

Your Quarterly Regulatory Briefing*

(compliments of Daphne Chisolm and Cyndie Baughman)



The SEC issues a long-awaited rule proposal making certain exemptive relief unnecessary, OCIE issues its 2019 examination priorities, and the SEC operates on its “operation during a shutdown” protocol as part of the Federal government shuts down at year end ...This is Your Quarterly Briefing.

March 4, 2019

Industry Regulatory & Enforcement Activity

1. SEC Investigative Report – Cyber Threats and Internal Accounting Controls
2. SEC Advisory Committee Held Nov. 7th Telephone Meeting
3. SEC Proposes Disclosure Improvements for Variable Annuities and Life Insurance Contracts
4. SEC Updates List of Firms Using Inaccurate Information
5. Division of Enforcement Issues FYE 2018 Results Report
6. SEC Charges Adviser with \$3.9 Million Fraud
7. The SEC, FINRA and MSRB to hold Compliance Outreach Program for Municipal Advisors
8. BNY Mellon to Pay Over \$54 Million for Improper Handling of ADRs
9. Daniel Kahl Named Deputy Director of OCIE
10. SEC Adopts Final Rules for Disclosure of Hedging Policies
11. SEC Proposal Rule for Fund of Funds Arrangements
12. OCIE Announces 2019 Exam Priorities
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Education & Training

This section lists upcoming conferences as well as on-line learning opportunities and free webinars suitable for various parties – trustees, compliance professionals, or those seeking CPE or CLE credits.

INDUSTRY REGULATORY & ENFORCEMENT ACTIVITY

1. SEC Investigative Report – Cyber Threats and Internal Accounting Controls

On October 16, 2018, the Securities and Exchange Commission (the “SEC”) issued a 7-page [investigative report](#) (the “Report”) cautioning public companies to consider cyber threats when implementing internal accounting controls. The Report was based on the SEC Division of Enforcement’s review of public companies that were victims to cyber fraud. The Report notes that the issuers considered in the Report span various industries and that each issuer experienced losses of millions of dollars as a

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About the Authors: Daphne Chisolm and Cyndie Baughman are attorneys that each have over 20 years of experience in the financial services and investment management industry. Ms. Chisolm has particular expertise in the area of exchange-traded funds. Ms. Baughman and Ms. Chisolm have been colleagues for nearly their entire careers and worked together at Dechert, LLP in Washington D.C. The Authors thank Nanlee Vang, who has extensive experience and proficiency in Workiva, a cloud-based EDGAR filing platform, for her contributions to this Quarter’s Briefing.

result of cyber-related frauds. The Report further notes that in numerous cases company personnel received compromised electronic communications resulting in personnel wiring large sums or paying invoices to accounts controlled by the perpetrators of the scheme.

In regard to accounting controls, the Report states:

Systems of internal accounting controls, by their nature, depend also on the personnel that implement, maintain, and follow them. In the context of the business email compromises the Division reviewed, the frauds succeeded, at least in part, because the responsible personnel did not sufficiently understand the company's existing controls or did not recognize indications in the emailed instructions that those communications lacked reliability.

In the [Press Release](#) announcing the Report, SEC Chairman Jay Clayton states, “[c]yber frauds are a pervasive, significant, and growing threat to all companies, including our public companies. Investors rely on our public issuers to put in place, monitor, and update internal accounting controls that appropriately address these threats.”

2. SEC Advisory Committee Held Nov. 7th Telephone Meeting

The SEC held an Investor Advisory Committee meeting on November 7, 2018 which was open to the public. Those interested in the agenda topics for this Meeting may look for the webcast archive [HERE](#). Agenda topics included a discussion of the SEC's proposed regulation best interest and proposed Form CRS relationship summary.

3. SEC Proposes Disclosure Improvements for Variable Annuities and Life Insurance Contracts

On October 30, 2018, the SEC announced it has proposed rule changes designed to improve disclosures for investors in variable annuity and variable life insurance contracts so that investors may better understand the features of these contracts, their fees and risks, so they can make better choices. Among other things, the rule proposal would allow these contracts to use a summary prospectus similar to what mutual funds have been using for nearly 10 years.

