GODFREY & KAHN

April 2024

Investment Management Legal and Regulatory Update

Godfrey & Kahn Investment Management Team Members Responsible for this Update:

Christopher M. Cahlamer
414.287.9338
ccahlamer@gklaw.com

Emily R. Enslow
414.287.9366
eenslow@gklaw.com

Carol A. Gehl
414.287.9255
cgehl@gklaw.com

Emma L. Janicki
414.287.9253
ejanicki@gklaw.com

Kathryne E. Keough
414.287.9272
kkeough@gklaw.com

LATEST DEVELOPMENTS

SEC Announces Departure of William Birdthistle; Natasha Vij Greiner Named Director of the Division of Investment Management

The SEC announced on February 28, 2024 that William Birdthistle, the Director of the Division of Investment Management, would leave the SEC effective March 8, 2024 to rejoin academia. Mr. Birdthistle has been replaced by Natasha Vij Greiner, who was the Deputy Director of the Division of Examinations.

Ms. Greiner has been with the SEC for 22 years, joining at the start of her career, and has served as the National Associate Director of the Investment Adviser/Investment Company (IA/IC) examination program which includes the Private Funds Unit. She has served in several other roles across divisions of the agency and according to Chair Gensler, "brings deep and broad expertise to the Division." Ms. Greiner received her J.D. from The Catholic University of America, Columbus School of Law and B.S. degree from James Madison University.

Source: SEC Announces Departure of William Birdthistle; Natasha Vij Greiner Named Director of the Division of Investment Management, SEC Press Release 2024-27 (Feb. 28, 2024), available here.

LATEST DEVELOPMENTS: ADVISERS

FinCEN Proposes Anti-Money Laundering Rule Applicable to Certain Investment Advisers

The Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of Treasury, has proposed a new rule to address illicit finance risk that would include registered investment advisers and exempt reporting advisers within the definition of "financial institution" under the Bank Secrecy Act (BSA). The proposed rule seeks to address regulatory gaps in Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) programs for certain investment advisers, including suspicious activity reporting and related recordkeeping requirements.

FinCEN is proposing the rule in light of the considerable expansion in the investment adviser industry. The proposed rule reported that in 2015 (the last time FinCEN proposed similar rules) there were approximately 12,000 registered investment advisers with approximately $67 trillion in assets under management and as of June 30, 2023 there were more than 15,000 registered investment advisers with approximately $125 trillion in assets under management. Unlike the 2015 proposed rule, the new rule would also apply to exempt reporting advisers who advise private equity funds, private funds, hedge funds and venture capital funds.

The proposed rule would require registered investment advisers and exempt reporting advisers to:

- *Develop and Implement a Written AML/CFT Program*: A program, "reasonably designed to prevent money laundering, terrorist financing, and other illicit finance activities," would need to be implemented which would require:
  - designating a person responsible for the program;
  - independent testing of the program;
  - ongoing training to comply with program requirements; and
  - ongoing customer due diligence (including identifying and verifying customers and developing customer risk profiles).
- *File Suspicious Activity Reports (SARs)*: The rule would require advisers to timely file SARs with FinCEN regarding suspicious transactions relating to possible violations of laws or regulations subject to certain threshold requirements.
- *Comply with Recordkeeping Requirements*: The rule would require advisers to maintain records related to the transmittal of funds as well as records of SAR filings and supporting documentation.

Notably, investment advisers to mutual funds and exchange-traded funds (ETFs) would be exempt from the proposed rule as it relates specifically to their mutual funds and ETFs because those products are already subject to separate reporting obligations under existing AML/CFT requirements. Under the BSA, mutual funds and ETFs have implemented customer identification programs, due diligence requirements, and suspicious activity reporting in order to combat illicit finance risks. Advisers that manage other accounts in addition to mutual funds or ETFs would still be subject to the rule with regard to those other accounts.

If finalized, the rule would delegate examination authority to the SEC in reviewing an adviser's compliance with the rule. The comment period for the proposed rule closes on April 15, 2024.

Sources: Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers and Exempt Reporting Advisers Notice of Proposed Rulemaking (NPRM), Financial Crimes Enforcement Network Fact Sheet (Feb. 13, 2024), available here; Department of the Treasury, Proposed Rule (Feb. 15, 2024), available here; FinCEN Proposed Rule to Combat Illicit Finance and National Security Threats in Investment Adviser Sector, Press Release (Feb. 13, 2024), available here.

