

RIA Regulatory Review

by David Tang and Michael Schmieder

This RIA Regulatory Review highlights certain key regulatory developments affecting investment advisers. Please contact us with any questions on the topics covered below.

SEC Adopts Amendments to Regulation S-P

The SEC adopted amendments to Regulation S-P to require SEC-registered investment advisers, among other entities, to develop, implement, and maintain written policies and procedures for an incident response program that is reasonably designed to detect, respond to, and recover from unauthorized access to or use of customer information. The incident response program must also include procedures for providing a timely notification to individuals whose sensitive customer information was, or is reasonably likely to have been, accessed or used without authorization.

SEC and FinCEN Propose Customer Identification Program Requirements for Investment Advisers

The SEC and FinCEN jointly proposed a new rule that would apply customer identification program (“CIP”) requirements to registered investment advisers and exempt reporting advisers. The proposed rule would require advisers to establish, document, and maintain a written CIP appropriate for its size and business that, at a minimum, includes: (i) customer identification procedures, (ii) maintaining records of information obtained under CIP’s procedures, (iii) checking whether a customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency, and (iv) providing customers with adequate notice that the adviser is requesting information to verify their identities. Read Dorsey’s eUpdate on the proposed rule.

SEC Issues Risk Alert on Marketing Rule Compliance

The Staff of SEC’s Division of Examinations issued a risk alert regarding investment advisers’ compliance with Rule 206(4)-1 (the “Marketing Rule”) under the Investment Advisers Act of 1940. Through examinations of investment advisers, the Staff observed:

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- David Tang
- Michael Schmieder

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(i) policies and procedures were not reasonably designed or implemented to address compliance with the Marketing Rule; (ii) books and records deficiencies relating to the Marketing Rule; (iii) failure to properly update Form ADV Part 1A Item 5.L.; (iv) deficiencies related to the Marketing Rule's general prohibitions; (v) not providing fair and balanced treatment of material risks or of specific investment advice in advertisements; (vi) not providing performance results in a fair and balance manner; and (vii) advertisements that were otherwise materially misleading.

SEC Settles with Five Investment Advisers for Marketing Rule Violations

The SEC found five advisers advertised hypothetical performance on their respective websites without adopting or implementing the appropriate policies and procedures required by the Marketing Rule. Without admitting or denying the SEC's findings, the advisers consented to the SEC's order stating that they violated the Advisers Act and agreed to pay \$220,000 in combined penalties. Read Dorsey's eUpdate on the settlements.

SEC Wins "Shadow Trading" Insider Trading Case

The SEC won its case when a California jury found Matthew Panuwat liable for insider trading based on the SEC's "shadow trading" theory. *SEC v. Matthew Panuwat* is a first-of-its-kind case in which the SEC successfully argued that trading in the securities of one company based upon material nonpublic information about a separate company (in whose securities the defendant did not trade) can nevertheless constitute insider trading in violation of the federal securities laws. In view of the Panuwat case, investment advisers should evaluate their insider trading policies and controls addressing confidential information, including specifically, the treatment of confidential information regarding a company that can be considered material nonpublic information with respect to a separate company.

Investment Adviser Off-Channel Communications Enforcement Action

The SEC settled its first off-channel communications enforcement action against a stand-alone investment adviser. Employees of the adviser at various levels of authority communicated about firm-related business internally and externally using personal texting platforms and other non-adviser electronic communication services. As a result, the adviser failed to retain a substantial majority of these off-channel communications. The adviser admitted to violating recordkeeping and code of ethics requirements under the Investment Advisers Act and agreed to pay a \$6.5 million penalty. Read Dorsey's eUpdate on the enforcement action.

First Form N-PX Say-on-Pay Disclosures for Institutional Investment Managers due August 31, 2024

Advisers are reminded that the SEC's amendments to Form N-PX under the Investment Company Act of 1940 require institutional investment managers that exercise investment discretion over \$100 million or more in Section 13(f) securities to annually report on Form

N-PX how they voted: (i) on the approval of executive compensation, (ii) the frequency of such executive compensation approval votes, and (iii) votes to approve “golden parachute” compensation in connection with a merger or acquisition. Institutional investment managers must file their first Form N-PX, covering shareholder meetings occurring during the period of July 1, 2023 to June 30, 2024, by August 31, 2024.

Upcoming Compliance Dates

- Custody Rule delivery of annual audited financial statements to investors in “funds-of-funds” due June 28, 2024.
- Form 13H Quarterly Amendment due July 10, 2024.
- Code of Ethics Quarterly Transaction Reports due July 30, 2024.
- Form N-PX First Report for Institutional Investment Managers due August 31, 2024.