A fact sheet and the press release on the rule proposal can be found [HERE](#). The public comment period on the proposal ended on February 15, 2019.

4. SEC Updates List of Firms Using Inaccurate Information

On October 31, 2018, the SEC announced it updated its currently running list of unregistered firms that use misleading information to target and solicit non-U.S. investors. Typically, the list includes firms that claim to be registered and are not, firms that impersonate legitimate firms, and fake regulators. This list is based on firms subject to investor complaints and is known as “Public Alert: Unregistered Soliciting Entities” or “PAUSE.” The list can be found [HERE](#).

5. Division of Enforcement Issues FYE 2018 Results Report

On November 2, 2018, the SEC Division of Enforcement issued the annual report of its ongoing efforts to protect investors and market integrity (the “Report”). The 45-page Report can be found [HERE](#). At the end of FYE 2018, the SEC brought 821 enforcement actions and returned \$794 million to harmed

investors. The Report highlights the types of cases with the majority, as in 2017, relating to securities offerings, investment adviser/company, and issuer reporting/audit and accounting.

6. SEC Charges Adviser with \$3.9 Million Fraud

On November 2, 2018, the SEC announced that it charged an Altoona, Pennsylvania investment adviser and registered representative with a long-running offering fraud. The SEC's complaint alleges that Douglas Simanski raised more than \$3.9 million from 27 brokerage customers by telling them their money would be invested in a "tax-free" fixed rate investment, rental car company, or one of two coal mining companies in which Mr. Simanski said he had an ownership interest in. Instead, Mr. Simanski used the money largely to repay other investors and for his own use. The scheme was uncovered when one of his clients contacted the Financial Industry Regulatory Authority ("FINRA").

7. The SEC, FINRA and MSRB to hold Compliance Outreach Program for Municipal Advisors

On December 13, 2018, the SEC, FINRA and the Municipal Securities Rulemaking Board ("MSRB") announced they would open registration for their fourth annual Compliance Outreach Program. The Program currently is scheduled for May 21, 2019 in San Francisco, California. The agenda and other information can be found [HERE](#).

8. BNY Mellon to Pay Over \$54 Million for Improper Handling of ADRs

On December 17, 2018, the SEC announced that the Bank of New York Mellon would pay over \$54 million to settle charges of improper handling of "pre-released" American Depositary Receipts ("ADRs"). "Pre-release" allows ADRs to be issued with the deposit of foreign shares so long as brokers have an agreement with a depositary bank and the broker or customer owns the foreign shares required. The SEC's Order found that BNY Mellon improperly provided ADRs to brokers in thousands of pre-release transactions when neither the broker nor its customer owned the foreign shares needed to support the ADRs. The Press Release can be found [HERE](#).

9. Daniel Kahl Named Deputy Director of OCIE

On December 18, 2018, the SEC announced that Daniel Kahl had been named the Deputy Director of the Office of Compliance Inspections and Examinations ("OCIE"). Mr. Kahl has been with the SEC over 17 years and served as OCIE's Chief Counsel since February 2016.

10. SEC Adopts Final Rules for Disclosure of Hedging Policies

On December 18, 2018, the SEC announced it had adopted final rules for disclosure of hedging policies. The final rules implement Section 14(j) of the Securities Exchange Act of 1934, which was enacted by Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The rules require companies to disclose in proxy or information statements for the election of directors any practices or policies regarding employees or directors engaging in certain hedging transactions with respect to company equity securities. The rules require a summary of practices or policies in regard to these transactions and if no practice or policy exists then a registrant must disclose that fact or state that hedging is generally permitted. The Fact Sheet released by the SEC can be found [HERE](#) and the Final Rule may be found [HERE](#).

11. SEC Proposes Rule for Fund of Funds Arrangements

On December 19, 2018, the SEC proposed Rule 12d1-4 to allow funds to invest in other funds beyond the limits set forth in Section 12(d)(1) of the Investment Company Act of 1940. For years, funds have sought exemptive relief in order to engage in such fund of funds arrangements and, if the rule is adopted, exemptive relief will be unnecessary. Rule 12d1-4 will include certain conditions including those relating to control and voting, redemption limits, excessive fees and complex structures – generally the same conditions that have been required by exemptive orders.

