain clients' consent to changing agreements.

Examination of Investment Advisers to Private Funds

The Division will prioritize certain topics specific to advisers of private funds, including their:

- Management of portfolio risks relevant to market volatility and higher interest rates.
- Adherence to contractual requirements regarding limited partnership advisory committees, advisory boards and notification and consent processes.
- Accuracy in calculating fund-level and investment-level fees and expenses.
- Due diligence practices with respect to private equity and venture capital fund assessments of prospective portfolio companies.

- Management of private funds side-by-side with registered investment companies.
- Compliance with Advisers Act requirements regarding custody.
- Policies and procedures for reporting on Form PF.

Investment Companies

Noting the importance of mutual funds and ETFs to retail investors, the Division stated it will continue to prioritize the evaluation of registered investment companies, specifically their compliance and governance practices regarding board approval of fund fees, disclosures to investors, valuation practices and derivative and liquidity risk management programs.

The Division will prioritize reviewing companies' fees and expenses, as well as any compliance programs for advisory fees, waivers and reimbursements. Behavior that will trigger enforcement alerts include companies charging different advisory fees to different share classes of the same fund, offering identical strategies by the same sponsor but charging differing fee structures, charging relatively high advisory fees and charging high fees and expenses relative to peers with stronger performances. This focus appears to continue the SEC's thematic focus on the advisory contract approval process and could portend future enforcement action in this area. For additional discussion of the SEC's focus on the advisory contract approval process, see our article "SEC Focuses on Advisory Contract Approval Process" in the October 2022 *Investment Management Update*.

Authorities will also conduct derivatives risk management assessments to ensure that registered investment companies and business development companies implement compliance programs that comply with the Investment Company Act Rule 18f-4. To do so, examiners will review derivatives risk management programs, board oversight, disclosure accuracy and valuation procedures.

Lastly, the Division will review compliance with the terms of exemptive order provisions and liquidation procedures, as well as other recent market dislocations and volatility issues.

Broker-Dealers

- **Regulation Best Interest:** The Division will continue to review broker-dealers to ensure their recommendations to clients meet the Regulation Best Interest standard. Officials will focus on products, including microcap securities, that are complex, expensive, illiquid and proprietary. Authorities will also continue to focus on dual registrants and their account allocation and selection processes. In applying the standard, examiners will focus on broker-dealers' recommendations, disclosures of COI to clients, mitigation of COI, processes for reviewing alternatives and consideration of investors' unique investment profiles.
- **Form CRS:** The Division will examine the content of the broker-dealer's relationship summary to see how it describes fees and costs, COI, disciplinary history and the relationships and services it offers to retail customers.
- **Broker-Dealer Financial Responsibility Rules:** The Division will address how broker-dealers comply with the Net Capital Rule and the Customer Protection Rule, focusing on their fully-paid lending programs, accounting of liabilities and liquidity levels.
- **Broker-Dealer Trading Practices:** The Division will prioritize compliance with Regulation SHO's aggregation units and locating requirements, Regulation ATS and the consistency of broker-dealers' alternative trading systems with their disclosures on Form ATS and ATS-N, and Exchange Rule 15c2-11. When examining wholesale market makers, the Division will focus on quote generation, order routing and execution practices, market data ingestion, regulatory controls and risk management.

Risk Areas Impacting Various Market Participants

- **Information Security and Operational Resiliency:** The Division emphasized its focus on cybersecurity. Examiners will assess how registrants train staff in cybersecurity issues, address the risks of using third-party providers, secure customer information across multiple offices and maintain cyber resiliency. In addition, examiners will confirm that registrants' transactions meet the new shortened settlement cycle of one business day.
- **Cryptoassets and Emerging Financial Technology:** The Division will prioritize the review of broker-dealers' and advisers' new products, services, and practices that utilize emerging technology, such as cryptoassets, broker-dealers' mobile applications and automated investment advice. For cryptoassets that are funds or securities, the Division will assess whether advisers are complying with custody requirements under the Advisers Act and following their standards of conduct when advising clients.
- **Regulation Systems Compliance and Integrity (SCI):** The Division will continue to evaluate whether SCI systems have established and enforced programs to ensure the systems' capacity, integrity, resiliency, availability and security.
- **Anti-Money Laundering (AML):** The Division will continue to review broker-dealers and registered investment companies' AML programs and Suspicious Activity Report (SAR) filings.

FINRA Appoints Bill St. Louis as New Head of Enforcement

On August 21, 2023, the Financial Industry Regulatory Authority (FINRA) appointed Bill St. Louis as the national head of the Enforcement Division. In this role, Mr. St. Louis will manage approximately 350 enforcement staff members across 11 of FINRA's U.S. offices, overseeing the development of FINRA's enforcement policies and procedures and supervising the prosecution of FINRA's disciplinary actions.

Mr. St. Louis is a continuing executive vice president of FINRA. He formerly served as the head of FINRA's National Cause and Financial Crimes Detection Program within Member Supervision and managed the National Cause program, the authority's Financial Crimes Surveillance initiative, the Financial Intelligence Unit, the membership application program and investigative units responsible for regulating anti-money laundering, cybersecurity, cryptoassets and high-risk representatives and for protecting vulnerable adults and seniors.