LITIGATION/ENFORCEMENT ACTIONS

Sixteen Firms Settle for Over $81 Million in Off-Channel Communications Recordkeeping Failures

The SEC recently announced settlements with 16 broker-dealer and investment advisory firms for failure to maintain and preserve electronic communications. The regulator's investigation of off-channel communications has resulted in enforcement actions against more than 40 firms and spans a period of over two years, though the SEC shows no signs of slowing down its recordkeeping sweep.

According to the SEC orders, the SEC staff uncovered "widespread and longstanding" uses of unapproved communication methods, such as personal text messages or WhatsApp messages, to communicate internally and externally regarding business matters. This occurred firm-wide and across multiple levels of authority, in violation of Section 17(a) of the Securities Exchange Act of 1934 (Exchange Act) and Section 204 of the Investment Advisers Act of 1940 (Advisers Act).

The orders state that employees of the investment advisory firms sent and received off-channel communications related to, among other things, recommendations made or proposed to be made, and advice given or proposed to

be given. Additionally, employees of the broker-dealer firms communicated about business matters such as placing and executing trades. Furthermore, the orders allege that the firms' widespread failure to implement their policies and procedures that prohibit such off-channel communication led to a failure to reasonably supervise personnel in violation of Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(6) of the Advisers Act.

At the SEC Speaks conference held in early April, the Deputy Director of the SEC's Division of Enforcement discussed the six key factors the SEC considers in determining how much to fine the firms that have received penalties under the recordkeeping initiative. He said the agency considers: (1) the size of the firm, to ensure the penalty is an adequate deterrent; (2) the scope of the violations, including both the breadth and depth of off-channel communications in a firm; (3) a firm's efforts to comply with its recordkeeping obligations and to prevent off-channel communications, such as through the implementation of technological solutions; (4) precedent, namely the many settled orders that have come out of this initiative since 2021; (5) whether a firm self-reported, which is considered by the agency to be the most significant factor in terms of mitigating penalties; and (6) cooperation – firms that do not self-report may still receive credit based on their cooperation during the investigation.

A spokesperson from the SEC's Division of Examinations Chicago Regional Office recently indicated that their office is looking at off-channel communications primarily from the perspective of compliance with policies and procedures, and less as an exercise in searching employees' personal devices for every instance of unapproved communications; though egregious violations may prompt the Division of Examinations to conduct a more intensive review.

As part of the settlements, all firms agreed to retain independent compliance consultants to conduct comprehensive reviews of their policies and procedures relating to the retention of electronic communications found on personal devices.

Godfrey & Kahn Note: While instituting a policy prohibiting off-channel communications is a good starting place, firms must take additional steps to show they are actively monitoring compliance with their policies, such as using a vendor service to capture employees' business communications.

Sources: Sixteen Firms to Pay More Than $81 Million Combined to Settle Charges for Widespread Recordkeeping Failures, SEC Press Release 2024-18 (Feb. 9, 2024), available here; SEC vs. Guggenheim Securities LLC et. al., No. 3-21851 (Feb. 9, 2024), available here; Sanjay Wadhwa, Remarks at SEC Speaks 2024 (Apr. 3, 2024), available here.

SEC Charges Investment Adviser for Failing to Disclose Influencer's Role in Promoting ETF Launch

Van Eck Associates Corporation (Van Eck), a registered investment adviser, recently agreed to pay a $1.75 million civil penalty as part of a settlement with the SEC after being charged with failing to disclose the involvement of a social media influencer in the launch of its new ETF, the VanEck Social Sentiment ETF (the BUZZ ETF).

The BUZZ ETF, launched in March 2021, was marketed as tracking an index (the BUZZ Index) based on the performance of 75 large-cap U.S. stocks showing "the highest degree of positive investor sentiment and bullish perception" sourced through content from social media, news articles, blog posts and other alternative datasets. While negotiating the licensing deal with Van Eck, the index provider notified Van Eck that it planned to partner with a "well-known and controversial social media influencer" to raise awareness for the BUZZ Index. While the SEC order does not name the influencer, multiple sources reported that it was Dave Portnoy, founder of Barstool Sports Inc., who frequently comments on investing, sports betting and other pop-culture topics. Due to the influencer's proposed involvement, the index provider proposed new licensing terms whereby the influencer would receive a share of the sliding-scale licensing fee Van Eck would pay to the index provider, so as to incentivize the influencer to promote the BUZZ Index.

The SEC order alleges that at various times leading up to, and immediately after, the launch of the BUZZ ETF, Van Eck misrepresented and omitted material information to the Board of Trustees of the BUZZ ETF, concerning the licensing arrangement with the index provider, the involvement of the influencer, the compensation paid to the influencer and the controversies surrounding the influencer.