The comment period for the proposed rule begins 90 days after the rule’s publication in the Federal Register. The Press Release may be found [HERE](#) and the Proposed Rule may be found [HERE](#). A statement by Commissioner Kara M. Stein regarding the proposed rule can be found [HERE](#).

12. OCIE Announces 2019 Exam Priorities

On December 20, 2018, OCIE announced its 2019 examination priorities which included the following categories: (1) compliance and risk at registrants responsible for critical market infrastructure; (2) matters of importance to retail investors, including seniors and those saving for retirement; (3) FINRA and MSRB; (4) digital assets; (5) cybersecurity; and (6) anti-money laundering programs. The exam priorities publication can be found [HERE](#).

13. SEC Charges Two Robo-Advisers with False Disclosures

On December 21, 2018, the SEC announced it settled proceedings against California-based Wealthfront Advisers, LLC and, separately, New York City-based Hedgeable, Inc. These represent the first actions brought by the SEC against providers of automated, software-based portfolio management services. In the action against Wealthfront Advisers, LLC, the SEC found that it had re-tweeted prohibited client testimonials, paid bloggers for client referrals without required disclosure and failed to maintain a compliance program reasonably designed to prevent violations of the securities laws. In the action against Hedgeable, Inc., the SEC found that the company made a series of misleading statements about its investment performance including postings on its social media account and website of comparative performance that included less than 4% of its client accounts that had higher than average returns. The SEC found that Hedgeable, Inc. violated antifraud, advertising, compliance, and books and records provisions of the Investment Advisers Act of 1940.

14. Two Advisory Firms Charged with Fund Share Class Disclosure Violations

The SEC announced on December 21, 2018 that it had charged American Portfolio Advisers, Inc., PPS Advisors, Inc. (two New York-based advisers) and the CEO of PPS Advisors, Inc. with investing advisory client assets in mutual fund share classes that paid 12b-1 fees to the advisers’ representatives when less expensive share classes of the same funds were available. The SEC’s Orders found, among other things, that the advisers violated their duty of best execution and failed to disclose conflicts of interest. The Order for American Portfolio Advisers, Inc. can be found [HERE](#) and the Order for PPS Advisors, Inc. and its CEO can be found [HERE](#).

15. JP Morgan Charged with Improper Handling of ADRs

On December 26, 2018, the SEC announced it had charged JP Morgan Chase Bank N.A. for improper handling of “pre-released” ADRs. JP Morgan Chase Bank N.A. will pay more than \$135 million to settle these charges. The charges are similar to those brought against BNY Mellon (See #8 above) just a week earlier. The SEC’s Order can be found [HERE](#).

The above is merely our summary of industry activities that we feel may be of the most interest to those in the investment management field – funds, their trustees/directors and service providers. The full text of SEC press releases, proposed and adopted rules, enforcement actions and other news can be found on the [SEC’s Website](#).

EDUCATION & TRAINING

Date	Location	Sponsor	Event
Various	On-Line	Financial Industry Regulatory Authority (“FINRA”)	FINRA offers a variety of e-learning courses, free webinars, and other events that can be found HERE .
March 17-20, 2019	San Diego, California	Investment Company Institute (“ICI”)	2019 Mutual Funds and Investment Management Conference
May 2, 2019	Washington, D.C.	Independent Directors Council (“IDC”)	2019 Fund Directors Workshop
May 2-3, 2019	Washington, D.C.	ICI	2019 Mutual Fund Compliance Programs Conference
May 15-17, 2019	Washington, D.C.	FINRA	2019 Annual Conference
September 22-25, 2019	Marco Island, Florida	ICI	2019 Tax and Accounting Conference
October 21-22, 2019	Chicago, Illinois	IDC	2019 Fund Directors Conference
November 7, 2019	New York, New York	ICI	2019 Closed-End Fund Conference