The SEC alleged that Van Eck willfully violated Section 15(c) of the Investment Company Act of 1940 by failing to fulfill its duty to furnish information as may reasonably be necessary for the board to evaluate the terms of the advisory contract, and Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. Without admitting or denying the SEC's findings, Van Eck agreed to a cease-and-desist order and a censure in addition to the monetary penalty of $1.75 million.

Sources: SEC vs. Van Eck Associates Corporation, No. 3-21857 (Feb. 16, 2024), available here; SEC Charges Van Eck Associates for Failing to Disclose Influencer's Role in Connection with ETF Launch, SEC Press Release 2024-20 (Feb. 16, 2024), available here; Van Eck Associates Settles SEC Claim It Didn't Disclose Social Influencer's Role, Wall Street Journal Article (Feb. 16, 2024), available here.

SEC Approves Spot Bitcoin ETF after X Account Hack

On January 10, 2024, the SEC announced it had approved the listing and trading of a number of spot bitcoin ETFs. Spot bitcoin ETFs purchase bitcoins that are held in a secure digital wallet by a custodian, which allows investors to trade an asset that is tied to the current value of bitcoin without holding the bitcoin itself.

The announcement was highly anticipated by the crypto industry, and came just one day after a hacker gained access to the SEC's X (formerly known as Twitter) account and posted a fake message announcing the approval of the spot bitcoin ETFs. The SEC later removed the post and refuted the false announcement. According to the SEC, the hacker gained access to its X account by using a staffer's phone number, which it compromised through a "SIM swap," to change the password on the account.

The SEC statement accompanying the announcement highlights the investor protections afforded by ETFs that other platforms used to access bitcoin may lack. These protections include:

- disclosure requirements in registration statements and other periodic filings; and
- rules of the registered national securities exchanges on which the ETFs will trade that seek to prevent fraud and manipulation and address conflicts of interest.

Sources: Statement on the Approval of Spot Bitcoin Exchange-Traded Products, SEC Statement (Jan. 10, 2024), available here; SEC Probing Fake Post on its X Account, Bitcoin ETFs Not Yet Approved, Reuters (Jan. 10, 2024), available here; Spot Bitcoin ETFs: What Are They, And How Do They Work?, Forbes (Feb. 22, 2024), available here.

COMPLIANCE DATES FOR FINAL RULES

Final Rules	Compliance Dates
Amendments to Form N-PX and Say-on-Pay Vote Disclosure	Rule and form amendments effective for votes occurring on or after July 1, 2023, with the first filings subject to the amendments due by August 31, 2024 for the 12-month period ended June 30, 2024.
Shareholder Reports, Rule 30e-3 Amendments and Amended Advertising Rules	Rule and form amendments were effective January 24, 2023, with a compliance date of July 24, 2024.
Private Fund Advisers ▪ Quarterly Statement Rule ▪ Private Fund Audit Rule ▪ Adviser-Led Secondaries Rule, Restricted Activities Rule and Preferential Treatment Rule	 ▪ March 14, 2025 ▪ March 14, 2025 ▪ Larger private fund advisers ($1.5 billion or more in private fund assets): September 14, 2024 Smaller private fund advisers (less than $1.5 billion in private fund assets): March 14, 2025
Investment Company Names	Larger fund groups (net assets of $1 billion or more): December 11, 2025 Smaller fund groups (net assets of less than $1 billion): June 11, 2026
Corporate Transparency Act	Subject entities in existence on January 1, 2024 must file an initial report by December 31, 2024. Entities created on or after January 1, 2024 must file an initial report within 30 days after receiving notice of their creation or registration.
Modernization of Beneficial Ownership Reporting	▪ Schedule 13G filing deadline: September 30, 2024 ▪ Compliance with the structured data requirement: December 18, 2024

STATUS OF PROPOSED RULES

Proposed Rules for Funds and Advisers	Status
Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices	The SEC has indicated final amendments for rules and forms will be issued in April 2024.
Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies	The SEC has indicated final rules will be issued in April 2024.
Proposed Rules for Funds	**Status**
Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting	The SEC has indicated final rules will be issued in April 2024.
Proposed Rules for Advisers	**Status**
Outsourcing by Investment Advisers	The SEC has indicated a final rule will be issued in April 2024.
Safeguarding Advisory Client Assets	The SEC has indicated final rules will be issued in April 2024.
Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Customer Information	The SEC has indicated final amendments to Regulation S-P will be issued in April 2024.
Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers	The SEC has indicated final rules will be issued in April 2024.
Retirement Security Rule	The DOL accepted comments on the rule until January 2, 2024. The Office of Management and Budget received the rule on March 8, 2024, and completed its review on April 10, 2024. It is anticipated the rule will be finalized during the second or third quarter of 2024.